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Source: *Political Science Quarterly*, Vol. 72, No. 3 (Sep., 1957), pp. 380-387
Published by: The Academy of Political Science
Stable URL: https://www.jstor.org/stable/2145324

Accessed: 30-03-2022 19:33 UTC

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THE SOCIAL COST OF CORPORATE MONOPOLY PROFITS

I

PROBABLY no one subject has interested economists as much as the extent and effect of monopolistic influences on the economy. I believe that, as compared with competition, monopoly is feared for three main reasons: (1) profits may be excessive (reflecting higher prices and restricted output); (2) costs may be higher; and (3) technological progress may be slower. Because so much discussion of the matter gets bogged down in defining and measuring monopoly, I am not certain how students of the subject would weigh the relative importance of these three evils. But from the small scope of the professional literature devoted to the effect of monopoly on costs or technological progress—and also from the small extent of the literature dealing with monopoly outside the corporate area—it is my impression that the main concern has been with excessive corporate profits. It is the purpose of this note to suggest that worry on this score is largely unnecessary—that, in fact, if it were possible to eliminate the effect of monopolistic influences on corporate profits and prices by saying " abracadabra ", consumers would hardly notice the over-all difference.

Excessive corporate profits, and the higher prices and lower output that make them possible, have two effects: they cause " maldistribution " of income—more for the monopolists and less for everyone else—and " misallocation " of resources. Resources (land, labor and capital) are " misallocated " because less resources are utilized in monopolized areas of the economy and more in competitive areas in comparison with the pattern of resource use that would emerge if competition prevailed and resources were distributed so as to maximize consumer satisfaction. The harm done by misallocation of resources is separate from, and in addition to, that which results from the maldistribution of income. If, for example, all industries were *uniformly* monopolistic, re-

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sources would not be misallocated but income would still be maldistributed. Vice versa, even if appropriate taxation of corporate income were to recapture all corporate monopoly profits and so eliminate income maldistribution, the harm done by misallocation of resources would nonetheless remain. But Arnold C. Harberger has examined the welfare loss involved in resource misallocation and concluded that it is quite small.[1] Our main task, therefore, will be to consider the harm caused by the maldistribution of income that results from excessive corporate profits. Then we shall summarize Harberger's discussion of the loss involved in resource misallocation, and reach the final conclusion that, even when both are added together, the total remains insignificant.

The main point to be made regarding maldistribution of income follows directly from the well-known fact that most corporate profits are either taken by corporate income taxes or retained in the business. In recent years such profits have amounted to about 12 per cent of the national income, with roughly half going to pay taxes, one quarter retained in the business, and one quarter paid out as dividends. There has, of course, been an extensive debate regarding the propriety of including corporate taxes in the national income (as is done by the Department of Commerce). To this debate I have no desire to add. Instead I propose to point out that, under present arrangements, consumers who do not own stock would not be much better off if corporate profits as a whole were eliminated and would therefore be even less benefited if monopolistic influences alone were removed. The argument proceeds in three steps: we shall first examine the *direct* effects likely to result if corporate prices were sufficiently reduced to eliminate corporate profits; next we shall consider possible *indirect* effects; and finally we shall speculate on the extent to which corporate profits are the result of monopolistic influences.

II

Suppose corporate prices are lowered sufficiently to eliminate profits entirely. If we wish savings and government

[1] "Monopoly and Resource Allocation", *Proceedings of the American Economic Association,* May 1954.

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revenue to be maintained, then the consumption of non-owning consumers can *directly* increase only by the same amount that consumption out of corporate profits is reduced. For, obviously, if corporations do not pay taxes or save, then the taxes paid and the savings done by the rest of the economy must increase correspondingly. Such consumption as does result from corporate profits comes out of dividend payments, which amount to about 3 per cent of national income. But not all dividend payments are consumed. Although stock ownership is probably becoming more widespread, it remains highly concentrated, with about half of dividend payments going to the top 1 per cent of income recipients. Obviously the marginal rates of taxation and saving by those receiving dividends are high. There is little information on the matter, but I would be surprised if more than two thirds of such payments are spent on consumption. To the extent that this is correct, the direct benefit to non-owning consumers from the elimination of corporate profits would be in the order of 2 per cent of the national income—or rather less than 3 per cent of consumption.[2]

This estimate also seems to me to be a measure of the direct and immediate gain to those not owning common stock that would result from an uncompensated expropriation by the government of all owners of corporations.[3] We should not, however, think that the present situation—where the recipients of 12 per cent of the national income account for rather less than 3 per cent of national consumption—is in any sense inevitable. In a country such as Mexico, for example, profits have recently been estimated to have reached 45 per cent of the national income at a time when saving from all sources *and* the share of government *together* accounted for only 17 per cent of the gross national product.[4]

2 The relative *importance* of profits is perhaps best measured with reference to the private economy (national income less government), but *benefit* seems appropriately compared with national income.

3 The estimate may also throw light on why the mere fact of nationalization has solved so few problems abroad.

4 Adolph Sturmthal, "Economic Development, Income Distribution, and Capital Formation in Mexico", *Journal of Political Economy*, June 1955, pp. 194 and 196.

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In commerce, which accounts for 25 per cent of Mexi
real domestic output, it is estimated that " No less than
per cent of income payments . . . go to capital." [5] Our o
situation toward the end of the last century, though har
as extreme, was very different from that which prevails
day; the Sixteenth Amendment *has* made a difference.

But what of possible *indirect* benefits from the elimi
tion of corporate profits? Let us start with taxes. No c
can deny the possibility that the revenue which now flo
to the government via higher prices and corporate ta
might be raised in a " better " fashion. But I doubt i
would be easy to get agreement on how this should be do
in view of the fact that present tax-incidence theory is
more than a little difficulty. For excise taxes are curren
being rehabilitated on the ground that income taxes dist
the choice between work and leisure and the contention
put forth that part at least of corporate profit taxes are
reality passed along to be " borne " by consumers. C
tainly our tax system is not perfect, but I do not see an
priori reason for believing that it would be much impro
by the elimination of corporate taxation, given the conc
tration of corporate ownership and the probability t
some at least of the " burden " remains on corporate owne

What of saving? The issue is topical in that liberals h
answered the plea of business men that they need hig
prices to finance expansion by asking why savings provi
by the general public through the higher prices should
dound to the exclusive benefit of corporate owners. Wo
not the general public benefit in the long run if prices w
reduced sufficiently to eliminate the income retained by c
porations even if the public were made to save an equival
amount so that there was no initial increase in consumpti
For in the long run the benefits of the saving would then
received by the general public rather than accrue solely
corporate owners. In essence this is the question, remo
to the future, of why corporate owners are entitled to c
sume even 2 per cent of income—in other words, why
should have private ownership of capital. In a world wh

[5] *Ibid.*, p. 198.

[6] Note that Russia continues to utilize her trusts as tax collectors—th
chief reliance is on the turnover tax rather than the income tax.

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socialism is spreading and ownership of capital is perha
more frequently the result of inheritance than abstinence,
believe that this is a question which deserves more explic
attention than it frequently receives. Note that a discussio
of "marginal productivity" does not help, both because
meaning is not clear when prices are administered and i
come substantially redistributed by tax policy and, mo
basically, because a man is entitled to the marginal produ
of the capital he controls only under social arrangemen
which themselves have to be justified. My own answer, u
argued here, is simply that 2 per cent of income is a chea
price to pay for the benefits flowing from private allocatio
of capital. So far as the immediate question of possible i
direct benefits resulting from saving being done by oth
than corporate owners is concerned, it seems sufficient
contend that, if 2 per cent is acceptable compensation f
the services currently rendered by corporate owners, th
there appears to be no objection to their obtaining owne
ship of corporate saving provided that the consumption th
they receive in return for their services in the future remai
at an acceptable level.[7]

Let us turn to the remaining question of the quantitati
importance of monopolistic influences on corporate profi
As we are interested in "abnormal" profits in excess of t
"normal" profits which prevail in competitive industr
one approach which suggests itself is to allow, let us say, a
per cent return on net worth after taxes as an approximatio
of a "normal" return and consider the excess as "abno
mal". But American corporations are currently earnin
after taxes only about 5 per cent on their net worth, so th
this approach does not advance the matter. Further, wh
we look at actual statistics, we have to allow for more th
"normal" profits in the sense of those which would preva
in a competitive industry *in the long run*. For the prof
reported in any year include those resulting from innov
tion, changes in demand, and other short-run influenc

[7] There is no automatic reason why an acceptable level should prev
The structure of claims arising from private corporate ownership perm
consumption to behave quite differently from income, so that holding c
sumption to appropriate levels may not be easy. This British socialists h
found out, leading to demands for an expenditure tax in place of the
come tax. *Vide* Nicholas Kaldor, *An Expenditure Tax* (London, 1955).

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All in all I find it hard to believe that normal long-run prof its and short-run profits resulting from influences other than monopoly do not between them account for at least two thirds of reported corporate profits.[8] But even if the figure is no more than half—so that half of all profits result from monopolistic influences—it follows that the direct benefit to non-owning consumers from saying abracadabra would amount to no more than 1 per cent of income—provided of course that our previous estimate is accepted that the direct benefit of non-owning consumers from the complete elimi nation of corporate profits would not be more than 2 per cent. As I am not inclined to put much weight on the pos sible indirect benefits, I am driven to conclude that 1 per cent is at most all that is involved.

Furthermore, it can be argued that our approach greatly overestimates the *welfare loss* that results from improper dis tribution. For we have concentrated entirely on the bene fit that would accrue to those not owning corporations from the elimination of monopoly profits without making any al lowance for the harm suffered by those who would lose in come as a result of the elimination of such profits. Given the difficulty of making interpersonal comparisons of utility there is no easy way of measuring the net social loss involved. In fact, there may be those who would argue that corporate owners are such superior " pleasure machines " that monop olies cause a net social gain rather than a loss. But whatever may be the capacity of monopolists for innocent enjoyment it remains true that, provided monopolists have any such capacity whatsoever, there must be deducted from the bene fit accruing to non-owning consumers, if they were to receive an additional 1 per cent of the national income, whatever loss we agree to attribute to the offsetting reduction in the income of monopolists. Thus saying abracadabra would ap pear to involve a welfare gain of significantly less than 1 per cent. How much less does not seem very important; *de minimis non curat lex*.

[8] Harberger concluded that " it is quite implausible that more than third of our manufacturing profits should be monopoly profits; that is profits which are above and beyond the normal return to capital and are ob tained by exercise of monopoly power " (*op. cit.*, pp. 84-85). As manufactur ing is probably more monopolistic than the rest of the economy, it would appear that in Harberger's judgment monopolistic influences would account for less than a third of total corporate profits.

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III

What of the harm done by misallocation of resources? After examining the matter in detail Harberger reached the conclusion " that monopoly misallocations [in manufacturing industry] entail a welfare loss of no more than a thirteenth of a per cent of the national income." [9] His approach was to measure monopoly misallocations by calculating divergences from average profits in manufacturing industry, which are treated as providing the level to which profits (and hence resource allocation) should conform. The analysis leads to the conclusion that, even in the case of the industry (toilet preparations) with the highest rate of return, achievement of average profits would require an increase in output of less than 20 per cent.[10] In no other case was an expansion of more than 11 per cent required, while the largest restriction was a little over 7 per cent, with the average working out at 4 per cent.[11] But it seems reasonable to assume that close to the margin it cannot make much difference to consumers if they consume a little more cabbage and a little less spinach, so that the welfare loss involved in adjustments of this size cannot be large when viewed against manufacturing production as a whole. Harberger concentrated on manufacturing industry partly because information on manufacturing profits was readily available, but also because manufacturing is, in all probability, more monopolistic than the rest of the economy. But even if we were to assume that the rest of the economy is as monopolistic as manufacturing industry, the total welfare loss would still be less than 1/3 of 1 per cent of the national income.

Note again that Harberger estimates that 4 per cent of resources would have to be transferred to eliminate misallocation in manufacturing industry. The reason why the resulting welfare loss is so small is that, on plausible assumptions, it cannot make much difference to their welfare if people consume, to repeat the example, a little more cab-

[9] *Op. cit.*, p. 85.

[10] George J. Stigler, " The Statistics of Monopoly and Merger ", *Journal of Political Economy*, February 1956, p. 34.

[11] Harberger, *op. cit.*, pp. 80-81.

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bage and a little less spinach. In the case of income maldistribution, on the other hand, the assumption that a little more income for monopolists and a little less for everyone else would not make much difference would hardly be acceptable. Hence our basic analysis was carried out without allowing *any credit whatsoever* for any benefit monopolists might have received from their enlarged incomes; only at the end of the analysis was the possible capacity of monopolists for the enjoyment of such income mentioned. It is this difference which explains why the estimate of the harm done by misallocation is relatively so much smaller than the estimate for maldistribution.

Suppose now we add both estimates together on the rather extreme assumption that the rest of the economy is as monopolistic as manufacturing industry. The total would still be only 1 1/3 per cent—hardly noticeable on any over-all basis in an economy where productivity increases each year perhaps twice as fast!

IV

My purpose in writing this note is not to argue that the Antitrust Division should be disbanded; actually I would be delighted to see its appropriations tripled. Rather my fundamental point is that we have concentrated far too heavily on the price, output, and profit aspects of monopoly. My guess is that, in terms of social waste, misallocation of resources as a result of consumer ignorance is a very much more serious problem than misallocation as a result of monopoly influences and that costs that are higher than socially necessary account for vastly greater waste than the excess consumption of monopolists. Above all I would like to know a great deal more regarding the effects of monopoly on technological progress. If monopolists must behave like monopolists and restrict something, I would not mind very much their trying to restrict prices and output—if only I were sure that they would be shot at sunrise for even thinking about restricting research expenditures!

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