8. Toward social control

The preceding chapters have sought to develop the analytical framework necessary for understanding the causes of inflation in a technologically advanced economy such as that of the United States. From the explanation just offered of how prices, along with wages and dividends, are determined in the oligopolistic sector of the American economy only one conclusion is possible—that inflation results not from any "excess" of aggregate demand but rather from the efforts by powerful groups in society to maintain their own relative income position in the face of the redistributio
nal effect, which the inevitable change in the aggregate growth rate is certain to have. This struggle over relative income shares can be seen most clearly in the frequently observed wage-price spiral, with the first apparent sign being a gain for the middle and upper classes. The income of the wage-earner, however, is also affected by the spiral, and in this connection we should note the effects of the spiral on the rates of growth of real wages and employment. The spiral of inflation, in short, is a complex phenomenon that cannot be fully understood without a detailed analysis of the underlying forces.

Were the price level the only casualty, the periodic jousting between labor and management, most directly over wages but indirectly over prices as well, would hardly warrant the attention it has received in this treatise. After all, what more harmless way is there for releasing pent-up social tensions than for the GNP deflator to take a beating? While it is true that the chief victims of the conflict are generally the less organized groups in society, even this untoward effect is a minor one compared to the actual consequences which the post World War II inflation has had for the United States. The fact is that the government, harrying to the outcry of rentier groups, has continually intervened in the economy in an effort to bring a halt to rising prices. Yet without an adequate understanding of the basic economic forces at work, this intervention has succeeded only in transforming the wage-price spiral into a political trade cycle. With aggregate demand unnecessarily curtailed, physical output has been irretrievably lost, the secular growth rate has been held far below what it should have been and—most serious of all—many Americans have been deprived of the employment opportunities which they had every right to expect. Indeed, all of the government's efforts to alleviate poverty at home have been of minor import compared to the disastrous consequences of its misguided policies to control domestic inflation.

Now that a suitable analysis of the dynamic underlying the wage-price inflationary spiral has been provided, all that remains is to draw out some of the policy implications. The primary emphasis will, of course, be on the measures which the government can take to prevent a secular rise in the price level. This will be the subject of the section immediately following. The existence of the megacorp, as part of an oligopolistic
industry structure, creates other types of problems as well, however. These other problems, such as inadequate social control over investment, the distorting effect of dividends on the distribution of income, and the lack of managerial accountability, will also be touched on in this final chapter.

Alternative approaches to social control

Once it is recognized that the very structure of the American economy - specifically, its large oligopolistic sector - leads to the type of inflation which cannot be effectively controlled by the conventional tools of fiscal and monetary policy, one is forced to choose between one of two approaches - unless, of course, one is willing to remain caught on the horns of the Phillipsian dilemma. The first involves a concerted effort to change the structure of the economy, eliminating the market power of the megacorp and reducing the oligopolistic sector to insignificance. The other approach involves the search for a more effective means of regulating the megacorp than the market place alone can provide.

There is little need to dwell at length on the first approach. Despite the surviving rhetoric, the United States long ago abandoned any real attempt to restructure the economy through its antitrust laws (cf. Whitney, 1958; Dewey, 1965; Stigler, 1966b, especially p. 236). And insofar as the purpose of those laws was to make all of industry conform more nearly to the polypolistic model, it was probably wise to do so. At the time the choice was made, during World War I, Americans were most deeply impressed by the greater ability of the megacorp to mobilize resources on behalf of the then pre-eminent social goal (Eichner, 1969, ch. 11). Today, if the preceding chapters are correct in their analysis of the non-oligopolistic subsector's dynamic properties, Americans would have to be at least equally struck by the stabilizing role which megacorps play in the overall economy. It is doubtful that they would opt for a more volatile business sector, such as would exist if the savings and investment functions attributed above to the non-oligopolistic subsector were to characterize the business sector as a whole.

In any case, the antitrust laws as they are applied today have little more than a nuisance value, affording the government, it is true, some scope for the type of arbitrary intervention analyzed in chapter 3 but nonetheless without any real prospect of changing the structure, and hence the behavior, of the industries being singled out for attention. The main effect of this effort, as Galbraith (1967b) has pointed out, is to blind the lay public to the need for more effective measures to regulate the market power of the megacorp (see also Barber, 1970, ch. 12).

In contemplating what those more effective measures might be, one
is likely to think first of direct control over prices. This can take any one of several forms: a general price freeze, establishment of independent regulatory commissions in individual industries, even nationalization. There are, of course, important differences between these various forms of direct control. An independent regulatory commission, for example, is more likely to be able to take into account the factors unique to any particular industry - though it is also more likely to be captured by the members of that industry and the direction of control thereby reversed. Nationalization, on the other hand, permits other objectives besides the mere control over prices to be achieved - though it also places the greatest restraint on the initiative of the individual enterprise. There is one point, however, which must be made about all these forms of direct control. Though they give public officials the power to decide what price shall ultimately prevail, they still leave those officials up in the air as to how they should exercise their power. In other words, the various forms of direct control simply beg the question of what is a socially optimum price.

If the goal is simply to curb inflation, it might seem that this is not a very important question. As long as prices can be prevented from rising, what does it matter whether they are 'socially optimum' or not? On these grounds, a general price freeze is the most effective anti-inflationary measure the government can adopt. A complete prohibition on all price changes, however, has the effect of neutralizing the price mechanism as an aid in making allocative decisions - especially the longer the freeze remains in effect. While this is hardly likely to provoke a public outcry, the parallel effect on relative income shares almost certainly will. The fact is that the longer prices remain unchanged, the greater will be the number of persons who feel that the existing structure of prices is unfair to them. And given the change in underlying economic conditions which is likely to be occurring simultaneously, they will quite often have a persuasive case. If political pressures are not going to eventually undermine whatever form of direct control has been established, prices, too, will have to change. But what new structure of prices would be fair to all? This is why the question of what is a socially optimum price cannot be avoided - even if the goal is simply to curb inflation.

The answer which economists usually give to this question - that the price should be equal to marginal (social) cost - is not very helpful insofar as the oligopolistic sector is concerned. With marginal cost equal to average variable cost, at least in the short run, this prescription fails to explain how the megacorp's overhead costs, not to mention its investment expenditures, are to be financed. If, however, the argument is modified so that long-run marginal costs are substituted for short-run marginal costs, thereby taking into account the firm's overhead expenses,
the argument loses its analytical sharpness. Indeed, the prescription then reduces to the full-costing principle, and the question then becomes which of the megacorp's various disbursements are to be regarded as true social costs.1

There is usually no dispute about the megacorp's actual contractual expenses - wages, the cost of raw materials, fixed-interest payments and the like. What lends itself to controversy is the difference between those costs and the price currently being charged. It is this margin above costs - what is usually referred to as 'profit' - which some persons have trouble accepting as a true social cost. And their skepticism seems somewhat justified in light of the pricing discretion which the megacorp typically enjoys as a result of the market power it shares with the other oligopolists in its industry. For what is to prevent the megacorp from using that discretion to increase its own income at the expense of those dependent on it for the goods they need? The 'profit' in other words, may simply represent an unwarranted exaction on the rest of the community.

It is easy for an economist to show that in an expanding economy at least some margin above cost, whatever it might be called - 'profit', 'turn-over tax', or the enterprise's 'surplus' - is necessary, for without that margin, investment would not be possible.2 The question still remains, however, of how much that margin need be. There are two quite different ways in which this question can be answered, and thus two quite different ways of arriving at a socially optimum price.

The first approach stems from neo-classical theory and the capital accumulation and allocation model implicit in that theory. In this view of things, growth, if it does occur, is financed from the savings which households have managed to set aside out of their income and which business firms than compete for in the capital funds market. From this it follows that households must be compensated for the income claims which they have relinquished, the payment they receive being a necessary social cost of obtaining the funds required for growth. The first approach, then, involves the determination of how much compensation households must receive to induce them to make the required amount of savings available to the business sector. It is this amount of compensation, and this amount alone, which the first, and more conventional, approach suggests must be added to the firm's contractual costs to arrive at a socially optimum price.

One may well question the relevance of this capital accumulation and allocation model in an economy such as that of the United States wherein more than two-thirds of the investment funds for the business sector as a whole, and more than 90 per cent of the funds in manufacturing alone, do not even pass through the capital funds market (see note 17 to chapter 1). Indeed, under the circumstances, it is doubtful that
what economists generally see as the advantage of this model - that it leads to household savings being placed in the hands of those firms which can employ them to the best advantage - is even remotely realized in practice. Yet to make the model more relevant, by adopting measures which would force a larger proportion of the total savings utilized by the business sector to pass through the capital funds market, would probably require, if the same aggregate rate of investment is to be maintained, either that the government itself provide the necessary funds through its taxing powers or that there be vastly greater inequality in the distribution of personal income. The more important point, however, is that if direct control over prices is to be established using the approach derived from this model of the capital accumulation and allocation process, it is necessary to determine, on an industry-by-industry - if not on a firm-by-firm basis - the margin above costs, or 'profit', required to induce the household sector to provide the necessary funds for investment. This is because the capital-output ratio and thus the amount of compensation paid to the household sector will itself vary from industry to industry and even from firm to firm. For this reason the above approach can be described as a microeconomic one; and it gives rise to all the problems observed in connection with public utility regulation in the United States (for a comprehensive survey of these problems see Kahn, 1970).

The alternative approach can be described as a macroeconomic one. It is based on the extension of Keynesian theory which has been developed in this treatise and on the model of the capital accumulation and allocation process which is implicit in that theory. In this view of things, growth is a continuous phenomenon, even if the rate itself varies, with the expansion being financed out of the funds which the megacorp - along with the government - is able to extract because of its power, non-economic as well as economic. From this it follows that the margin above costs on the goods produced, at least in the oligopolistic portion of the business sector, will depend on the aggregate growth rate. - the higher that growth rate, the higher the margin. This suggests the possibility that the margin above costs - that is, the amount of corporate and governmental levies - can be controlled through the aggregate growth rate. It is for this reason that the approach can be regarded as a macroeconomic, or post-Keynesian, one. Let us see how this approach might in practice work out.

The macroeconomic approach

As the previous chapter sought to demonstrate, the government can, through its fiscal policy, initiate any change in the secular growth rate it wishes. An increase in the rate of growth of government expenditures,
holding tax rates constant, will lead to an upward shift in the investment
demand function for the economy as a whole and thus to an increase
in the rate of growth of aggregate output. It is this scope for discretionary
action that gives the government its critically important leverage on
the economy.

The new, higher aggregate growth rate will be a sustainable one,
however, only as long as the government is willing to continue running
the requisite deficit. Once it ceases to add to its debt burden at the
same rate, the higher aggregate growth rate can be maintained only
if, by coincidence, some other sector is willing to play the same role
or, what is somewhat more easily arranged, only if the savings curves
for all the sectors can be shifted so as to bring the rate of growth
of savings in each sector into line with the rate of growth of investment.
In the final analysis, then, maintaining a higher aggregate growth rate
requires being able to shift the savings curves for all the individual
sectors of the economy, including the oligopolistic sector, in such a
way that the resulting debt burden and distribution of national income
is acceptable to those groups in society with the power to change them.
This, in turn, means recognizing that the national incremental wage
pattern, \( W_p \), along with the various tax rates, is an instrumental variable
which can, and must, be manipulated in order to bring about the necessary
macroeconomic balance.

Making the national incremental wage pattern an instrumental variable
can be regarded as a form of incomes policy - though not necessarily
the sort which underlies the popular conception of such a policy. For
many persons, an incomes policy simply means putting a restraint on
the gains achieved by trade unions at the collective bargaining table.
Yet, as the preceding analysis has sought to make clear, the national
incremental wage pattern may be not only too high for the desired growth
rate to be maintained without an upward movement of prices, it may
also be too low. With the steady rise in output per worker which economic
growth accompanied by technological progress implies - and it is hard
to conceive of one without the other - a continuous increase in the
various rates of compensation paid to household members is the only
means by which the resulting marginal social surplus can, in the face
of the downward rigidity in prices attributable to the oligopolistic sector,
be widely distributed throughout the society. If the national incremental
wage pattern is too low, with the result that the increase in the various
rates of compensation is also too low, a rise in prices may be avoided
but the desired secular growth rate will not be maintained. Indeed, due
to insufficient demand, the secular growth rate will almost certainly
decline.

It can thus be seen that determining the national incremental wage
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pattern involves a delicate balancing act, with a false step in one direction likely to launch the economy on a wage-price spiral and a false step in the other direction likely to produce a minor recession or worse. For this reason it is essential that a better mechanism be developed for determining the national incremental wage pattern - one which avoids the shortcomings which have already been noted in the present mechanism whereby the pattern is set through the key bargain reached in the bellwether industry.

Both the guideposts promulgated under Presidents Kennedy and Johnson and the different boards established by President Nixon under Phases II and III of his new economic policy were efforts to deal with some of those shortcomings. The guideposts eventually broke down because they were too inflexible. They simply could not deal with the new conditions created by the stepped up war effort in Southeast Asia after 1965 while still maintaining credibility with the public (cf. Sheahan, 1967; see also Heller, 1966, pp. 43-7; Schultz and Aliber, 1966). The several boards established under Phases II and III were somewhat of an improvement over the guideposts, both because of the greater flexibility which was inherent in them and because of the statutory power they had to enforce their decisions. Even so, they failed to deal with the basic political problem posed by the power of the trade unions, and especially their champion in the bellwether industry, to determine the national incremental wage pattern pretty much as they wish, subject only to resistance of the companies with which they bargain. Success by the boards, as by the guideposts, required that the trade unions surrender, or at least hold in check, this power. It was not clear, however, either what the trade unions were to receive in return or what their bargaining partners, the megacorps, were on their part to surrender. The boards, then, seemed to represent what the trade unions have usually found an incomes policy to be - simply a restraint on wages alone. Since the trade unions were in effect bargaining on behalf of the entire household sector, this meant a restraint on the rate of growth of disposable income as well.

The Nixon Administration sought to counter this impression about its anti-inflationary program by imposing a similar type of restraint on the profit margins - and thus on the average corporate levy - of megacorps. How serious the government was in these efforts need not concern us. The fact is that, as the above chapters have tried to make clear, once the administration set the course of its fiscal policies, thereby determining the secular growth rate, it had already in effect decided what those profit margins had to be. The only difference made by its efforts to control profit margins directly was that, insofar as the profit margins required by the secular growth rate were greater than the profit
margins allowed under Phases II and III, the fear of government intervention became a far more significant factor in the pricing decision of megacorps; and this, in turn, may have led to a somewhat greater reliance on external financing. The conclusion to which the above analysis leads is that if the trade unions are to receive anything meaningful in return for surrendering, or at least holding in check, the power they now have to determine the national incremental wage pattern, it must be a greater voice in determining the target variable which not only controls the profit margins of megacorps but also most directly affects the growth of real income for their members. That target variable is the secular growth rate.

How to give the trade unions, as well as other groups in society, a greater voice in determining the secular growth rate is easy to say – though difficult perhaps to implement. The various groups need to be brought together in a social and economic council where the implications of alternative growth rates can be discussed and some sort of consensus reached. These deliberations would be more informed, to be sure, if there were a secretariat to provide members of the council with an objective economic analysis of the possibilities, both in the short run and over a longer time period. The more important condition, however, is that the consensus reached by the social and economic council, assuming the council were a sufficiently representative body, become the basis for government policy, in the legislative branch as well as in the executive branch. What this amounts to is a form of indicative planning, such as is now carried out by several Western European countries. The advantage to be gained from it is that, with broad agreement reached as to what the secular growth rate should be, the determination of the national incremental wage pattern would no longer need to involve simply a power struggle between megacorps and trade unions.

The inescapable economic fact is that, once the existing productive resources are fully utilized, progressively higher rates of growth of aggregate output, \( \dot{G} \), can be achieved only at the expense of progressively lower rates of growth of disposable income, \( \dot{Y}_D \). There is thus a fundamental trade-off between the rate of growth of aggregate output and the rate of growth of real income for the household sector; any group such as a social and economic council, in deciding on the one, is in effect deciding on the other simultaneously. The choices confronting such a group at any given point in time are similar to those shown in figure 27, with points A, B, C, D and E representing the alternative combinations of \( \dot{G} \) and \( \dot{Y}_D \) which are presently achievable. The task of the social and economic council would, of course, be to choose one of those combinations.
The rate of growth of disposable income so selected would, in turn, largely dictate what the national incremental wage pattern should be. With $\dot{Y}_D$ already decided upon, only one value for $W_n$ would, in fact, be consistent with price stability on the one hand and assure a sufficiently high level of aggregate demand to achieve the target growth rate on the other. That one, non-inflationary value for $W_n$ is unlikely to be the same as the value for $\dot{Y}_D$ already decided upon. How closely the two will correspond will depend on the allowance which must be made for what other countries have come to term 'wage drift,' for the differential rate of growth of wages between unionized and non-unionized workers and for the rate of growth of both transfer and rentier income. Yet, with the secular growth rate, along with the preferred rate of inflation, having already been agreed to, the exact relationship between $\dot{Y}_D$ and $\dot{W}_n$, as well as possibly the exact relationship between $\dot{G}$ and $\dot{Y}_D$, should be the only points actually open to dispute. This is the macroeconomic, or post-Keynesian, approach to controlling inflation. And it involves the recognition that both the rate of growth of wages and the margin above costs within the oligopolistic sector may have to vary, depending on the secular growth rate chosen by the society through its political institutions.

This macroeconomic approach is not without its problems. There is first the technical problem of determining, to the satisfaction of those
whose relative income shares are at stake, the econometric relationship
between the various instrumental and target variables. This is particularly
difficult because of the complicated interrelationships which exist among
the various sectors of the economy (Aukrust, 1970; Eichner, 1974). Some
of these interrelationships have already been pointed out in contrasting
the pricing dynamics of the oligopolistic and non-oligopolistic sectors.
But the reality of the American economy with its separate agricultural,
service, regulated, non-profit and import sectors is more complicated
than even the five-sector model used throughout this treatise would
suggest. What is required is a further elaboration of that five-sector
model, with empirically derived estimates of the savings and investment
functions for each of the separate sectors.

Far more serious than the technical problem, however, is the political
one of securing the cooperation of all the groups in society whose support
is necessary if the macroeconomic approach to controlling inflation is
to work. Here the problem is made more difficult by what the macro-
economic approach, as so far presented, takes for granted - namely,
the power of the megacorp to determine its own margin above costs,
subject only to the restraint imposed by the substitution effect, the
entry factor and the fear of meaningful government intervention. However
well suited the macroeconomic approach may be for dealing with the
problem of inflation, it seems blind to the megacorp's pricing power
and the strong likelihood that that power will be abused.

Actually, however, the pricing model developed in this treatise as
a microeconomic foundation for post-Keynesian theory does suggest
a way in which the megacorp's pricing power can be brought under
effective social control. It would require somewhat more elaborate social
mechanisms than now exist, and for this reason establishing effective
social control over the megacorp would not be as easy to accomplish
as simply ending the wage-price spiral. Still, the megacorp can be
satisfactorily tamed - and without the disadvantages which more direct
forms of control, especially those based on the microeconomic approach,
carry with them. This is fortunate since, unless important groups in
society, the trade unions especially, can be convinced that the megacorp
will not be able to abuse its pricing power, the political problem associated
with the macroeconomic approach may be insoluble.

As this treatise has repeatedly pointed out, what is generally regarded
as the 'profit' of the megacorp after taxes actually consists of two quite
different components. The dividends paid out to the equity debt holders
comprise one of these components, and the earnings retained by the
megacorp comprise the other. The treatise has emphasized the dissimi-
larity of the two components by treating the dividends as part of the
megacorp's fixed costs and the retained earnings as part of the corporate
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levy. Because of these two quite different components of its 'profit', effective social control over the megacorp requires two quite different tacks.

Insofar as the dividends are concerned, it is difficult to discern what it is that, from society's point of view, warrants the payment of this form of compensation. Here several important facts should be kept in mind.

The first is that only 10 per cent of the investment in the unregulated portion of the oligopolistic sector is financed externally - and less than 5 per cent is financed through new equity issues (see note 17 to chapter 1). What this suggests is that the equity debt holders are hardly indispensable as a source of investment funds. In fact, there is reason to believe that, with the effort to regulate the economy primarily through monetary policy abandoned and with a proper macroeconomic balance achieved, the role of the equity debt holders in financing new investment could be eliminated altogether.\textsuperscript{8}

The second important fact to keep in mind is that the real return to the equity debt holders on the funds they have made available to the megacorp far exceeds the real return to the fixed-interest debt holders. For example, anyone supplying a representative megacorp with investment goods on a fixed-interest basis in 1945 would have found that, simply as a result of inflation, his rate of compensation in real terms had by 1965 fallen to approximately 57 per cent of what he had originally contracted to receive, while anyone supplying the same megacorp with investment funds on an equity basis would have found that, taking into account the rise in dividends as well as the effects of inflation, his rate of compensation in real terms had by 1965 increased by more than 2 1/2 times.\textsuperscript{9} This nearly five-fold differential in the relative rates of compensation, even without taking into account any capital gains, is more than can be justified by any supposedly greater risk which the equity debt holders incur because they have no contractual claim on the megacorp's revenue. As proof of this contention, it would only be necessary to convert all the megacorp's common stock into non-voting, cumulative preferred shares and then see what differential, if any, still remained in the real return to the two different types of debt. Indeed, it is hard to avoid the suspicion that the greater rate of compensation presently enjoyed by the equity debt holders is due entirely to the voting power they have, a legal right which gives them an effective club over the group responsible for deciding what their rate of compensation should be.

The third important fact to keep in mind is that the equity debt holders provide little in the way of a check on the performance of the executive group. The shareholders are rarely in a position to impose their views
on the executive group; and when they are, as during a take-over bid by some outside group, the criterion they are likely to follow - which of the two contending factions is apt to compensate them more generously in the future - is only tangentially related to the question of how well the company is being managed, either in the interests of the company qua organization or in the interests of the larger society. The substantially greater return enjoyed by the equity debt holders is thus not a necessary social payment for the work of the executive group being overseen. Indeed, as already noted, it is the fixed-interest debt holders who are likely to provide what little check there is on the executive group's performance (see above, chapter 3, pp. 58-9).

The fourth and final fact to keep in mind is that dividends are the single most important source of income inequality in the United States. In 1962, 10 per cent of all US households owned 62 per cent of the equity in those companies whose shares were publicly traded. These shares, together with other types of marketable securities, were in fact the most unequally distributed of all forms of wealth, and it is unlikely that the situation has changed significantly over the decade (Projector and Weiss, 1966; see also Lampman; 1962; Ackerman et al., 1971). Inequality in the distribution of wealth, because of the property income to which it gives rise, is in turn the primary cause of inequality in the distribution of income.

One might hesitate, even in the face of these four facts, to urge elimination of dividend payments entirely - first, because it would discourage neo-classical proprietorships from evolving into megacorps, thereby eliminating an important means by which the oligopolistic sector is continually being rejuvenated, and, second, because it would generate such bitter social conflict that there would be room for little else on the political agenda. However, there seems no reason not to try to hold down the rate of growth of dividends as much as possible.

To be of practical import, any limit placed on the rate at which dividends could be increased would have to be lower than the national incremental wage pattern, \( W_p \). How much lower would, of course, depend on the political strength of equity debt holders as members of the rentier class. The closer to zero this limit was, however, the less would be the skewing effect of dividends on the distribution of national income. It might be argued that this type of constraint would do little to eliminate the capital gains which, in some ways, are the most pernicious aspect of the present distributional arrangements (see note 39 to chapter 5). Those who take this position are, however, simply allowing themselves to be taken in by the myth that all of the megacorp's revenue after taxes accrues to the equity debt holders and that it makes no difference what proportion of the net revenue is paid out in dividends. It is precisely because
so many of those who benefit from the present arrangements believe in this myth that a limit on the rate at which dividends could be increased might prove feasible politically.

An alternative ploy would be to change the law so that the federal government's social security trust fund could be used to purchase common stock in megacorps. This would end the scandalous situation in which those reserves are now invested in low-yield government bonds. Not only would the returns be greater if the social security trust fund were used instead to obtain an equity interest in the oligopolistic sector, it would also give some truth to the argument that dividends are the means by which widows, orphans and others unable to provide for themselves are spared from becoming dependent on public charity. Furthermore, as the social security trust fund increased its stock holdings, the public would gain a stronger voice in the affairs of megacorps. This second ploy is not so much an alternative to the first as a complement. Indeed the two measures may both be necessary to give assurance that the pricing power of the megacorp is not being used simply to enhance the income of one group in society at the expense of others - in this case, through the payment of dividends.

Insofar as the retained earnings component of the megacorp's 'profit' is concerned, the situation is entirely different. From what has already been said, it should be clear that the retained earnings, as part of the corporate levy, serve the important social function of enabling the megacorp to finance its investment expenditures. Indeed, its crucial role in the capital accumulation process suggests that the entire corporate levy is a true social cost. The means by which the megacorp finances most of its investment nonetheless constitutes a tax on the consuming public. As in the case of a public levy, those being taxed have every reason to insist that the funds thus obtained are being used in ways that best serve the general interest.

It is important not to exaggerate the scope of the problem. The largest part of the corporate levy, it must be realized, is used to acquire the additional productive capacity which an expanding economy requires - with much of that new plant and equipment embodying the improved technology which makes possible higher output per worker. Still, there are certain broad uses to which the corporate levy is put which raise serious social questions.

The sums spent on advertising are perhaps the least defensible of the investment outlays which the corporate levy permits. Indeed, it is hard to see what public good, if any, is served by this type of expenditure. Rather than informing the potential buyer, advertising, especially that placed in the mass media by the megacorp, merely obfuscates and confuses. The main effect, in fact, is to debase and corrupt a large
part of society's informational network. The economic arguments on behalf of advertising, meanwhile, are hardly to be taken seriously. Even if it were true that advertising could shift the aggregate consumption function, there are certainly better and more direct ways of avoiding a decline in the overall growth rate. In reality, the primary function of advertising - and the only reason that megacorps spend as much money on it as they do - is to protect the market position of established firms by erecting formidable barriers to entry.

Advertising, however, is not the only questionable investment outlay by the megacorp. Even with regard to the sums spent on research and development, customer servicing, annual model changeovers and similar means of strengthening market position, there is good reason to believe that the social returns fall far short of the private returns. Since all of these types of expenditures have some redeeming value, however small, it might not be wise to ban them outright. Besides, there is a better strategy for eliminating the undesirable effects to which these types of expenditures give rise, including their dissipation of the available social surplus. This strategy consists of forcing megacorps to undertake their advertising, R & D, customer servicing and similar activities on an industry-wide basis by placing severe restrictions on the freedom of individual firms to carry out such activities. Most of the undesirable effects of these types of investment outlays, it turns out, derive from inter-firm rivalry and would be avoided if the expenditures were to be handled by the industry as a whole.

The restrictions on the individual megacorp's freedom of action would have to take different forms depending on the type of investment outlay. In the case of advertising, for example, individual megacorps might be limited to reprinting whatever objective comparison of its product with those of other firms a newly created consumer protection agency might report. In the case of R & D, individual megacorps might be placed at a disadvantage in obtaining patent rights unless they joined in an industry-wide research effort. While the relaxation of the antitrust laws implicit in the above strategy might go against the grain of those who still feel that the Golden Age of Competition can be restored, it would in fact simply end competition in areas where it has been shown that competition has undesirable consequences.

Even if the strategy were successful in eliminating those undesirable consequences, however, a somewhat more subtle question would remain. This is whether all the uses to which the corporate levy is likely to be put at any given point in time represent the best allocation of that part of society's discretionary income. The question, really, is whether the short-circuiting of the capital funds market which results from primary reliance on internal financing does not prevent investment funds from
flowing to where, from society's point of view, they will do the most good.

Conglomerate expansion, as already pointed out, is the primary means by which, under oligopolistic conditions, investment funds are shifted from less rapidly growing to more rapidly growing industries. Indeed, this means of shifting funds may be far more effective than the capital funds market which exists in a country like the United States. Even so, the necessary amount of investment funds may not always flow to where, from society's point of view, it will do the most good. A large part of the problem would, of course, be eliminated if regulated industries were to be placed on an equal footing with other industries by being permitted to finance their investment through a corporate levy also. To go beyond this reform and assure even better allocation of investment funds within the business sector would require the creation of a new type of social mechanism as an adjunct to whatever system of indicative planning might be established.

The necessary new social mechanism is a series of industry planning panels, with government officials and representatives of the consuming public joining with company executives and labor leaders to decide what type of investment program, including R & D, is going to be required if each industry is to meet the long-range goals set by the social and economic council. The investment program decided upon by the panel would be regarded as a socially optimum one, and that part of the government charged with coordinating economic policy would then see to it, both through the margin above costs allowed firms in the industry and through the credit extended by the government's own specialized lending agencies, that this amount of investment was financed. Capital expenditures other than those called for under the investment program agreed to by the industry panel could still be made by the individual firm, but no provision would be made for them in calculating the industry's necessary margin above costs.

It should be emphasized that the creation of these industry panels would make sense only as a further development of the system of indicative planning already called for. Within that context, but only within that context, they would represent the ultimate form of social control over at least the retained earnings component of the megacorp's 'profit'. However, there are more important, and more immediate, steps that would have to be taken to assure the better allocation of the current marginal social surplus.

That marginal social surplus, as already pointed out, is reflected not only in the investment funds expended by the business sector but also in the tax monies spent by the government itself - as well as in the consumer durables purchased by the household sector and in the non-
monetary capital flows abroad. The optimum allocation of the social surplus requires therefore that, at the margin, the social benefit from the use of society’s discretionary income be equal in all five sectors. Yet the task of allocating the marginal social surplus among the various sectors is not one which the market mechanism, by itself, is capable of performing. The need, already indicated, for making the national incremental wage pattern an instrumental variable subject to conscious political choice is one reflection of this fact and the ability of the government, through its tax and spending powers, to determine at least the initial thrust along any expansion path is another. Indeed, the one-fifth of GNP which flows through the government sector is the most compelling evidence as to the limited ability of the market to make certain types of allocative decisions. It is these limitations of the market which argue for a system of indicative planning.

Confronting the inherent weakness of the market mechanism merely serves, however, to point out the weakness – hopefully transitory – of contemporary political institutions. How well do the decisions reached by government reflect the preferences of the general citizenry? And what reason is there to believe that, however great the unmet need may be for public services, the government is capable of making a wise choice in how it spends its money? Recent advances in public budgeting theory, especially the advent of program budgeting (Schultze, 1968; Rivlin, 1971), suggest that some progress is being made on at least the second of these two questions. Still, until there is reasonable assurance on both points, one must temper the call for a comprehensive system of indicative planning. It hardly makes sense to grant the government the power needed to eliminate the last source of misallocation within the business sector when the government lags so badly in the quality of its own decision-making. For a country like the United States, further progress in the political sphere may well be a precondition for further progress in the economic realm.

Achieving social control

The policy implications of the preceding analysis can thus be summarized as follows: with some means found either for limiting or siphoning off the growth of dividends, it is possible to establish effective social control over the megacorp to a large extent simply by establishing effective social control over investment. This means regulating the overall economy through government fiscal policy, thereby determining the secular growth rate of megacorps, and then supplementing this overall control with restrictions on some of the specific uses to which the corporate levy can be put. Indeed, with dividends limited and investment regulated,
only one further step would be required to assure complete social control over the megacorp.

This would be a procedure for placing the megacorp in receivership - and thus for securing a change in the executive group - when and if its performance was found to be inadequate from a social point of view. The more precise the grounds for invoking this remedy, the less subject to abuse it would, of course, be. A number of grounds which seem sufficiently precise can be suggested, among them the megacorp's failure to maintain a certain rate of growth relative to other megacorps and the failure to meet the standards for product quality which government agencies might establish. There is another ground which can be suggested for placing the megacorp in receivership, and it is one which would provide the final stroke required for regulating the megacorp through investment. This ground would be the megacorp's failure to follow an optimal pricing rule - that is, a pricing rule based on setting a margin above costs just sufficient to finance the investment called for under a system of indicative planning.

The procedure for placing the megacorp in receivership would, if adopted along with the other measures proposed in this final chapter, go far in dealing with the key problem raised by this treatise - the largely unchecked power of the megacorp's executive group. This is a power capable of great good, as evidenced by the high rates of economic growth in the United States. But it is also a power which can work to the public detriment, as evidenced by the role of the megacorp in the recent inflationary experience, an experience which has made governments hesitate to stimulate the economy and thereby achieve higher rates of growth both of employment and of output. That power, both for good and bad, can be brought under effective social control if the critical determinants of the megacorp's behavior, along with the crucial part played by the oligopolistic sector in the overall economy, are properly understood. All that is required, at least intellectually, is a different set of theoretical models from those economists are accustomed to employing.