5. The distribution of income

Up to this point, average variable and fixed costs have been held constant so that a change in price could be analyzed in terms of a change in the margin above costs, or average corporate levy. Now the procedure is to be reversed. The average corporate levy will be held constant so that a change in price can be analyzed in terms of a change in average variable and fixed costs.

This shift in focus bears on more than just the pricing policies of the megacorp. It touches on the distribution of income, for the change in average variable and fixed costs which is to be emphasized in this chapter is the change that occurs when the rates of compensation paid by the megacorp to those who supply it with essential inputs or otherwise have a claim to a portion of its revenues are revised, usually upward. Any such increase in the rates of compensation received by certain of the megacorp's constituencies will be one element in the ongoing dynamic that characterizes pricing behavior in the oligopolistic sector of the economy. The other element, at least insofar as costs are concerned, pertains to the secular growth of output per worker. This windfall from technological progress is not to be confused with the change in productivity which occurs when various inputs are used in different combinations. The latter is essentially a short-run phenomenon, and is precluded, in the present analysis, by the assumption of fixed technical coefficients. What is to be taken into account here is rather the change in productivity which occurs when technological progress makes it possible to achieve greater output over the long run with the same, or a similar, fixed combination of inputs. Normally this increase in output per worker serves to offset, at least in part, the increase in the rates of compensation paid by the megacorp to its several constituencies, and for this reason it is an integral part of the pricing dynamic. Indeed, as will subsequently be brought out, the increase in the rates of compensation which the megacorp is required to pay will, to some extent, depend on the secular rise in output per worker. The precise nature of this interrelationship and its impact on the cost structure of the megacorp are the principal subject matter of this chapter and the next two.

Thus, while chapter 3 sought to determine the amount of residual income which the megacorp would attempt to gain for itself as an organization, this chapter will take up the question of how, independently of that sum, the megacorp's revenue is apportioned among certain of its constituencies, in particular, the laboring manpower force and the
equity debt holders. It is thus concerned with the distribution of income within the megacorp and, on a larger scale, with the distribution of the income originating in the oligopolistic sector of the American economy.

The chapter will take up, in turn, each of the major theories of income distribution which have at one time or another found favor among social scientists, this with the aim of ascertaining the extent to which they pertain to the megacorp. These major theories are (1) the marginal productivity theory of conventional, neo-classical analysis; (2) the power-focused theory of the institutionalists; (3) the normative theory of the medieval scholastics and latter day sociologists; (4) the surplus value theory of Marx, and (5) the aggregate demand-related theory that has emerged in the wake of the Keynesian revolution in economics. From these various theories an eclectic model will be developed to explain changes in the rate of compensation received, first, by the megacorp’s laboring manpower force and, second, by its equity debt holders. It is the change in these two rates of compensation which, with a fixed rate of growth of output per worker, will determine the change in the megacorp-price leader’s average variable and fixed costs from one pricing period to the next and hence, with the corporate levy held constant, the change in the industry price level over that interval.

Marginal productivity theory

The most widely taught, if not the most widely held, theory of income distribution in the Western world is the marginal productivity theory developed by the neo-classical economists (Ferguson, 1969; Schumpeter, 1955, pp. 909-24; Stigler, 1941; Kaldor, 1955-6). According to this, the conventional theory, each factor of production will receive as compensation for its services the value of its marginal product. More specifically, it will receive the market value of the increment of output made possible by the employment of the last additional unit of that factor in the production process.

The marginal productivity theory, it should be noted, has several characteristics that particularly recommend it to economists, both those with purely academic interests and those with certain political proclivities. First, it can be applied to any factor of production, whether it be a member of the laboring manpower force, a piece of capital equipment or even a natural resource such as land. No matter what the input may be, its rate of compensation will, according to the theory, be equal to the value of its marginal product. This, by eliminating the need for separate theories to explain different factor shares, greatly simplifies the analysis of income distribution (cf. Tobin, 1960; see also Kaldor, 1960b). Second, the marginal productivity theory readily lends itself
to mathematical treatment using calculus. Assuming that all of the firm's revenue can be accounted for by the value of each factor's marginal product, partial differentials can be derived to delineate the relative contribution of each input. This, aside from permitting the powerful tools of mathematics to be used, is essential to any empirical research on factor productivity. Finally, since the marginal product of any factor is determined solely by technological considerations interacting with factor endowments, the theory provides a strong argument against conscious efforts to redistribute income within the firm. To do so, it can be argued on the basis of the theory, will have an adverse effect on either output, employment or efficiency. This provides powerful intellectual support for certain political stances.

The marginal productivity theory nonetheless has a serious defect. Its usefulness in analyzing the distribution of income in a modern, technologically sophisticated society such as that of the United States is, to say the least, questionable. This is a point which has been made many times before - most recently by the Cambridge, England, critics of neo-classical growth models - and there is no need to repeat all of those arguments here. What perhaps does need to be brought out is the precise way in which the special characteristics of the megacorp limit the relevance of marginal productivity theory, at least insofar as the oligopolistic sector is concerned - why, in fact, the theory cannot be used to explain (a) the relative rates of compensation received by different members of the laboring manpower force; (b) the relative rates of compensation received by different capital debt holders, and (c) the relative rates of compensation received on the one hand by the laboring manpower force as a whole and on the other hand by the capital debt holders en masse. These very considerable shortcomings of marginal productivity theory, it will be shown, can be traced to (1) the bureaucratic nature of the megacorp; (2) the distinction between the marginal efficiency of investment and the value of a capital good's marginal product, and (3) the fixed nature of the technical coefficients governing production by the megacorp in the short run.

The laboring manpower force attached to a megacorp is not simply an undifferentiated mass, as is generally assumed in the conventional analysis, but in fact consists of individuals with quite numerous and varied skills. The division of labor which such a heterogeneous work force makes possible is a major source of the megacorp's manifest productivity. If individuals so numerous and varied in their skills are to work together effectively, however, they must be governed by a set of rules and relationships. It is the latter, defining who are each employee's superiors and subordinates - that is, the persons from whom he takes direction and the persons to whom he gives direction - that constitute the megacorp's bureaucratic structure.
Once established, a bureaucratic structure can be expected to set rather narrow limits within which may vary the relative rates of compensation received by different members of the laboring manpower force. If organizational morale is to be maintained, employees must be paid a wage or salary that is at the same time both higher than that received by their subordinates and lower than that received by their superiors. Of course, if two individuals are both supervised by the same person (or by two different persons of equal rank) and thus are peers within the bureaucratic structure, the higher wage or salary will most likely go to the individual whose job requires the greater skill, physical exertion, responsibility or risk to his health (cf. Reynolds, 1964, pp. 503-8, especially p. 504 fn7; Sibson, 1960). Similarly, if two individuals perform functions which are essentially identical and thus fall within the same job classification, the higher wage or salary will most likely go to the individual with more years of service to the company. But these are only qualifications to the more general rule governing relative rates of compensation within a bureaucratic structure. The distribution of income among the laboring manpower force depends, then, not on marginal contributions to the firm's overall revenue - contributions which, due to the group nature of most work activity, cannot in any case be ascertained - but rather, on relative position within the corporate hierarchy. It is the differential rates of compensation thus determined that constitute what is referred to as the internal wage structure of the laboring manpower force (Livernash, 1957). This internal wage structure, in turn, is what makes it possible to speak of the rate of compensation received by the laboring manpower force as a whole - for an increase in that overall rate of compensation simply means an increase in each of the separate rates that make up the internal wage structure.

The inability of marginal productivity theory to explain the relative rates of compensation received by various capital debt holders derives from a somewhat different source - the generally ignored distinction between the marginal efficiency of capital and the value of the marginal product of capital goods. The capital debt holders, it should be kept in mind, do not themselves contribute anything directly to the production process but rather simply provide funds so that certain types of physical resources can be purchased and used by the firm. These capital goods are as heterogeneous as the skills of the laboring manpower force (Sraffa, 1960; Lachman, 1956). What makes it possible to treat the capital debt holders as a homogeneous body is the presumption that the funds they supply, when used to purchase capital goods, will all add the same increment to the firm's total revenue. In other words, it can be assumed that a dollar provided by one capital debt holder will, at the margin, have the same value to the firm as a dollar provided by another capital
debt holder - or even a dollar provided by the firm itself from internal sources. This being the case, the firm should be willing to pay each and every capital debt holder a rate of compensation equal to that increment in total revenue - or, in other words, a rate of compensation equal to the marginal efficiency of investment.

Superficially, this might seem to be but an application of marginal productivity theory. The marginal efficiency of investment, however, is not the same as the value of the marginal product of capital goods. The latter represents the change in the firm's total revenue that occurs as the quantity of capital goods is varied, holding all other inputs constant. It thus reflects the greater physical productivity of that factor - it being possible to determine how much of the additional output is to be attributed to the capital goods alone only because the influence of the other inputs has, in effect, been neutralized by holding them constant. The marginal efficiency of investment, however, need not imply that the quantity of other inputs remains unchanged. In fact, the amount of capital goods and the amount of other inputs used in the production process may both be increased together - the marginal efficiency of investment, in this case, simply reflecting the anticipated growth in the firm's total revenue after the cost of those other inputs has been taken into account. It is for this reason that it is possible to specify a marginal efficiency of investment even if, as will soon be pointed out, the factor coefficients are fixed and the value of the marginal product of capital goods cannot therefore be separately determined.

The megacorp's capital debt holders, it should also be kept in mind, comprise two major classes. On the one hand there are those whose debt holdings consist of fixed-interest obligations. In return for supplying the firm with investment funds, they become contractually entitled to an unvarying amount of compensation equal to the marginal efficiency of investment at the time the commitment of funds is made, less the cost of brokerage services and the premium required, if any, to offset the risk to the executive group from an increase in fixed-interest obligations (see above, pp. 86-7). Since the marginal efficiency of investment can be expected to vary over time - even if new long-term debt is entered into only infrequently - different groups of fixed-interest debt holders will, as viewed from the perspective of the megacorp, be receiving different rates of compensation, depending on the dates at which they have provided the firm with investment funds.6

On the other hand, there are those whose debt holdings consist of equity shares. In return for supplying the firm with investment funds, they become implicitly entitled to a rate of compensation in the form of dividends which, though initially less than that received by the fixed-interest debt holders, can nonetheless be expected to increase over
time. Precisely what determines the growth of the dividend rate from one year to the next will be discussed at some length later in this chapter. All that need be noted at this point is that the upper limit will depend on whether previously projected returns from investment are being realized, the lower limit on the non-economic pressure which the equity debt holders are able to bring to bear on the executive group through their right, acting collectively, to depose the incumbent management. If the megacorp were managed entirely in the interest of its putative owners, the equity debt holders could, of course, be confident that all of the increment in revenue would accrue to them — eventually, if not in the short run — and the lower limit would, in that case, be the same as the upper limit (see above, pp. 25-7, 52-4, as well as the discussion below in this chapter, pp. 164-72).

The distribution of income among the capital debt holders depends, then, not on the marginal productivities of the capital goods which their funds have enabled the megacorp to purchase at various points in time but rather on the marginal efficiency of investment over the years, both \textit{ex ante} and \textit{ex post}, as well as the non-economic power of the equity debt holders \textit{vis-à-vis} the executive group. It is the relative rates of compensation thus-determined that constitute what may be termed the megacorp’s capital cost or external debt structure. However, since the fixed obligations, once entered into, are invariable, only the equity portion of this capital cost structure need be taken into account in considering changes in relative income shares. An increase in the rate of compensation received by the capital debt holders means therefore an increase in the dividend rate.

Though marginal productivity theory has been shown to be inapplicable to both the laboring manpower force and the capital debt holders as separate entities, the theory may nonetheless be capable of explaining the division of the firm’s total revenue between these two principal constituencies. In other words, if the assumption is made that production is carried out with only two composite inputs, one supplied by the laboring manpower force and the other by the capital debt holders, it may then be possible to determine the value of the marginal product of each of those two inputs on the basis of marginal productivity theory, the respective rates of compensation being equal to the value of the two marginal products. This possibility is precluded, however, by one of the characteristics of the megacorp already emphasized — the fixed nature of the technical coefficients governing production in the short run (see above, pp. 28-30). As Stigler (1939) pointed out many years ago, the marginal productivity theory of income distribution becomes inoperative if these coefficients are invariable, ‘since it is not [then] possible, by incremental analysis, to impute productivities’. The same point
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applies, of course, even to the distribution of income among the members of the laboring manpower force, insofar as men of different skills must be used in fixed combinations, and to the distribution of income among the capital debt holders, insofar as machines of different types must also be used in fixed combinations (Finkel and Tarasco, 1969). It thus reinforces the earlier arguments about the inapplicability of marginal productivity to the short-run determination of relative rates of compensation within each of the megacorp’s two principal constituencies.

Granted, marginal productivity theory may not be so inapplicable to the longer run situation. As already stressed, the megacorp will be in the process of continually adding new plant and equipment, both to replace existing facilities which have become obsolete and to make it possible to meet any likely increase in future industry demand. This new plant and equipment will embody the technology compatible with current trends in relative factor prices. Thus, if the price of labor has been growing relative to the cost of capital — as has been the recent historical experience in the Western world for reasons which, as will eventually be pointed out, are inherent in a progressing economy — the demand will be for capital equipment which is labor saving. While the evolution of technology is subject to laws other than economic, a general tendency will nonetheless be discernible for the new equipment being developed by the manufacturers of capital goods to involve the substitution of capital for labor in the manner suggested by marginal productivity theory. However, what the marginal productivity theory purports to explain in this long-run situation is not the distribution of income among the various factors of production but rather, given certain trends in relative factor prices, the combination of inputs that will be used in the production process (Dunlop, 1957). To pretend that it is more than simply a theory of factor proportions is to place more intellectual weight on marginal productivity analysis than the theory is capable of holding.

If one wishes to understand the distribution of income, in the long run as well as for shorter periods of time, it is necessary to turn to other explanations.

Power theory

The distribution of income being indeterminate on the economic grounds stressed by marginal productivity theory, it might seem reasonable to conclude that the division of the megacorp’s revenue will be decided, as certain of the institutional economists have suggested, by the power - non-economic as well as economic - which the various claimants can bring to bear in a bargaining process. As the lawyer Robert Hale has put it,
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All incomes, in the last analysis, whether derived from ownership of property or from personal services, are not products created by the recipients; they are payments derived from the rest of the community by the exertion of some sort of pressure. To say this is not to condemn the exertion of such pressure; it is the only means a man has, under present arrangements, and perhaps under any workable scheme of things, for keeping alive . . . The justification of each income must rest on some other ground than that the recipient has produced it. (Tugwell, 1924, quoted in Gams, 1946, p. 12.)

The view of the institutional economists is that this struggle over who will receive what share of the available income is waged, not by atomistic individuals in the market place but rather, by organized social groups operating within an institutional framework that includes value systems, political mechanisms and the law. To pursue this line of inquiry it is therefore necessary to specify the organized social groups and the institutional framework relevant to the distribution of the megacorp's revenue.

Actually, only one additional organization, aside from the megacorp itself, need be introduced at this point. This is the industrial trade union which is likely to represent a substantial portion of the megacorp's production workforce — that is, the workers who are directly involved in the production process and who are generally paid on an hourly basis. As an organization, the trade union can be expected to have goals of its own, separate and distinct from those of its members. Still, if it is to retain the loyalty and support of the rank and file, and thus remain a viable entity, it must take as its primary function the pressing of those workers' claims against the megacorp. This it can be expected to do through a process of collective bargaining, with the trade union leadership periodically sitting as an equal across the table from the representatives of the company to work out mutually acceptable arrangements. While the trade union cannot be said to speak for all of the megacorp's laboring manpower force — and perhaps not even for all of its production workers — it will nonetheless be the key social agent, together with the megacorp itself, for determining the compensation to be paid employees. This is because the bargain reached between the union and the megacorp will set the wage standard for the entire laboring manpower force. Indeed, whatever gains are won by the trade union for its members are likely to be extended, almost as a matter of course, to all other employees since any other policy would lead to greater dissatisfaction, higher turnover rates and, eventually, an increase in the percentage of the laboring manpower force represented by a trade union.

The same argument applies to megacorps whose employees, for some reason, have not yet been organized by any trade union. These megacorps, too, in order to keep the trade unions out of their plants, can be expected
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to extend to their employees whatever wage gains are won by the organized workers in their branch of industry or in similar skill categories (see, for example, Rosen, 1969). It is for this reason that the assumption made implicitly throughout the rest of this treatise, that every megacorp faces a trade union in collective bargaining, is not an unreasonable one to make even though there are a number of exceptions within the oligopolistic sector.

The capital debt holders, on the other hand, are not likely to be as highly organized as the unionized portion of the laboring manpower force – except in unusual circumstances, as for example when the megacorp defaults on its fixed-interest obligations and a bondholders committee is formed. There are two reasons for this lesser reliance on formal associations. One is the existence of a well-organized capital funds market which enables capital debt holders, especially those owning stock, to sell out and obtain some other financial asset instead when they are dissatisfied with their treatment by the megacorp. The other reason is the close identification with the capital debt holders that the megacorp’s executive group is likely to have – a point which will be elaborated on shortly. The megacorp’s other constituencies are even less formally structured – with several notable exceptions. For example, the automobile and retail gasoline dealers, virtual satellites of the megacorps from which they must obtain their products, have in certain cases set up associations in order to increase their bargaining power. However, these associations are generally more concerned about the terms of the franchise agreements than the prices they must pay for the product. Conspicuous is the absence of any formal organization to represent the interests of the general consuming public, that is, the household sector.

Thus the analysis of the power relationships determining the distribution of the megacorp’s revenue – once the cost of material inputs and of future investments have been met – need only be concerned with the process of collective bargaining between two organized social groups, the industrial trade union representing a significant portion of the laboring force and the megacorp itself. It is the agreement reached between these two contending parties that is the single most important factor determining the apportionment of the megacorp’s revenue. Again, in examining a particular industry, it is sufficient to focus on the price leader alone, since the settlement reached between it and the trade union will in most cases set the pattern for the industry as a whole.

While there is no generally accepted theory of bargaining comparable to the marginal productivity theory of income distribution, there is wide agreement that such a theory must indicate, first, the objective market forces which set the limits within which bargaining will take place and,
second, the subjective factors (or states of minds of the negotiators) which will determine the actual agreement that is reached. In the case of contract negotiations between a megacorp-price leader and an industrial trade union, the range of possible agreement is bounded, on the one hand, by how low the megacorp can push wage rates without losing the labor services it needs and, on the other hand, by how high the trade union can push those same wage rates without jeopardizing the employment of its members. These objective constraints on the bargaining process - or 'competition limits on the contract zone', as Pen (1959, p. 61) terms them - still leave considerable room for discretion, however.

Even if the trade union were so weak that the megacorp-price leader could impose whatever settlement terms it wished, the wages received by the members of the trade union could not fall below what those workers could earn from alternative employment outside the industry. Were the rate of compensation to be set below this floor, the megacorp would find itself losing at least part of its manpower laboring force and, insofar as the technical coefficients are fixed, forced to cut back proportionately on production. The objective lower limit on the rate of compensation that is to be negotiated will therefore be determined by conditions in the labor markets outside the oligopolistic industry.

This floor on wages will be considerably below the current rate of compensation, both because of the specialized knowledge which the trade union's members are able to exploit on their current jobs and because of the past gains won by the trade union. This means that, unless the megacorp's management is prepared to insist on substantial wage cuts, the floor set by market forces will have no influence on the actual negotiations. Yet the historical experience indicates that a megacorp's management is unlikely to insist on a wage cut - even a small one - except under the same depressed business conditions that lead to substantial price cutting. For this reason it is perhaps more useful to regard the lower limit on the negotiations as being the current rate of compensation, a limit determined by subjective factors still to be explained rather than by objective market forces.

At the same time, if the megacorp-price leader were so weak that the trade union could impose whatever settlement terms it wished, the wages received by its members could not rise above the point where either at existing price levels no revenue was left to meet other contractual obligations or, alternatively, the amortized cost of obtaining and training a new work force was less than the cost of the settlement. If wages were to be pushed up to the point where no revenue was left to meet other contractual obligations, the megacorp would be forced into receivership, thereby nullifying the trade union's claims to a larger share of the revenue. On the other hand, if the amortized cost of obtaining
and training a new labor force were less than the cost of the settlement, the megacorp could simply dismiss or lock out its present organized labor force, thereby eliminating the need for further collective bargaining. Which of these two conditions will impose the ceiling on negotiations will, of course, depend on which is encountered first.

No matter what the ceiling is, however, the trade union will still be able, within that objective upper limit, to secure a substantial increase in the rate of compensation for its members. On the one hand, the cost of obtaining and training a new work force to replace the organized one will be considerable - if not prohibitive. While the American economy usually operates with somewhat more slack than that of most Western European countries (cf. Shonfield, 1965, pp. 11-18; Sorrentino, 1972), it is nonetheless doubtful whether the large number of organized workers employed in a typical oligopolistic industry could be immediately replaced en masse at existing rates of compensation. Moreover, even if the replacements could be found, it is doubtful whether they could be brought up to the skill and efficiency level of the old work force without a long period of on-the-job training. On the other hand, the portion of the megacorp's revenue currently earmarked for investment and the payment of dividends could all be diverted to increased compensation for the manpower laboring force - or for the organized work force alone - without immediately endangering the company's solvency.

What is more - and it is this condition which uniquely characterizes the bargaining environment of the megacorp - the trade union will be able to secure a substantial increase in wages without any offsetting loss of employment, at least in the short run. For insofar as the megacorp operates with fixed technical coefficients, employment after the increase in compensation will be the same as it was before. Of course, in the long run, when the existing plants and equipment have been scrapped in favor of new machinery embodying more capital intensive methods of production, the effect of the higher wages on employment will be felt. But if in the long run not all union members are dead, some will have retired and others will have moved on to other jobs. Even if the goal is to maintain a stable union membership and thus to protect the viability of the organization, union officials will find that the jobs lost through the adoption of labor-saving technology may be more than made up for by the jobs created through the coincidental growth of demand as a result of population and real income trends (Finkel and Terascio, 1969). While it can be argued that union membership will still be less than it would have been had the increase in wages not stimulated the development of more capital intensive production methods, it is questionable whether this long-run consideration is one which does and ought to influence the union's bargaining position.13
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The significance of the fact that an increase in the rate of compensation leaves employment unaffected, at least in the short run, is that it removes what has sometimes been thought to be the principal restraint on trade union demands. For whatever it is that the trade union is assumed to want to maximize — whether it be individual wages, short-term employment, the total wage bill or some variant of these three (cf. Dunlop, 1950, pp. 32-50) — the goal is consistent with a rate of compensation equal to the objective upper limit specified above, provided that factor coefficients are fixed.

That upper limit, together with the lower limit previously discussed, provide such a wide range within which the actual rate of compensation can fall that is questionable whether, by themselves, they explain very much about the outcome of the negotiations between the megacorp and the trade union. Given this wide range, it is necessary to focus on the non-market factors influencing the collective bargaining process.

Within the competition limits of the contract zone the power relationships emphasized by the institutional economists might at first seem to be determining. The economic strength of the two parties (the resources they can draw upon in the event of a strike), their political strength (the support they can expect to receive both from government and various social groups), their psychological state (the degree of internal cohesion and fastness to bargaining goals), the individual bargaining skill of the respective negotiators and — most important — how the negotiators evaluate these factors subjectively would appear to be crucial to the outcome of the bargaining. Yet, even when all these elements of power have been taken into account, the fact remains that, as the system of collective bargaining has developed in the United States, neither of the two parties can be compelled to agree to any particular rate of compensation.

Both the typical megacorp and the typical union have such ample resources at their command that, except for an improbably long strike, they need take little account of the debilitating effect that an extended struggle may have on their respective strengths. Indeed, they are likely to carefully marshal their resources before the negotiations so as not to be limited by that consideration. The support which the two parties can expect to receive from government and various social groups is, meanwhile, best regarded as a supervening element in the bargaining situation, this factor historically determining the legal climate in which negotiations are conducted. Currently, the legal climate dictates that — with certain notable exceptions — neither government representatives nor any third party intervene directly to force a settlement on one of the parties. In other words, compulsory arbitration of the differences between the megacorp and the trade union over the rate of compensation is at present precluded by law. Finally, the psychological states of the parties, the individual bargaining skill of their respective negotiators
and the subjective evaluation of these factors would appear to be little more than random factors which cancel themselves out over time and across sample populations. Thus, while the power relationships pointed out by the institutional economists will not be absent, they are more properly treated as parameters of the collective bargaining process (cf. Pen, 1959, pp. 98-112; Coddington, 1968, pp. 68-70, 77-80). This means that still another theory must be invoked, at least as a complement, to explain the share of the megacorp's revenue received by the laboring manpower force - not to mention the share received by the megacorp's other principal constituency, the capital debt holders.

Normative theory

It being impossible to erect a model on the power relationships alone, one must ask whether there is some additional element in the collective bargaining situation which determines the nature of the settlement reached between the two parties and thus helps to explain the division of the megacorp's revenue among its principal constituencies. Such an element would be the existence of an external standard of compensation to which both the megacorp and the trade union could be expected to give obeisance, even if they could not be compelled to accept it. This would imply a normative theory of income distribution similar to that propounded by the medieval scholastics with their notion of a 'just' or 'fair' price.

To pursue this line of inquiry it is necessary, first, to specify what that external standard of compensation might be and, second, to indicate the extent to which it is likely to be consistent with the divergent goals which both the megacorp and the trade union carry with them into collective bargaining. The point at which to begin this task is with a consideration of the latter, the goals which the megacorp and trade union are likely to pursue in collective bargaining.

These particular goals will, of course, depend on the more general goals which the megacorp-price leader and the industrial trade union pursue as ongoing institutions. The previous chapters have already argued that, insofar as the megacorp-price leader is concerned, its objective within a given industry will be to maintain and perhaps even increase its relative share of the market. This can be viewed as the derivative of a larger goal common to all such institutions, to grow at the maximum rate and, if nothing else is possible, at least to preserve the organization as a functioning entity. The trade union can be presumed to pursue the same general goal, with the particular objective of maintaining and perhaps even increasing the proportion of the laboring manpower force - or rather the proportion of the production work force - which it represents. The leaders of the trade union will seek first and foremost
to preserve their organization as a functioning entity for the same reason that the megacorp's executives will seek to preserve theirs: whatever status they have in the larger community will be but a reflection of the power and prestige enjoyed by the trade union they head. And while it is even more difficult to determine empirically the behavioral pattern of the trade union than it is to determine that of the megalopolis, the logical connection between the proportion of the production workforce which the trade union represents and the ability of the trade union to survive as a functioning entity can be well demonstrated.

For one thing, the income which the trade union receives, that is, the economic resources which it can potentially command, will be a function of the number of persons included in the various collective bargaining units it represents. The more workers it covers, whether formally enrolled in the union or not, the larger will be the amount of dues which it collects. Second, and perhaps even more crucial, the trade union must be able to count on the loyalty of a certain minimum number of workers, that is, be assured they will follow its orders to stay off the job, if it is to have effective bargaining power. Unless this critical degree of response by the workers can be assured, the trade union will be unable to bring a halt to production by the megalopolis and will therefore lack the *quid pro quo* to exact an agreement from the megalopolis's management.

Of course, the response of the workers to the trade union's strike call will depend, at least in part, on the trade union's past success in achieving gains for its members. It will thus be a complex set of interdependent factors that will have historically determined the degree of 'solidarity', as the trade union officials themselves term it, which the labor organization currently enjoys. The points to be noted here are that the trade unions which typically represent the production workforce in oligopolistic industries will already have achieved sufficient solidarity to be able to bring production to a halt, and that given the importance of this solidarity, they will insist on obtaining through collective bargaining a contract which does not endanger or diminish the loyalty of their members. In other words, as the trade union officials themselves express it, they want a contract they can 'live with'.

The question still remains, however, as to what kind of contract trade union officials can live with. Such a contract, it should first be pointed out, will contain many provisions, only a small number of which will pertain to the rate of compensation (defined to include fringe benefits and other labor cost items). This chapter will ignore all the other provisions - though much the same type of analysis could be applied to them. Thus it is only one part of the contract, and a minor part at that, with which this chapter will be concerned. So delimited, the contract which
trade union officials can live with is a contract containing satisfactory provisions affecting the rate of compensation. In the words of trade union officials, it is a contract which provides an 'equitable' wage.

The concept of equity is a sociological rather than an economic one. That is, it reflects the normative values of a society or a particular subgroup within the society, these values resulting from the social interaction of its members rather than from the balancing of objective market forces. A theory of income distribution based on the concept of equity has not been fashionable among economists since certain of the mercantilist writers began to question the usefulness of the medieval notion of a 'just' price (Roll, 1942, pp. 99-107; Schumpeter, 1955, ch. 2). A normative theory based on traditional values was, of course, hardly likely to prove useful in a society starting to undergo rapid economic development, a process which in itself tends to undermine established norms. Still, the fact that social philosophers once paid too little attention to the forces of supply and demand is no reason why economists should in turn ignore the role played by social values, whether traditional or otherwise, in the market process.

Economists have been able to close their eyes to this factor because they have implicitly assumed that most of the important markets were of such wide scope, covering so large a territory or so many disparate individuals, that the social interaction necessary to develop a consensus on values would be lacking, particularly in view of the rapid changes likely to be occurring in the underlying material endowment. Of course, the more thoughtful members of the profession have recognized that where markets were narrowly circumscribed, social values - or 'custom' - might play a prominent role. This was particularly likely to be true, they realized, with regard to labor markets, these tending to be essentially local in character. (cf. Mill, 1965, Book II, ch. 4; Marshall, 1920, Book I, chs. 2 and 3).

Important as this acknowledgement of the role played by social values may be, it would seem to have little relevance to the problem at hand - namely, the determination of a rate of compensation through collective bargaining. For the large number of megacorps and trade union officials involved in such negotiations, their dissimilar interests and their lack of continuing personal contact with each other would seem to preclude the type of social interaction necessary if a general consensus as to what constitutes an 'equitable' wage is to develop. Indeed, under the circumstances, it would seem that social values would be able to play a role in the determination of wages through collective bargaining only if there were an institutional arrangement to make up for the lack of continuing personal contact among the parties to the negotiations. Yet in the United States no formal arrangement of this sort exists. There
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is no meeting ‘at the top’, such as there is in Sweden, between the trade union organization representing all blue-collar workers and the management organization representing all employers to determine, in accordance with nationally planned economic objectives, a wage pattern for the country as a whole. Nor is there a system of compulsory arbitration enforced by the courts, such as there is in Australia, to accomplish the same end (Roberts, 1958, ch. 6; A. Weber, 1963; Turner and Zoeteweij, 1966, ch. 5). In the absence of any such formal arrangement, it has been necessary in the United States to fall back on an informal system, one that is based on the national incremental wage pattern established in certain ‘bellwether’ industries through a ‘key’ bargain.

The remainder of this chapter will explain how power and normative factors together determine the rate of growth of compensation for the megacorp’s two principal constituencies, the laboring manpower force and the equity debt holders, through the intervening mechanism of the national incremental wage pattern. First the nature of the national incremental wage pattern and its influence on wage rates within the oligopolistic sector will be described. Next the effect which acceptance of the wage pattern is likely to have on the megacorp’s cost structure, including dividends, will be analyzed. Finally, the extent to which those higher costs can be passed on to customers through a rise in price will be brought out. While two additional theories, the Marxian and the Keynesian, still remain to be woven into the argument before the explanation can be considered complete, an appreciation of the role played by the national incremental wage pattern is the critical first step in understanding the distribution of income within the megacorp.

The national incremental wage pattern. The norm as to what constitutes a ‘fair and equitable’ increase in wages is, under ordinary circumstances, established through the collective bargaining agreement reached in one of the ‘bellwether’ industries. Since the end of World War II, a period in which trade unions in the United States have been able to demonstrate their enduring nature and a period in which therefore the informal system has emerged, these ‘bellwether’ industries have at various times been automobiles and steel. The choice of these two industries reflects the fact that the parties to collective bargaining - both the industrial trade unions and the megacorp-price leaders in automobiles and steel - are at the same time among the strongest economically of their kind and the most evenly matched. It is as though the two sides to the historic class struggle between labor and capital (or rather, in the modern context, between labor and management) have each selected their most powerful member to act as champion in the periodic jousting over the division of the national income. While the industrial trade unions and the
megacorp-price leaders in automobiles and steel are perhaps best equipped to don the colors of labor and management at present, changing economic fortunes could in the future bring the industrial trade union and megacorp-price leader of some other industry into the lists.

Several factors serve to convert the wage settlement reached in the bellwether industry - the so-called 'key' bargain - into a national standard of what constitutes a 'fair' or 'equitable' percentage increase in the rate of compensation for the organized laboring manpower force. This percentage increase in compensation, \( W_p \), is what is meant by the national incremental wage pattern. One of the factors which serves to convert the 'key' bargain into a national standard is the existence of what Dunlop (1957, pp. 17-20) has called 'wage contours' - groups of industries 'linked together (a) by similarity of product markets, (b) by resort to similar sources for a labor force, or (c) by common labor market organization and/or the recognition that they have 'common' wage-making characteristics'.

The most important of these wage contours in the United States is the group of capital intensive, mass production industries which Soffer (1959) has labeled the 'auto-steel orbit'. It includes, in addition to automobiles and steel, the aluminum, agricultural implements, electrical equipment, rubber and flat glass industries. Besides the features already mentioned, these industries share in common certain important input-output relationships and a similar geographical concentration in the Midwest. To the above list could be added the air frame, petroleum refining, meatpacking, shipbuilding, and copper industries. These have many of the same characteristics as the members of the auto-steel orbit including, most important, the fact that they are oligopolistically structured with a large proportion of their production work force organized into powerful industrial trade unions.

Because of the national base of comparison which these common features provide, it is difficult for the firms in one industry not to grant the same percentage increase in the rate of compensation, \( W_p \), which has already been obtained from firms in another industry within this enlarged auto-steel orbit. The invidious distinctions which would otherwise be created would serve as a constant source of worker grievances, and the trade union leadership could not fail to respond to resentment over the issue. In the absence of any objective guide as to how high wages should be set, trade union leaders can be expected to seize upon any such 'inequity', making the elimination of that inequity their prime goal in collective bargaining. In this way, the pattern which is established in the bellwether industry - whether automobiles or steel - eventually comes to be adopted by all the members of the group (Maher, 1961; Eckstein and Wilson, 1962; Eckstein, 1968; Ripley, 1966).
Since the industries forming this principal wage contour employ nearly half of all production workers in oligopolistic industries, the wage settlement reached in the bellwether industry is, for this reason alone, quite likely to become the national norm as to what constitutes an 'equitable' percentage increase in the rate of compensation received by workers. In addition to this private obeisance, however, there is the further recognition often given the bellwether industry's wage settlement by the Federal government itself.

Because of the responsibility which it has assumed for the orderly functioning of the economy, the Federal government frequently finds itself forced to intervene in the labor disputes that arise in either of the two bellwether industries. On the one hand, if the parties remain deadlocked so that a strike ensues and production within the industry comes to a halt, the aggregate output of goods and services may be seriously impaired. On the other hand, since a change in the rate of compensation in the bellwether industry is likely, as will soon be argued, to affect the price level in all oligopolistic industries, a settlement may have significant inflationary consequences. Since neither of these two possibilities are without their disruptive effect on the economy, the Federal government will be forced by political considerations to try to influence the outcome of the collective bargaining in the bellwether industry. But by so intervening - whether by the threat to issue a Taft-Hartley injunction, by the release of statements to the public, or by one of the other methods that are used to sway the positions of the two parties - the Federal government acknowledges that what is being established is a national norm as to what constitutes an 'equitable' percentage increase in the rate of compensation for members of the organized laboring manpower force throughout the economy.

The time that elapses between the setting of a wage pattern in the bellwether industry, as described above, and its replacement by a new wage pattern is sometimes referred to as a 'wage round'. It may consist of one or more contract renewals, a new wage round occurring only when a different basis for determining the rate of compensation in the bellwether industry has been agreed to. Thus, if the pattern of settlement in two consecutive negotiations has been an increase in wages and other benefits of 4 per cent each year, the signing of a new contract in the bellwether industry calling for an increase in wages and other benefits of 5.5 per cent each year thereafter over the life of the contract will mark the beginning of a new wage round with $W_n$ equal to 5.5. A number of such wage rounds can be clearly discerned in the post World War II period from the available data.

What has been said so far has been intended simply to point out how a national norm for wages most typically emerges; it has not been
intended to show how the actual wages in a particular oligopolistic industry are determined. In this connection, it should be noted that because of the unique role accorded the contract negotiations in the automobile and steel industries, those deliberations cannot be taken as being typical of collective bargaining in the United States. Since it is by means of those negotiations that a national incremental wage pattern is usually established, the contract negotiations in one of those two industries will ordinarily have to be conducted without the aid of any wage norm. Moreover, since what is in effect being determined is the distribution of the nominal increment in the national income between the laboring manpower force (and, indirectly, as will soon be brought out, the equity debt holders as well) on the one hand and all megacorps on the other hand, it is particularly difficult for a settlement to be reached - unless, of course, a wage norm has already been established through some other means, for example, through government action. On what basis the key bargain will, in fact, be struck in the absence of such an exogenously determined wage norm will be brought out later. All that need be noted here is that collective bargaining in the automobile and steel industries is unrepresentative of the process whereby the rate of compensation is determined in other oligopolistic industries.

These other industries begin with the point of reference provided by the national incremental wage pattern, $W_p$. Insofar as this increase in the rate of compensation is viewed by the leaders of the trade union in a particular oligopolistic industry as being 'fair and equitable', and thus compatible with the continued existence and growth of their organization, it is likely to constitute the minimum wage terms to which they will, in the absence of a strike, agree. But will it also constitute the maximum wage terms to which the megacorp-price leader's management will agree? This will depend on how, in the eyes of the executive group, the increase in the rate of compensation will - if granted - affect the megacorp's ability to achieve its own long-run goals. The answer, it can be shown, will depend on (a) the impact of the increase in the rate of compensation on the megacorp's cost structure, and (b) whether the resulting increase in costs can be offset by an increase in the industry price level.

**Impact on the cost structure.** In considering the impact which acceptance of the national incremental wage pattern will have on the megacorp's cost structure, it is necessary to focus separately on the average variable costs and on the fixed costs. With respect to the former, the task of developing an estimate is somewhat simplified if the megacorp has a policy of automatically granting to the rest of the production work force the same percentage increase in compensation as that obtained by the
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trade union for its members — and there is good reason to believe that, even aside from the need to forestall further trade union inroads, this will, in fact, generally be the case (see Zeman, 1966, especially p. 1252). Under the policy of automatically granting the rest of the production workforce whatever gains have been obtained by the trade union for its members, it is necessary to know only the ratio of labor compensation to total direct costs. This ratio, applied to the percentage increase in compensation established as the norm by the national incremental wage pattern, will indicate the percentage by which the megacorp’s average variable costs will increase, from labor expenses alone, if it follows the lead of the bellwether industry.  

Wages, however, are not the only item of direct expense. Acceptance of the national incremental wage pattern may also have an impact on the cost of the megacorp’s material inputs. This is especially likely if wages in the industries supplying the megacorp with its material inputs are keyed to those in the megacorp’s own industry or are otherwise subject to the same general influences. In other words, an increase in the rate of compensation received by the megacorp’s laboring manpower force may well lead to an increase in the firm’s other direct costs. While the precise amount of this related effect cannot be known in advance — it being dependent on the prices set in other industries — certain estimates of the probable rise in material costs, based on past experience, can nonetheless be made. From what has happened on previous occasions when the trade union representing the oligopolistic industry’s production work force has obtained an increase in the rate of compensation, it should be possible to estimate statistically the relationship between a rise in industry wages and the resulting change, if any, in other direct costs. The full increase in average variable costs resulting from acceptance of the national incremental wage pattern will, then, reflect both the direct increase in labor costs experienced by the megacorp itself and the indirect increase in labor costs experienced through the rise in the price of material inputs.

As for the impact on the fixed cost component of the overall cost structure, it should first be noted that only those indirect costs which are not fixed with respect to time — more specifically, those indirect costs which are renegotiable before the end of the next planning period — are likely to be affected. These costs consist primarily of the compensation paid overhead personnel and the dividends paid stockholders. Each will be discussed in turn.

The megacorp, again to avoid the type of disaffection which leads eventually to trade union inroads among the unorganized, can be expected to extend to most of its overhead personnel the terms of any new contract covering the organized portion of its production work force. While not
all salaries paid members of the overhead work force will thus be directly
keyed to the trade union agreement, a significant portion will. Two
ratios, then, are needed to transform the projected increase in the rate
of compensation for those covered by the agreement into a projected
increase in overhead labor costs. There are (a) the ratio of the compen-
sation paid that part of the overhead work force whose wages are keyed
to the trade union agreement to total labor compensation, and (b) the
ratio of overhead labor compensation to total fixed costs. These two
ratios, applied to the percentage increase in compensation established
as the norm by the national incremental wage pattern, will indicate the
percentage by which the megacorp's total fixed costs will increase from
labor expenses alone, should the megacorp follow the lead of the
bellwether industry. This leaves only any consequent rise in the dividend
rate to be taken into account. To what extent will an increase in the
rate of compensation received by the laboring manpower force lead
to an increase in the dividend rate? To answer this it is necessary to
face up to a crucial question which has so far been avoided - namely,
what are the factors which determine the rate of compensation paid
the equity debt holders?

The firm's dividend rate. The equity debt holders, though not formally
organized like some segments of the laboring manpower force, are
nonetheless not without recourse if they feel dissatisfied with their current
and projected rates of compensation. They can, as already noted, dispose
of their claims against the megacorp's revenue through one of the
established stock exchanges, using the proceeds to purchase some other,
presumably higher yielding asset. This response, aside from protecting
the equity debt holders against the loss of their wealth, can be expected
to give the megacorp's executive group pause. For if, as a result of
selling pressure, the market value of the company's shares should decline,
the price-dividend ratio will be lowered and thus the cost of external
funds will be increased (see above pp. 86-8). Even more serious, since
the megacorp is likely to be forced to resort to equity financing only
rarely, the fall in the value of the company's shares will enhance the
chances of a successful take-over bid by some outside party. It is this
last possibility, raising as it does the spectre of a fall from power,
that can be expected to weigh most heavily on the minds of those who
form the executive group. At the very least, therefore, they are likely
to follow a policy with respect to the growth of dividends over time
that effectively protects them against the possibility of a successful
take-over by some outside party. If the members of the executive group
anticipate having soon to float a new equity issue, they may then be
willing to exceed, at least temporarily, that minimum rate of growth
in the dividend payment so as to reduce the cost of external financing.

While an outside group can seek to capture control of a megacorp through a proxy battle, that is, by persuading a majority of the equity debt holders to temporarily turn over to the outside group its voting rights, the far more practical and thus the far more prevalent method is the take-over bid. This involves an announcement by the outside party that it is prepared to purchase some percentage of the company’s outstanding stock, usually more than 50 per cent, at a price well above the current market quotation. Even if a proxy battle is contemplated, a take-over bid, as the only means of acquiring a sufficiently large block of stock to wage a successful campaign, may well be the necessary first step. The willingness of the outside party to pay a premium over and above the current market price presumes, however, that the group has some reason for valuing the company’s outstanding shares more highly than do the current holders of those shares. The voting rights which go with the stock cannot be the reason since they are merely the means to the end – the acquisition of control. The reason must be in the control itself.

The pay-off may, of course, come in the ability of the outside party, once it acquires majority or near majority control, to replace the incumbent management group with men of its own choosing. This motivation would seem to be most applicable in the case of a conglomerate megacorp attempting to acquire by merger another established firm in an unrelated line of business.

However, given the considerable financial outlays required if a take-over bid is to be successful, it follows that the payoff must, to a considerable extent, be financial. In particular, the outside group, be it another corporation or a financier and his associates, must be able, once it acquires control, to increase the rate of growth in the dividend payment sufficiently to compensate for the price it will have to pay for the company’s stock. Unless the outside group is simply seeking short-run speculative gains, it must be able to do this without reducing the rate of investment necessary to maintain the firm’s growth rate in the long run and hence the higher rate of growth in dividends. The chances of the outside group being able to achieve its goals in this respect will depend on two factors: (1) whether the company is being managed as efficiently as it could be by the incumbent executive group, and (2) whether the rate of growth in dividends is as great as that of other megacorps. The two factors are not necessarily unrelated.

Managerial incompetence may be of several types. Perhaps the most generally recognized is what Harvey Leibenstein (1966) has referred to as ‘X-inefficiency’ – that is, the failure to exploit all the currently available managerial techniques to achieve the highest possible output
with a given set of inputs. This type of incompetence is, however, particularly difficult for an outside group, especially one consisting of financiers, to discern. As long as reported net earnings, taken as a percentage of sales, do not differ significantly from those of other firms in the same industry, the X-inefficiency is virtually impossible for an outsider to detect. What is likely to be far more apparent is the failure to exploit the megacorp's investment potential - as evidenced by the continued growth of liquid assets beyond any reasonable need for a contingency reserve. The accumulated cash and other financial assets will show up prominently in the balance sheet, and there attract the attention of an outside group. Here the source of the incompetence is not inefficiency in any narrow sense but rather the inability to find a profitable outlet for the megacorp's investment funds - even if the funds are used for no better purpose than simply to purchase the company's stock in the open market. When the funds invested by the megacorp, for whatever purpose, fail to bring a return sufficient to maintain the firm's long-run growth - as evidenced by a fall in the requisite rate of growth in net revenue - the underlying cause is likely to be some combination of the above two types of managerial incompetence. Whatever its precise nature, however, the existence of the incompetence offers the possibility that an outside party, by adopting better management techniques, will be able to increase the rate of compensation received by the equity debt holders without having to reduce either investment or the rates of compensation received by other constituencies. In this sense, then, the existence of managerial incompetence increases the probability of a successful take-over bid.

Alternatively, the chances of a successful take-over bid will be enhanced by the failure of the executive group to maintain the same rate of growth in dividends as other megacorps. Of course, this failure to increase dividends sufficiently might simply be an indication of managerial incompetence, especially if there is the corroborating evidence of a low rate of growth in net earnings or a low ratio of net earnings to sales. Whether it be an indication of managerial incompetence or not, however, the very fact that dividends are not growing apace with those of other megacorps will facilitate a take-over bid. When a megacorp fails to increase dividends sufficiently, it can expect to be abandoned by its equity debt holders for more promising income-earning assets. The resultant selling pressure, by depressing the price of the equity shares, will not only serve to bring about an equalization of expected future yields, it will also lower the market value of the megacorp itself. This, in turn, will enable an outside group to purchase a controlling interest in the company with a smaller financial outlay of its own. Thus, whatever the prospects of the executive group's performance being improved upon,
the megacorp's failure to maintain the same rate of growth in dividends as other firms will increase the probability of a successful take-over bid (cf. Marris, 1964, ch. 1; J. Williamson, 1966).

Whether the obverse is true - that maintaining the same rate of growth in dividends as other firms will preclude the possibility of a successful take-over bid - depends on a further set of considerations. If it were true, as is commonly believed, that most other megacorps pursue policies designed to maximize the rate of growth of dividends over time, that is, if they are equity maximizers, then for any one megacorp to maintain the same rate of growth in dividends as other megacorps would suffice to preclude the possibility of a successful take-over bid. An outside group, taking over control of the firm, would have no way of increasing the rate of growth of dividends over the long run and thereby make possible the permanent capital gain which is necessary if the take-over bid is to have more than just a short-run financial pay-off. But if, as has been suggested earlier in this treatise, most other megacorps in fact seek to maximize their own rates of growth qua organizations, that is, if they are growth maximizers, then any one megacorp may still find itself threatened by a take-over bid even though it maintains the same rate of growth in dividends as other firms. An outside group, once it gained control, would have only to shift from a growth maximizing to an equity maximizing policy to achieve a permanent increase in the capital value of the firm.

Nonetheless, there are several factors which are likely to keep the probability of a successful take-over bid below the acceptable risk level. First there are the points stressed by Marris (1964, ch. 1, especially pp. 39-40) - that the difficulty of mounting a successful take-over bid increases with the size of the firm to be taken over, and that the number of persons able to organize a successful take-over bid is in any case quite limited. Then there is the question of why any one firm, as long as it maintains the same rate of growth in dividends as other megacorps, should be singled out for attack by an outside group seeking control. These arguments, by themselves, suggest that the larger the megacorp (as measured by the value of its outstanding equity shares), the greater the impunity with which it can pursue a growth maximizing policy.

In addition, however, there is the widespread belief, whether correct or not, that megacorps are actually equity maximizers. This belief, to the extent that it is shared by the small number of persons able to organize a successful take-over bid, will tend to deflect attention from any megacorp which is increasing its dividends at the same rate as other firms. And the same belief, to the extent that it is held by the great majority of equity debt holders, will cause any take-over bid which might nonetheless be mounted to be viewed with suspicion. Shareholders
will be hard to convince, in light of the dividend record, that the take-over bid is not simply a speculative flier, one which will leave them holding the short end of the stick when the organizers of the take-over bid subsequently sell out and take for themselves whatever short-run capital gains are to be had.

The dividend policy necessary, then, if the executive group is to be effectively protected against being deposed is quite simple. Assuming it is able to report both a growth of net earnings and a ratio of net earnings to sales which is no lower than those of comparable firms and assuming, moreover, it has not allowed financial assets to accumulate excessively, it need only maintain a rate of growth of dividends equal to that of other megacorps. Generally, this will also suffice to assure it of external borrowing costs no greater than those of other firms. However, if the executive group anticipates a particular need to resort to new equity financing in the near future, it can reduce the cost of those funds even further by announcing a dividend payment which falls above the previously established long-run growth rate. Even if this higher growth rate in dividends is not subsequently maintained, it may well give rise to expectations that will bring about a temporary bidding up of the price of the company’s shares and hence lead to a more favorable price-dividend ratio.

The above argument - that a megacorp’s executive group will be reasonably well protected vis-a-vis the equity debt holders as long as it maintains a rate of growth in dividends which is not less than that established by other megacorps - still leaves unanswered, however, the question of what, aside from the desire to reduce its external borrowing costs, might induce any significant number of executive groups to initiate a change in the rate of growth in compensation for the equity debt holders. Since the rate of growth in dividends established by one group of megacorps is likely to influence the rate of growth decided upon by others, the issue here really is what determines the rate of growth in dividends paid by megacorps in general. In other words, while the need to be protected against the dangers of a take-over bid can be expected to exert strong pressure toward the equalization of the growth rate in dividends among all megacorps, other forces will be exerting pressure of their own to determine what that single growth rate will be. The nature of those other forces is the next topic to be taken up.

The overall rate of growth in dividends. Two factors can be expected to influence whether a megacorp will increase its own dividend payments above the trend already established by other megacorps. They are (1) the extent to which the executive group is in empathy with the equity debt holders, and (2) the rate of growth in compensation received by
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the members of the laboring manpower force. Each of these two factors will be discussed in turn.

The megacorp's executive group has several reasons to be empathetic toward the equity debt holders, even aside from the voting rights which the latter exercise. In the first place, the members of the executive group are likely to identify themselves more closely with the equity debt holders than with any of the megacorp's other constituencies. They form part of the same social class, meeting frequently not only on business but also during leisure hours (C. Mills, 1959, chs. 6-7). As a result of this substantial interaction on a personal level, they are likely to share a common world view. This close identification which the members of the executive group have with the equity debt holders is further reinforced through stock option plans and, even more important, since shares acquired through those plans are likely to be disposed of as soon as possible in order to permit portfolio diversification, through the holdings which the members of the executive group have in other megacorps. As equity debt holders themselves, though not necessarily in their own company, the members of the executive group have good reason to be empathetic toward that constituency — even if it does not outweigh their first loyalty to the megacorp itself.

Secondly, the members of the executive group are likely to subscribe themselves, at least in some degree, to the myth that the megacorp actually 'belongs' to the equity debt holders. In part, this belief derives from the world view which the two groups both share. But it is also an important element in the group norms by which the behavior of the executive group itself is regulated. According to that code, the salaried officers of the megacorp occupy a position of trust which requires that they act in the best interests of the company and, indirectly, in the best interests of the stockholders as the group in whom the legal property rights reside. It is from fulfilling this fiduciary role that the authority of the executive group is said to be derived (Sutton et al., 1956, pp. 64-6). Indeed, on these grounds, the members of the executive group are able to argue that they are responsible to the stockholders, and to them alone. This position, as long as it remains convincing both to the members of the executive group and to others, serves two useful functions. In a socio-economic system that stresses either property rights or democratic election as the source of all authority, it satisfies a deeply felt need for legitimacy (Berle, 1959, especially pp. 98ff; Rostow, 1959); and in a democratic age which abhors unchecked power, it helps fend off demands for increased social control over the megacorp. These benefits are in addition, of course, to the protection against a take-over bid which comes from the feeling by stockholders that the members of the executive group themselves subscribe to the myth. While the
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Self-serving aspect is clearly evident, this does not preclude the members of the executive group from actually believing the myth of stockholder supremacy - at least to the extent that such a belief does not threaten either the executive group’s prerogatives or the megacorp’s ability to survive. This means that the equity debt holders are likely to be viewed with greater favor than any of the megacorp’s other constituencies, though not with greater favor than the megacorp itself. Still, to this limited degree, the myth of stockholder supremacy will further contribute to the empathy which the members of the executive group feel toward the equity debt holders.

How strong that empathy is will be put to the test whenever the rate of compensation received by the laboring manpower force is increased. On the one hand, there is no other factor, aside from the fear of being deposed, which is as likely to induce the members of the executive group to increase the rate of compensation being paid the equity debt holders. On the other hand, the higher wages and salaries obtained by the members of the laboring manpower force will provide a basis for invidious comparison between the treatment of the two constituencies. What may be postulated here is that the empathy felt by the members of the executive group toward the stockholders will be sufficiently great to assure that, whenever wages and salaries are increased, the dividend rate will be increased as well. This does not mean that dividends will necessarily rise immediately following any increase in wages and salaries, or even that the rate of growth of dividends will be a smooth one. It is only to point out that acceptance of the national incremental wage pattern by a megacorp will necessitate a certain percentage increase in the rate of compensation received by the equity debt holders, this increase to occur at some point in the future.39

Whether the percentage rise in dividends will exactly match the percentage rise in wages and salaries cannot be stated with any certainty a priori. One of the points which this chapter hopes to make clear is that the dividend rate, like the national incremental wage pattern to which it is at least partially linked, is indeterminate on economic grounds alone. This fact has two implications. The first is that, insofar as any theoretical model of the economy is concerned, the rate of growth of dividends, like the rate of growth of wages and salaries, is at least partially an exogenously determined variable; and that with certain changes in the socio-political environment it could even become an instrumental variable entirely subject to policy control by the government. The second implication is that, with institutional arrangements as they now are, the precise functional relationship between the percentage rise in wages and the percentage rise in dividends can only be determined with certainty through empirical investigation.
The hypothesis may nonetheless be tentatively advanced that, whatever the percentage increase in compensation granted the members of the trade union and through them the rest of the laboring manpower force – the equity debt holders will receive at least an equal percentage increase in dividends. A certain theoretical argument can be made on behalf of this hypothesis. To treat the equity debt holders any less generously would surely leave the members of the executive group open to the charge – a serious one in the social milieu they inhabit – that they were favoring the workers at the expense of the company’s legal owners. There is even some empirical evidence consistent with the hypothesis. In any case, it is a workable hypothesis, one which states in its boldest form the more fundamental point – to wit, that an increase in wages and salaries will necessarily lead to a rise in dividends, and that indeed this is the critical relationship.

It is, of course, possible that the empathy which the members of the executive group feel toward the stockholders will be sufficient to bring about a more than equivalent increase in the dividend rate. Several factors, however, can be expected to militate against the executive group’s generosity extending that far. On the one hand, any increase in the dividend rate represents a compromise of the megacorp’s primary goal – that of maximizing its own rate of growth over the long run. This is because the higher dividend payments will require either a rise in the price level or a reduction in the average corporate levy, a choice which, however made, is likely to place the megacorp at a competitive disadvantage. On the other hand, while an increase in the dividend rate at least equal to the growth of labor compensation may be essential to avoid the charge that the ‘workers’ are being favored at the expense of the ‘owners’, any further increase in the dividend rate beyond that point, assuming the possible threat of a take-over bid has already been sufficiently eliminated, offers no particular benefit to the members of the executive group. On this basis, that the empathy felt by the members of the executive group will be completely expended once the percentage increase in compensation obtained by the trade union for its members has been matched, it can be argued that an equivalent increase in the dividend rate is all that is likely to be received by the equity debt holders. This will, in fact, be the assumption made throughout the rest of this treatise. From such an assumption it follows that, upon acceptance of the national incremental wage pattern by a megacorp, not only the labor component but also the dividend portion of fixed costs will rise by the same percentage, \( W_p \). It should be added, however, that the assumption is made largely for expositional convenience and that none of the arguments which follow depend on it. Indeed, those arguments would still largely hold true if, instead, the dividend portion of fixed
costs were to rise by less than $W_p$ or, alternatively, by some multiple of $W_p$.

In summary then, acceptance of the national incremental wage pattern by a megacorp foretells a substantial increase in costs, going even beyond the higher wages obtained by the trade union for its rank-and-file. Both the salaries received by other members of the laboring manpower force and the dividends received by the equity debt holders are likely to have to be increased by an equal percentage, the precise impact that this will have on the megacorp’s cost structure depending on the relative importance of all three types of compensation. Whether the megacorp will be willing to accept this substantial increase in costs will depend on what the effect is likely to be on the megacorp’s ability to survive and grow. This, in turn, will depend on whether the megacorp is able to pass along the added costs in the form of higher prices or, alternatively, must absorb the added costs out of the existing corporate levy. Although chapter 3 has already discussed the factors determining the ability of a megacorp-price leader, acting as the surrogate for its fellow oligopolists, to increase the industry price, that analysis was predicated on the assumption that average variable and fixed costs remained constant. Now that the corporate levy is to be held constant as average variable and fixed costs are increased, the analysis needs to be modified accordingly.

A cost-compensating price increase. The restraints on pricing discretion, it will be recalled from the earlier chapters, are threefold. They derive from (1) the substitution effect, (2) the entry factor, and (3) the fear of meaningful government intervention. Each of these three restraints will be discussed in turn, as it bears on the megacorp-price leader’s ability, acting as the surrogate for the industry as a whole, to pass along in the form of a higher price level the increase in average variable and fixed costs resulting from acceptance of the national incremental wage pattern.

The substitution effect, not very powerful to begin with in an oligopolistic industry, is likely to be further weakened in the case of a rise in price made necessary by increased claims against the megacorp’s revenue in the form of higher wages, salaries and dividends. This is because the industries which produce the closest substitutes for the industry's product will themselves probably be forced to follow the national incremental wage pattern and will thus experience a comparable increase in average variable and fixed costs. This interdependence is most clearly evident for those industries which form the auto-steel orbit, but it will also hold true for those oligopolies which are part of some other wage contour. While different industries can be expected
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to have different labor-output (and different dividend-output) ratios, thereby necessitating different percentage increases to offset the higher costs, all will be subject to the same general pressure to raise their price levels. In this manner the substitution effect of a price increase in any one industry will be significantly reduced - if not completely neutralized - when the purpose of the price increase is to match the higher costs induced by a trade union agreement. Only when there is significant competition from imports is the substitution effect likely to loom large, but even then rising labor costs in the same industry abroad may tend to mitigate its restraining influence.

The entry factor, should the industry price be increased to offset higher costs, will be almost totally inoperative. This is because an industrial trade union, before it can demand significant wage concessions from the megacorps which comprise the industry, must have the organizational power to impose the cost-affecting terms of any settlement it reaches, not only on the firms already in the industry but also on any firms which might in the future try to gain entry. Once assured that the trade union has this prerequisite power, the megacorps - and in particular, the price leader - can be certain that any concessions they make will not give some other firm, even a new one, a competitive advantage in labor costs. Thus a potential entrant will find that an increase in price made necessary by the existing firms' acceptance of the national wage pattern will not lower the barriers to entry by increasing the margin between its own average variable and fixed costs relative to those of the established firms in the industry - except insofar as the new firm may be able to avoid matching any ensuing increase in the dividend rate. This last qualification should not be overemphasized, however, since the ultimate effect will be to make an equity interest in the new firm less attractive.

This leaves only the fear of meaningful government intervention as a possibly significant restraint on the megacorp-price leader's ability to raise the industry price following an increase in costs stemming from acceptance of the national incremental wage pattern. This fear, it will be recalled, imposes not a calculable cost but rather an upper limit on the percentage increase in price, n, which the megacorp-price leader is willing to announce, this upper limit being the price leader's estimate of the value for n which has associated with it a more than acceptable risk of government retaliation in some effective manner. The very fact that the price increase follows acceptance by the megacorp of the national incremental wage pattern will, however, make it extremely difficult for the government to intervene successfully. For the national incremental wage pattern, as the norm of what constitutes a 'fair and equitable' increase in the compensation of labor, reflects a social decision which
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the government must respect; this is particularly true since the government itself will ordinarily have given its tacit approval to the wage agreement in the bellweather industry by which the pattern was established.

The government – and in the American context at the present time this almost necessarily means the executive branch – will be able to muster the political support necessary for meaningful intervention only if it can be demonstrated that one of two conditions exists: (a) that the increase in price, \( n \), is greater than the increase in the firm’s total costs resulting from acceptance of the national incremental wage pattern,\(^{26}\) or (b) that the industry is presently generating excessive earnings, that is, that net revenue has increased sufficiently so that the industry can absorb part or all of the increased costs without being forced to cut back on investment outlays. To demonstrate the existence of either condition for any large number of industries is, however, extremely difficult for the government at the present time, with its limited access to confidential business data. In any case it suffices for now to point out that an increase in price limited to the amount necessary to offset the increase in costs brought about by acceptance of the national incremental wage pattern will be most unlikely to provoke meaningful government intervention.

In summary, then, the three restraints on pricing discretion, even when taken together, will ordinarily be insufficient to prevent an increase in average variable and fixed costs from being passed along to customers in the form of a higher price level. The value of \( R \), under those circumstances, is likely to be close to, if not actually equal to, zero, while the probability of meaningful government intervention can generally be discounted completely. It can thus be seen that while, on the one hand, the megacorp-price leader conducting contract negotiations faces a complete shutdown of its production facilities if it refuses to grant the trade union members an increase in compensation consistent with the national incremental wage pattern, it will, on the other hand, by raising its price, be able to grant that increase in compensation without incurring any substantial cost or penalty itself. This is not to argue that a strike will always be avoided. To the megacorp-price leader, a brief walkout by the trade union’s members may be the least expensive way to cut back on production temporarily. Similarly, to the industrial trade union, a brief work stoppage may be the best means of reviving a flagging sense of worker solidarity, that is, loyalty to the trade union. A strike may even ensue for other than wage-related issues. The point is that, strike or no strike; the wage provisions of the contract finally agreed to by the megacorp-price leader and the industrial trade union will almost certainly be those called for under the national incremental wage pattern. The higher rates of compensation which a settlement along those lines
implies for the trade union’s rank-and-file members will, almost as
certainly, for reasons already mentioned, be extended both to the
unorganized portion of the laboring manpower force and to the equity
debt holders. It is thus the national incremental wage pattern which
determines the increases in compensation, at least in nominal terms,
received over time by the megacorp’s two principal constituencies –
acceptance of the pattern being due both to the power relationships
stressed by institutional economists and to the normative factors empha-
sized by contemporary sociologists.37 What still remains to be explained
are the factors which determine the value of $W_p$, that is, the percentage
by which rates of compensation are to be increased under the national
incremental wage pattern. This, in turn, means being able to explain
the cost provisions in the key bargain reached in the bellwether industry.
As a preliminary step, however, it is necessary to introduce still another
theory of income distribution, that associated with Marx.

The surplus value theory

The relative value of any two goods, according to Marx, is determined
by the relative amounts of ‘socially necessary’ labor required to produce
them – including the labor embodied in the means of production. Thus
if it takes twice as much labor to produce the one as the other by
the best known method, a single unit of the first will, under competitive
conditions, tend to exchange for two units of the second. This was
the labor theory of value which Marx borrowed almost unaltered from
the English classical tradition.38 To the extent that labor costs are the
only costs of production – that is, to the extent that all other necessary
inputs are free to society – this theory has considerable plausibility.
Even today, with proper allowance for the time-related capital costs
incurred in the development of human competences, it provides perhaps
the best explanation of prices in the personal services sectors of the
economy, although, like all cost-of-production theories of value, it slighted
the demand side of Marshall’s famous scissors analogy.

Marx’s point of departure from the classical tradition was his insistence
that the relative value of labor – or to use his own term for the physical
and mental effort put forth by a worker on the job, the relative value
of laboring power – is also determined by the amount of socially necessary
labor required to produce it. In the case of laboring power, this socially
necessary labor is by definition equal to the subsistence level of wages.
Thus in a society in which the growth of knowledge and technique
is making labor increasingly more productive, there develops an ever-
widening gap between the value of what laboring power is responsible
for creating and the value of laboring power itself. This gap, which
is manifested in every commodity produced by modern methods, was called 'surplus value' by Marx (1935, chapters 7-8).

What Marx was primarily interested in demonstrating was the exploitation of labor by the owners of capital (cf. J. Robinson, 1962d). By assuming that labor was generally limited to subsistence wages and that the owners of capital, while contributing little or nothing to the production process, were nonetheless strategically situated to control it, Marx could quite logically argue that all of the surplus value went to the latter group in society. Although the validity of the two crucial assumptions would now be doubtful, at least for the United States, the usefulness of the general Marxian framework should nonetheless be recognized (cf. Samuelson, 1971). For what is being determined through the 'key' bargain which sets the national incremental wage pattern is the division of the surplus value or - when taken in the aggregate, the social surplus - between conflicting claimants to the megacorp's revenue. The term 'social surplus' in this context is meant to connote the total quantity of goods and services still remaining and available for other purposes after the subsistence needs of society have been met. (Subsistence is, of course, something largely determined by social values.)

In the conventional view, the conflict over the disposition of the surplus value, social surplus or however else it may be termed is usually seen as being between the 'workers', as represented by the trade union, on the one hand and the 'owners of capital', as represented by the megacorp's management, on the other. The extent to which the rates of compensation received by those two constituencies of the megacorp are inextricably linked has, however, already been pointed out. In a real sense the trade union, when sitting down at the bargaining table to negotiate a new contract, is setting forth the claims of the unorganized portion of the laboring manpower force and of the equity debt holders no less than the claims of its own rank-and-file members. The conflict, then, is actually between those constituencies with an understandable desire for increased current income, whether in the form of higher wages, salaries or dividends, and the megacorp itself with an inherent need for additional investment funds to finance future growth. This is especially true of the collective bargaining in the bellwether industry - even though a certain confusion on these points is likely to be found on both sides, complicating the task of reaching an agreement. The confusion derives, in part, from the continuing adherence by both the megacorp's executive group and the trade union leadership to the myth that the company actually belongs to the stockholders in some real sense and that therefore the retained earnings should be counted as part of the equity debt holders' returns. 39 But the confusion is also due to the difficulty of determining precisely what is the amount of surplus value available within the firm - or,
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Alternatively, the amount of social surplus available throughout the oligopolistic sector for distribution among the competing claimants (cf. Dye, 1967).

Fortunately, at least for the prospects of reaching an agreement, collective bargaining in the bellwether industry and in every other industry begins with a past history that has resulted in the present level of wages, salaries, dividends and corporate levy. As a consequence, the participants in the bargaining process need be concerned, not with the division of any total surplus value - assuming that the total surplus value could, in some meaningful manner, even be measured but rather, only with the division of any new or incremental surplus value that may have arisen since the previous contract negotiations. This is similar to the executive group's having to determine only an optimum change in the price level, not the optimum price level itself. Still, even the amount of incremental surplus value, as distinct from the total surplus value, will be difficult to determine precisely. This is because, while it is closely approximated by the increase in net earnings over time holding wages, salaries, dividends and investment constant, it is not the same as the increase in net earnings at any given moment. (This increase in net earnings is the equivalent of an increase in savings, or discretionary income, within the firm and the counterpart on the income side of the secular growth of output per workers taking place on the product side.) To explain why this is the case, it is necessary to introduce the final theory of income distribution to be considered in this chapter, that developed by certain of the Cambridge, England, economists as an extension of the Keynesian insights.

Keynesian and post-Keynesian theory

From the Keynesian division of the national income into two parts - the one representing the claims used to purchase consumption goods and the other the claims which, by not being so exercised, constitute the aggregate level of savings - it is possible to develop two separate, though related, macroeconomic theories of income distribution. All that is necessary is to make the not unreasonable assumption that the aggregate level of savings, whatever it may be, derives entirely from the net revenue, or profits, earned by business firms. This means that the national income can also be divided into those claims which, on the one hand, accrue to workers in the form of wages (and salaries) and which are then used entirely to command the available consumption goods and, on the other hand, those claims which accrue to property owners, or capitalists, in the form of profits (and rents) and which are then the sole source of societal savings.
The first of the two macroeconomic theories focuses on the cyclical, or intermediate-run, behavior of relative income shares, and it is the version most directly traceable to Keynes himself. Keynes' own way of putting it was that any increase in aggregate demand would lead to a rise in the price level relative to nominal wages, with the result that real wages would decline. Even in the oligopolistic sector, although the price level might not rise, profits could still be expected to increase as output expanded and average total costs simultaneously fell. Either way, with a rise in aggregate demand, there would be an increase in the proportion of national income accruing to the property-owning class in the form of profits. Conversely, with a decline in aggregate demand, there would be, where competitive conditions prevailed, a fall in the price level, an increase in real wages and a reduction in the share of national income represented by profits. Even if, because of oligopolistic market structures, the price level did not fall, a decline in aggregate demand, by lowering sales volume and thereby pushing up per-unit costs, would still reduce the relative share of profits. These ideas, found only in embryonic form in Keynes' own writings, have since been worked out with some care by a number of economists.

The second of the two macroeconomic theories emphasizes the secular, or long-run behavior, of relative income shares. It is a theory implicit more in Harrod's dynamic extension of Keynesian theory than in the Keynesian analysis itself, and for this reason it is best regarded as post-Keynesian theory. The model depends, not on the rate at which a given amount of capacity is presently being utilized but instead, on the rate of accumulation, or investment, taking place continuously while the rate of capacity utilization is held constant. The important distinction - one which converts the static analysis of Keynes into a dynamic one - is between the effect of an increase in investment as an event at a single moment in time and the effect of having a high rate of accumulation taking place steadily over time. As the post-Keynesian theory of income distribution points out, the more capitalists as the property-owning class invest, the larger will be the share of the national income they command in the form of profits. This is because the higher the rate of accumulation, the greater will be the proportion of total output that must be made unavailable to workers for consumption - the curtailment of consumption being reflected in the relative increase of profits, or savings. If it can be assumed that workers save nothing out of their wages, or that the amount they save is equal to the expenditure on new residences and similar household durables, the relationship between investment and profits is even more direct. Then, as in Kalecki's pithy saying: 'Capitalists get what they spend and workers spend what they get.'
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The preceding discussion of the megacorp and its oligopolistic milieu suggests the need for certain refinements in both the Keynesian cyclical and the post-Keynesian secular theories of income distribution. In the first place, as has been emphasized throughout this work, the owner-entrepreneur, or capitalist, of the nineteenth century has been replaced, insofar as effective control is concerned, by the executive group representing the megacorp qua organization. The capitalist’s direct descendants, as the legal owners of the properties involved have become mere rentiers, receiving dividend payments as a sort of pension. To the extent that these dividends simply constitute part of the income available to the household sector to finance consumption expenditures, they are no different, at least insofar as the macrodynamic behavior of the economic system is concerned, from the wages and salaries received by the laboring manpower force. The effect which dividends have on the relative distribution of income is, of course, another matter, but that is a point which will be taken up later. 45 What does make a difference, in terms of the macrodynamics of the economy, is the remaining portion of what is commonly regarded as the profits, or net revenue, of the megacorp. This remaining portion, the retained earnings, taken together with the depreciation allowances plus whatever sums are devoted to advertising, K & D and the like, comprises the total corporate levy used to finance investment expenditures within the oligopolistic sector. It is equal to the gross savings generated within that sub-component of the business sector. 46

The more significant distinction, therefore, is not between wages and profits but rather between the compensation received by the megacorp’s two principal constituencies — both the laboring manpower force and the equity debt holders — and the residual income accruing to the firm itself in the form of the corporate levy. Where the post-Keynesian literature sometimes refers to the portion of national income represented by profits, it is perhaps more appropriate to speak of the portion represented by the corporate levy — keeping in mind that the respective rates of compensation received by the megacorp’s two principal constituencies may not vary together, that the marginal propensities to save out of the resulting wages and dividends may not be identical, and that the total amount of savings thus generated within the household sector may not be equal to the demand by the business sector for external funds. 47 These latter qualifications are necessary if the subsuming of dividends within household income is not to conceal certain potentially significant consequences of the pattern of income distribution within the megacorp itself. 48

Secondly, as also emphasized in the previous discussion, the profit margin — or rather the average corporate levy — is not likely to be
adjusted in response to short-run changes in industry and aggregate demand. The usual procedure in an oligopolistic industry is for the price leader to announce a new price level based on the consideration of certain long-run factors, then for all the firms in that industry to maintain the new price level for the remainder of the current pricing period, regardless of short-run fluctuations in demand. Of course, wage rates are likely to be adjusted even more slowly than the average corporate levy, especially given the prevalence in the United States of multiple-year labor contracts. This means that the intermediate-run redistributive effect emphasized in the cyclical Keynesian model depends not on changes in the margin above costs, but rather on changes in the megacorp's actual operating ratio.

As previously noted, the amount of corporate levy being realized is quite sensitive to changes in that ratio. Since the corporate levy being realized at the margin is greater than the corporate levy being realized on the average, the megacorp's total residual income — whether viewed as net revenue, cash flow, or otherwise — will rise and fall at a more rapid rate than the actual operating ratio itself. The latter, in turn, is quite sensitive to changes in industry sales and, as the force behind that statistic, to changes in aggregate demand. While fluctuations in final goods inventory provide something of a cushion between industry sales and the actual operating ratio, the two can be expected to vary quite closely together over the intermediate run, that is, over the planning period.

An increase in aggregate demand, because of its effect on the actual operating ratio, will therefore lead to a disproportionate increase in the corporate levy, even if the industry price level remains unchanged (Moyer, 1968). It will also, because of the additional labor inputs required to produce the greater output, lead to an increase in the total compensation received by the laboring manpower force — whether because previously laid-off workers will have to be recalled or the existing labor force will have to be paid overtime — but this increase in labor compensation is more likely to be only proportional to the higher operating ratio. Similarly, a decrease in aggregate demand will lead to a disproportionate decline in the total corporate levy being realized, though more likely to only a proportional decrease in the compensation received by the laboring manpower force. The compensation received by the capital debt holders, including even those with equity shares, will, of course, remain the same whatever the actual operating ratio.

This impact which short-run changes in aggregate demand have on the amount of corporate levy realized will, it is true, tend to be neutralized over the business cycle. The standard operating ratio, as the part of the oligopolistic pricing formula which takes into account the likely
fluctuations in industry sales, is specifically designed to accomplish that purpose. It is for this reason that the redistributive effect suggested by the Keynesian cyclical model is not likely to influence industry price levels directly. This does not mean, however, that the effect is unimportant or can be ignored. Indeed, it is the failure to take into account this cyclical effect, controlling for its influence and focusing instead on the secular pattern of income distribution emphasized in post-Keynesian theory, that explains why the key bargain in the bellweather industry often leaves the executives of megacorps with the feeling that they have no choice but to raise their prices. To understand this point, it is necessary to consider the dynamic by which the key bargain, and thus the national incremental wage pattern, is determined.

The size of the key bargain. As already noted, the megacorp and the trade union involved in negotiating the key bargain are, in effect, trying to determine what proportion of the incremental surplus value which has emerged in that firm or industry in the form of increased net earnings should be distributed to the megacorp’s two principal constituents. This amount of incremental surplus value is more or less typical of the incremental surplus value available throughout the oligopolistic sector. The surplus value, it should be noted, has two sources: (1) the gains from technological progress, as manifest by a secular decline in average variable and fixed costs, that is, by the secular rise of output per worker, and (2) the growth of the firm itself, as manifest by the secular increase in engineer-rated capacity. Each warrants a brief discussion.

Though it is investment by the megacorp in new plant and equipment which makes it possible for emergent technological possibilities to be exploited, the developments themselves are more likely to come from other industries - in particular, from the industries in the capital goods sector which supply the megacorp with the various means of production it requires. Whether or not the firms in these other industries are themselves megacorps is beside the point. As part of their non-price competitive strategy, they will vie to supply the megacorp with those capital goods that will lead to the greatest possible reduction in costs. In the competition to put the most efficient plants and equipment on the market, these firms will be able to draw on the basic scientific knowledge which has been accumulated by men the world over ever since an unknown hominid took stone in hand and fashioned the first tool. This knowledge, before being applied, however, will have to be adapted along lines determined by the relative price of labor and capital inputs, a constraint imposed by the cumulative impact of past decisions as to how the megacorp’s available revenue should be apportioned. In the most general terms, then, a decline in the megacorp’s average variable
and fixed costs will reflect the growth of scientific knowledge through historical time, the past success of the trade union movement in increasing the relative cost of labor inputs, the rapidity with which the capital goods industry develops better products, and the rate at which the megacorp itself adds new plant and equipment. What this overview suggests is that technological change is, for the most part, capital embodied and that the individual megacorp's own contribution to the process does not go much beyond the role it plays in determining its own growth rate. This brings us to the second source of surplus value, the secular increase in engineer-rated capacity.

Even when it comes to determining its own growth rate, the individual megacorp's contribution is somewhat limited. Certainly without the executive group's ability to manage material and human resources effectively, survival - let alone growth - would not be possible. By this token, the very fact that the megacorp has succeeded in growing over time is evidence of the critical role played by those responsible for directing its fortunes. Yet as essential as effective management may be, it is not by itself sufficient to explain a megacorp's movement along a particular growth path. The earlier discussion of the demand for investment funds to purchase new plant and equipment stressed the importance of population and income trends. These, as well as most of the other factors likely to affect the fortunes of any particular industry, reflect forces beyond the control of any single firm and, to a large extent, even beyond the control of the industry itself. It is this dependence of the megacorp's growth rate and, a fortiori, of technological change on larger social determinants which justifies the treatment of the resulting increase in net earnings - and the corresponding growth of output per worker - as part of the surplus value created by the entire society, both past and present, and not as something produced by just one segment of that society contemporaneously.

Still, the surplus value - or at least the incremental portion of it - has to be apportioned in some manner. Toward this end, the trade union involved in negotiating the key bargain can be expected to insist that some "fair" or customary share go to those whom it represents. What that "fair" share is construed to be is likely to depend on the past history of collective bargaining within the bellwether industry. It reflects still another way in which normative judgments, backed by effective institutional power, help determine the distribution of income within the oligopolistic sector. For in the absence of any other standard, the share of the increase in net earnings which has customarily gone to the laboring manpower force, or at least the organized portion of it, takes on, through the precedent thereby established, a validity of
its own – certainly in the eyes of the trade union leadership, if in no other.

It is the willingness of a particular trade union to press its claim to this ‘fair’ share of the incremental surplus value steadfastly and determinedly, even to the point of undergoing a long and costly strike, that enables it to enter the lists as labor’s champion (and indirectly, as the pensioned-off capitalists’ champion, too). At the same time, it is the success of the trade union in having its claim met that determines the distribution of income, ostensibly between the megacorp’s two principal constituencies but actually, as it turns out, for both constituencies together vis-à-vis the megacorp. With distribution of the surplus value through a reduction in price levels virtually precluded by the lack of any advantage to the megacorp from doing so, a strong and vigorous assault by that one trade union upon the megacorp’s revenue as the spearhead of similar forays by other trade unions is the only alternative – at least under present arrangements. Besides, as already noted, it brings the leadership of that one trade union power and prestige, both within the ranks of labor and within the larger community.

In setting forth its demands, the trade union involved in negotiating the key bargain can be assumed to be guided by two considerations. The first is that its members should suffer no loss in real income. Toward this end the trade union can be expected to insist upon an increase in wage rates at least equal to the rise in the cost of living since the last contract settlement. This can be regarded as a minimal demand, one which ties the national incremental wage pattern to the rise in price levels throughout the economy. The second consideration is that the trade union’s members should receive their ‘fair’ or customary share of any incremental surplus value – either that which has already emerged in the industry or that which is likely to emerge in the future. Toward this end, the trade union can be expected to insist upon an increase in wages equal to what it considers the secular growth rate of net revenue within the industry; it is this further demand which, however imperfectly, links the national incremental wage pattern, $W_p$, to the secular rate of growth of output per worker in the oligopolistic sector, $\dot{y}$. As a first approximation to that secular growth rate, the trade union may well seize upon the percentage by which net revenue has increased since the last contract settlement. If the growth of net revenue has been greater than the rise in the cost of living, maintaining ‘labor’s’ customary share in this manner will be all that the trade union need be concerned about. It is only if the rise in the cost of living has exceeded the growth of net revenue within the industry that the trade union will be forced to focus instead on maintaining real wage rates. In general,
then, the trade union involved in negotiating the key bargain can be expected to insist upon the establishment of a wage pattern equal either to (a) the percentage increase in the cost of living or (b) the percentage increase in reported net earnings since the last contract settlement, whichever figure is higher. Yet for a number of reasons the megacorp-price leader and the other megacorps in the bellwether industry may find that figure unacceptable.

In the first place, if the growth of net revenue has been less than the rise in price levels, particularly for capital goods, these megacorps will already be faced with a decline in the purchasing power represented by the average corporate levy. The establishment of a new wage pattern, even if it represents a lower figure than the previous wage pattern, will, because of its effect on average variable and fixed costs, most likely further impair the ability of these firms to maintain their desired levels of investment with the industry price unchanged. While of course the industry price could be increased, this expedient may seem less desirable to the megacorp-price leader and the other members of the bellwether industry than trying to hold down wage rates. As a final comment, it should be noted that the rise in the cost of living is likely to exceed the growth of net revenue only when the economy has taken a sudden downturn just prior to the beginning of a new wage round.

More typically, the growth of net revenue can be expected to exceed the rise in the cost of living. Even in this case, however, two obstacles to the contract settlement may arise. One is that the increase in reported net earnings may reflect, not just the increment in surplus value due to technological change and the growth of the firm itself but, in addition, the redistributive effect produced by cyclically high levels of aggregate demand. That is, it may reflect the short-run Keynesian effect. Focusing exclusively on the amount of reported net earnings may therefore lead to an exaggerated notion of how much surplus value is actually available for apportionment.

It might seem that any controversy over this point would be relatively easy to resolve. All that is necessary is for the two parties to agree on the extent to which the actual operating ratio has exceeded the standard operating ratio since the last contract negotiations and then to make due allowance for that factor. The effect of this would be to shift from a Keynesian to a post-Keynesian framework. The problem is more complicated than that, however. One can never be entirely certain whether the past pattern of cyclical fluctuations still holds. The high levels of aggregate demand may well be consistent with previously experienced deviations from the established trend, but then on the other hand they may presage an entirely new trend. This complication would not, in itself, be so serious were it not for a second factor - the asymmetrical
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bargaining positions which the two parties often take. The megacorp’s executive group has, of course, good reason to insist, when the actual operating ratio has been running above average, that any increase in the rates of compensation be limited to the more modest secular growth rate of net earnings; but it is generally unwilling to accept the argument in reverse. When the actual operating ratio has been running below average, it is likely to urge, citing the threat of insolvency, that increases in the rates of compensation be limited to the even more modest growth in reported net earnings since the last contract negotiations. Needless to say, the trade union is often guilty of taking the same asymmetrical bargaining position, it being generally unwilling to accept a reduction in the rates of labor compensation even though the megacorp’s net revenue may actually have declined. At the root of the conflict is the uncertainty over what proportion of any increase in net earnings represents incremental surplus value and what proportion represents the temporary redistributive effect produced by a cyclical change in aggregate demand.

This obstacle to a settlement in the bellwether industry is a minor one, however, compared to a second - the megacorp’s frequent desire to increase the proportion of the incremental surplus value accruing to itself. The megacorp’s motive in seeking this larger share is to obtain the investment funds deemed essential to its future growth and survival. Indeed, the industry price level may well have been raised at a prior point in time with this objective specifically in mind. To the megacorp’s executive group, the resulting increase in reported net earnings is simply part of the corporate levy, and thus is unavailable for distribution among the firm’s principal constituencies. But to the trade union it is part of the returns to ‘capital’, and as such represents a reduction in ‘labor’s’ customary share of the incremental surplus value. At the root of this even more fundamental conflict is the confusion, partially shared by members of the executive group, over whether the residual income belongs to the equity, debt holders as nominal owners or to the megacorp itself qua organization.

The impasse in collective bargaining likely to result from either or both of these two types of conflict would seem to preclude a settlement in the bellwether industry - except under the unusual circumstances when industry sales, the demand for investment funds and reported net earnings were all growing at the same rate and price levels were holding steady. The fact that an agreement is nonetheless always reached can be explained in terms of the intervention likely to occur from without and of the safety valve available from within.

The source of the probable intervention is the Federal government, concerned that an impasse may lead to a prolonged shutdown of a critical industry. While the nature and tenor of this intervention will vary,
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depending on which party controls the executive branch and what are the current political considerations, in general the Federal government can be expected to take a position more in line with that of the trade union than that of the megacorp. This reflects, not just the greater voting strength of the trade union but, perhaps even more important, the greater tractability of the megacorp. The latter can more easily be persuaded to accept the government's suggested basis for a settlement because it knows that, whatever the increase in labor compensation and other costs it may have to absorb, it will be able to largely offset them through a subsequent increase in the industry price level. In this respect, the megacorp responsible for negotiating the national incremental wage pattern has the same additional degree of freedom as do the other megacorps which will be forced to follow its lead. It is the ability of these firms to raise their prices, following the acceptance of a contract granting higher wages, which serves as an essential safety valve, dissipating social tensions which might otherwise burst the seams of society.24

In summary, then, the trade union involved in working out the key bargain can be expected to insist that its members receive their customary share of whatever increase in net earnings has occurred since the last contract negotiations - as long as the increase in wage rates is not less than the rise in the cost of living. Indirectly, of course, the trade union is putting forward a similar claim on behalf of both the unorganized workers in its own industry and the union members in other oligopolistic industries. Given the nature of the political forces shaping government intervention once the contract talks have reached their almost inevitable deadlock, the trade union is likely to be largely successful in achieving its goal - even if this means an increase in the rate of compensation for the oligopolistic sector's laboring manpower force that is greater than the increase in compensation projected for the equity debt holders under the present rate of growth of dividends. In that case, assuming the executive group's empathy with the stockholders is sufficiently strong, the dividend rate will also have to be increased so as to match the gains won by the trade union. Alternatively, if for some reason the increase in the rate of compensation obtained by the laboring manpower force falls short of the rate of growth of dividends, or even of the rate of growth of net revenue, the trade union can be expected to try, with increased determination, to make up the difference at the next wage round.

The point made earlier in connection with the determinants of the dividend rate applies here as well. The national incremental wage pattern, like the rate of growth of dividends which is linked to it, does not depend solely on economic factors. Indeed, economic factors merely set certain limits on the value which the national incremental wage pattern,
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\( W_g \) can take – at least in real terms. To explain the actual size of the wage pattern, even in nominal terms, it is necessary to posit the salient features of the larger socio-political environment.

Thus the arguments made in this section about the economic determinants of the national incremental wage pattern are based on the assumption of a certain institutional framework – the one which has existed throughout most of the post World War II period, with the wage pattern left to be determined through the key bargain reached in the bellwether industry. The arguments are based also on the assumption of a certain behavioral pattern on the part of trade union leaders, especially those in the bellwether industry. If that institutional framework or that behavioral pattern were to change, as could easily be the case in the future, the same economic relationships would not necessarily still apply. In fact, if the measures recommended in the final chapter of this treatise were to be adopted, \( W_g \) would become an instrumental variable whose value would depend, not on the consumer price index and/or reported net earnings in the bellwether industry but rather on the planned growth of aggregate disposable income. That the basis for establishing the national incremental wage pattern, and thus the basis for determining the growth of wages, can be altered in this or some other equally significant manner because neither the wage pattern nor the growth of wages depends solely on economic factors is one of the principal points which this treatise hopes to demonstrate.

Possible changes in the socio-political environment pertain, however, to what might be. Returning to the institutional framework which has existed for most of the post World War II period and which for the most part is still intact, the national incremental wage pattern depends on the collective bargaining agreements worked out in the bellwether industry. Presidential guideposts and pay boards notwithstanding, the key to the distribution of income within the oligopolistic sector continues to be the determination of the trade union setting the national pattern to obtain for its members an increase in wages equal to the percentage by which either prices for consumer goods or net earnings within the bellwether industry have risen since the last wage round. Its very success in doing so, however, together with the likelihood that any gains obtained by the trade union for its members will be matched by an equivalent increase in the dividend rate, means that, with the need to maintain a certain rate of growth for the corporate levy; the megacorp will be confronted by more claims against its revenue than it can meet at the existing price level. In the face of this type of pressure, it is generally the price level which, not surprisingly, gives way.

This suggests a distinction between nominal increases in the rates of compensation obtained by the megacorp's principal constituencies
as a result of a higher value for $W_p$ and what those increases in compensation actually come to represent in real terms once the effects of any ensuing rise in prices within the oligopolistic sector have been taken into account. To develop this point further, however, it is necessary to place the microeconomic variables dealt with so far into a post-Keynesian macrodynamic framework, such as the one provided in the next two chapters.