
Corporate Power in the Marketplace

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CORPORATE POWER IN THE MARKETPLACE

GARDINER C. MEANS

I have been asked to give you my perception at present of the issues raised in our book *The Modern Corporation*. As a macroeconomist concerned with a stable and productive economy, I will focus on the second theme of this issue, the power of corporations. At the same time I will keep in mind the extent to which the separation of ownership and control increases that power. Also I want to make it clear that in speaking of corporate power in the marketplace I am not concerned with monopoly power. Our book does not even list "monopoly" in the index. Rather, I am concerned with the market power that arises naturally from active competition among a few large independent corporations and is reflected in the pricing discretion in the hands of individual competing enterprises.

I

A. *The Basic Change in the Structure of the Free Market System*

As you know, the central aim of our book was not to give answers to the basic issues we raised but to present a realistic framework to replace the picture of economic life so skillfully painted by Adam Smith in 1776, which still provided the basic framework for the conventional wisdom fifty years ago.

At the time Adam Smith wrote, he was well justified in championing competition among the many small producers of his day as the great macrocoordinator of production and distribution. The individual small producer tended to have no significant market power over the pricing of his product; prices were determined by the invisible hand of market forces; and the free market system not only tended to direct resources into optimum uses in the long run but, more important for present purposes, it provided an automatic mechanism tending to maintain full employment through the flexible adjustment of prices. If general demand fell

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and the total money stock remained constant, a fall in the price level automatically increased the real buying power of the money stock, thereby stimulating real demand and restoring full employment at a lower level of prices.

Then the Industrial and Corporate Revolutions gradually altered the structure of the free market system by transferring much of the task of coordinating productive activity from the marketplace to the administrative actions of the managers of corporations.

This gradual shift from market to administrative coordination had two profound effects. First, it gradually increased the productivity of both labor and capital so that the average level of living rose greatly over the years. Second, it undermined the ability of the free market system to maintain economic stability. It gradually substituted a radically different kind of competition for that relied on by Adam Smith. So long as prices were set by the classical market, they were highly flexible since no one producer could expect to influence a market price ruled by the equating of supply and demand. But the increase in corporate production had the natural and legitimate effect of increasing the proportion of markets in which competition was between a few independent competitors who thereby obtained some degree of pricing discretion. An individual management could estimate its costs and the probable demand for each of its specific products and then set its price in the light of what it thought its few competitors would do if it set one price rather than another. Or it would adopt the price set by a price leader. In either case, the price would usually be set by the seller and would tend to be held constant for a period of time and a series of transactions. Under this different kind of competition, prices were set by the visible hands of competing managements and could perform the function of directing a nation's resources of labor and capital into optimum uses only if close to full employment could be maintained for the economy as a whole. But this is what the free market system cannot do if too large a proportion of prices behave in a nonclassical fashion.

By the time our book was published, the conventional wisdom had registered the great increase in potential productivity due to the corporation, but it still clung to the view that the free market system would operate automatically to eliminate excessive unemployment of labor and capital. Yet at that time (1932) real national income had fallen by nearly a third, 40 percent of the country's industrial plant was idle, and a quarter of its labor force was unemployed. Clearly a new framework was needed within which to work out the economic issues and policies for that day. *Laissez faire* was no longer a valid policy.

B. *Market Power in the New Framework*

As I now read what we said at that time, I continue to believe that the most important *economic* conclusion we reached is in the chapter on “Concentration of Economic Power,” where we said in our fifth and final conclusion, “Competition has changed in character and the principles applicable to present conditions are radically different from those which apply when the dominant competing units are smaller and more numerous.”¹ I fully agree with our final conclusion that the modern corporation has wrought such a change in the free market system that, “[n]ew concepts must be forged and a new picture of economic relationships created.”²

Our book provided the new framework, showing that by 1930 (1) roughly three quarters of the business wealth of this country was held by corporations; (2) practically half of this corporate wealth was controlled by the 200 largest; (3) a substantial part of this wealth involved a separation between ownership and control; and (4) the free market system had shifted from one dominated by markets in which competition was among the many to a system of such markets combined with markets in which competition was among the few, with significant market power in the hands of managements.

But we did not go much beyond these concepts to answer the basic question how such an economy, with a significant part of its industrial plant and manpower already idle, could be returned to health. What could take the place of the classical automatic corrective of free-falling prices as the mechanism to maintain high employment of resources? This was the economic problem we presented along with the legal and economic implications of the separation of ownership and control, which so greatly increased the power of individual corporations to grow in size.

II

A. *New Market Concepts for the Prewar Period*

When I turn from my present perception of what we said about market power and consider the new concepts which grew directly out of this new framework, I do not hesitate to say that far and away the most important new economic market concepts were those of “administered price,” “administrative competition,” and later, “administrative inflation,” arising

¹ Adolf A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property* 45 (1932).

² *Id.* at 351.

from "perverse pricing." An administered price is a price set for a period of time and a series of transactions. Administrative competition is a non-classical form of competition in which there are so few independent competitors that each has a significant degree of pricing discretion, so that setting prices becomes an active function of business administration. The other two concepts did not become important until after World War II and will be discussed in Section III.

The difference between classical and administrative competition can easily be seen in the difference between the markets for farm products and for farm implements. Corn and wheat prices are largely determined in public auctions with no one seller setting a price, whereas the price of a new farm tractor is set by the management of the individual tractor maker and kept constant for considerable periods. The difference is also obvious between Adam Smith's retail price arrived at by higgling and bargaining in the market and the modern chain store where there is no higgling and bargaining at the cash register.

What makes these two new concepts important is that they *alone* are sufficient not only to explain why, in the 1930s, the automatic corrective of classical competition could not work, but also to point to an alternative mechanism which could maintain high employment consistent with the free market system.

This problem and a solution were clearly brought out in a paper I gave before a joint session of the American Statistical Association and the Econometric Society in 1934.³ There I first publicly introduced the concept of an administered price and gave extensive statistical evidence that there were two quite different types of competitive markets, one in which prices changed frequently and were highly flexible and one in which prices changed infrequently and tended to be inflexible. This can be seen in Figure 1.

Briefly, the paper said that in a national economy where all production is sold in classically competitive markets and where there is initial full employment, if for some reason a fall in demand creates unemployment while the money stock remains constant, the conventional corrective will operate. Prices will fall, thereby increasing real aggregate demand, and this will restore high employment at a lower level of prices. The higher real buying power of the money stock will support a high real income. But in an economy where roughly half of production is sold in administratively competitive markets, there is no automatic corrective to maintain production. Only half of prices would fall in an automatically corrective

³ Gardiner C. Means, *Price Inflexibility and the Requirements of a Stabilizing Monetary Policy*, 30 *J. Am. Stat. Ass'n* 401 (1935).

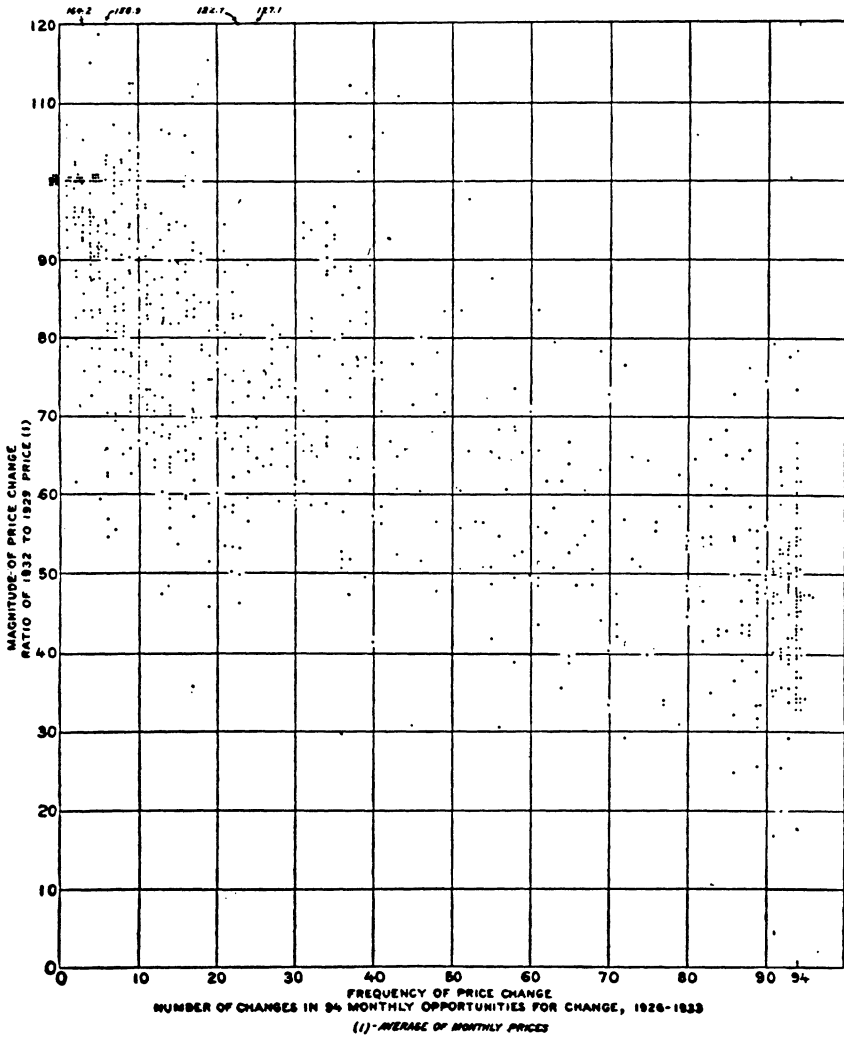


FIGURE 1.—Relation between frequency of price change and magnitude of price change during Depression, 1929–32. Distribution of 750 price series included in wholesale price index. (Gardiner C. Means, Price Inflexibility and Requirements of a Stabilizing Monetary Policy, *Journal of the American Statistical Association* 30 [1935]: 404.)

fashion, while half would drop insufficiently to correct the fall in real demand, thereby creating persistent unemployment and a distorted price structure. The resulting distortion in the price structure can be seen in the 1929–32 recession in Figure 2.

In the same paper, I showed that a monetary expansion could be expected to bring about economic recovery by raising classically competitive prices, raising production and employment in administratively competitive markets, and leading to a restoration of full employment with the distortion of prices largely eliminated. The rise in the nominal money stock would take the place of the classical fall in the price level as a whole at the initial price level.

As I look back on this 1934 analysis, I would now modify it only in two important respects. First, I would add Keynes's deficit spending to my monetary expansion as a possible but not a necessary way for government to expand aggregate demand when there is excessive unemployment. Second, I would point out that the 1934 analysis did not envisage the new kind of inflation we have been experiencing over most of the period since 1955, which will be discussed in Section III.

B. The Relevance of Classical Monopoly Theory

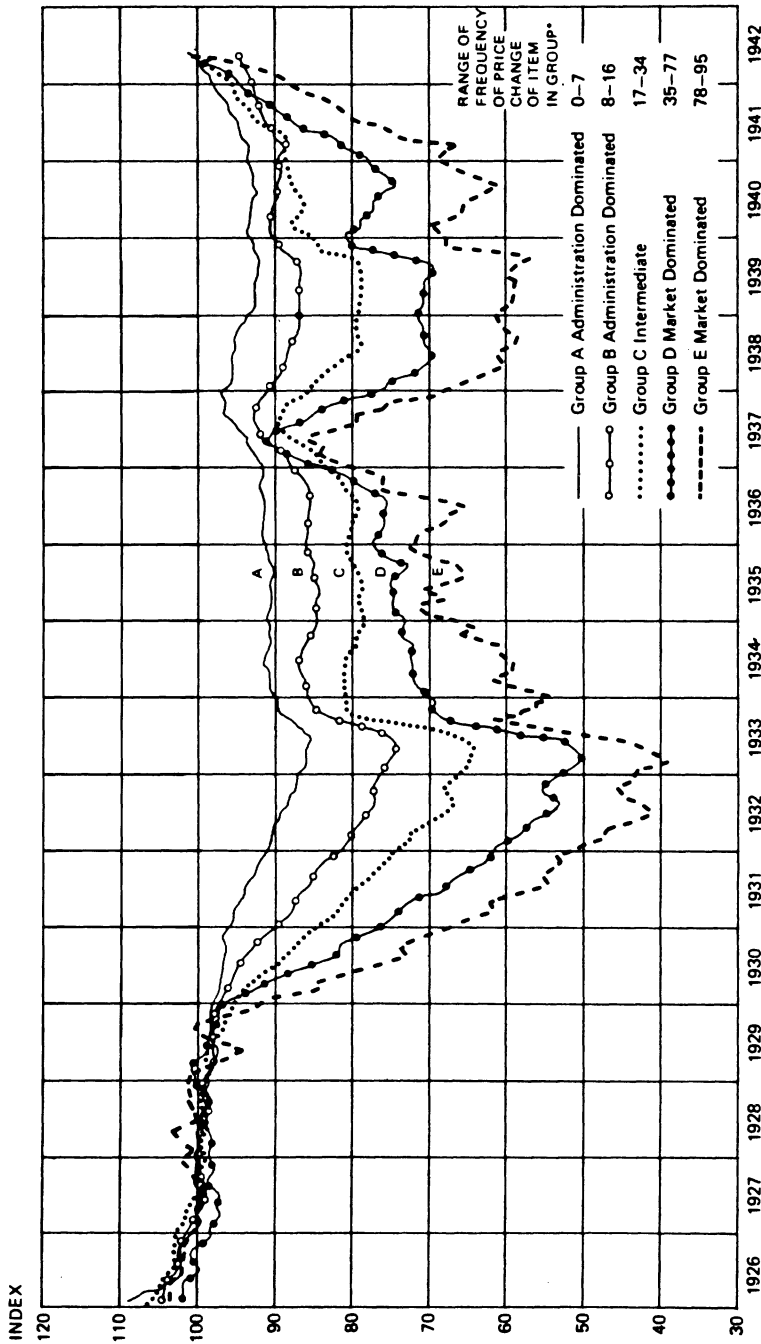
When the Great Depression forced economists to rethink macroeconomic theory beyond the range of the business cycle, it is not surprising that the principles of classical monopoly theory were applied to competition among the few. This is explicit in Chamberlin's book *The Theory of Monopolistic Competition*.⁴ My own experience in running a successful monopoly over a decade led me to reject monopoly theory in writing my 1934 paper. It would have been clarifying if I had given my reason.

My basic reason for rejecting classical monopoly theory turns on the simple mathematics of monopoly pricing. The textbooks present a correct statement of the mathematics but usually present only two of the three messages the mathematics carry. The first message is that, given figures for costs and revenue at relevant quantities, the most profitable price can easily be calculated. The second message is also clear, namely, that a price well above or below the most profitable price will produce much smaller profits. But the third and crucial message for practical pricing behavior is seldom discussed. It indicates that moderate departures from the most profitable price have little practical effect on profits.

This failure can be seen in the example of monopoly pricing given by Samuelson in his widely used text on economics.⁵ He shows in his mo-

⁴ Edward Chamberlin, *The Theory of Monopolistic Competition* (1933).

⁵ Paul Anthony Samuelson, *Economics: An Introductory Analysis* (10th ed. 1976).



*Price indexes are for 731 items included in the B. L. S. wholesale price index grouped according to frequency of price change in the months of the period 1926-1933.

FIGURE 2.—Deflation and reflation: wholesale prices for five frequency groups, 1926–March 1942. Price indexes are for 731 items included in the wholesale price index grouped according to frequency of monthly price change, 1926–33. Price freeze 1926–29 = 100.

nopoly example, first, that the most profitable price for his monopolist would be \$120 per unit, which would bring in \$230 of profits in a given period. He also shows that a \$20 departure up or down from this price would lose him \$30 of these potential profits and further departures from the most profitable price would bring even more sharp reductions in profits. But he does not point out that a moderate departure from the most profitable price would have only a minor effect on profits. In his example, a price \$1 higher or lower than \$120 would lose the monopolist less than 8 cents out of \$230. A price departure of \$2 would reduce profits by a mere 30 cents. Indeed, a \$5 departure from the most profitable price or a \$10 range would still bring the monopolist more than 99 percent of the full monopoly profit.

Even with perfect knowledge of demand and cost, there would be little inducement for a monopolist to be constantly changing its price because of moderate changes in demand or cost. And in the presence of some uncertainty over costs and demand and with positive costs in announcing price changes, there could easily be substantial periods of constant prices and sizable changes in price when they occurred. If this message, which is inherent in pure monopoly pricing, had been well understood, I believe the infrequency of price change where competition was among a few competitors would have been more quickly accepted.

C. The Actual Recovery from the Great Depression

The role of market power in the recovery from 1932 to 1942 can be seen in Figure 2. The five lines in the chart represent price indexes for wholesale prices grouped according to crude measures of frequency of price change. The difference in behavior is taken to reflect in large degree differences in pricing discretion arising from market power.

In the long period of recovery from the Great Depression, the basic analysis of the 1934 paper receives a remarkable confirmation in spite of the confusions of the period. By 1942, when full employment was finally reached and the price structure was frozen, the substantial unbalance between classically competitive and administratively competitive prices had disappeared and the wholesale price level at full employment in 1942 was almost exactly the same as at full employment in 1929.

During this twelve-year period there was great confusion about recovery policy. By the spring of 1933 the reliance on the classical corrective had been dropped in the 100 days of "new economic policy." By 1934 the Depression panic had been overcome with the introduction of "industrial self government" under the National Recovery Administration. It served an important role and was then declared unconstitutional. The Keynesian

explanation of oversaving and my own explanation of price inflexibility began to have some influence, with Keynes emphasizing government spending while I emphasized monetary expansion as a recovery measure. These theories pointed to the constructive use of monetary and fiscal measures by government and thus had some tendency to reinforce each other. But then, after excessive unemployment had been cut in half, unemployment began to rise sharply in 1937 when monetary growth was *unintentionally* brought to a halt, thus producing a new recession which shifted 4.7 percent of the total labor force to the ranks of the unemployed by early 1938, when the mistake was recognized and corrected. But excessive unemployment did not wholly disappear until 1940, when the money stock had been increased by nearly a fifth over the 1938 figure and war spending began. Another source of confusion grew out of the theoretical treatment of competition among the few as a branch of monopoly theory. A third source of policy confusion arose from a basic flaw in Keynes's theory which denied the potency of monetary expansion when interest rates were very low.

This confusion in policy was finally resolved. In place of the classical automatic corrective of a general fall in price level, there has been substituted an increase in aggregate demand generated by monetary and fiscal measures stimulated in part by war demand. This produced the same full-employment price level as before the recession, reversing the distorting decline in flexible prices. The success of this basic shift in policy led to the enactment of the Employment Act of 1946, which made the maintenance of aggregate demand a federal responsibility.

III

A. *Structural Change and the New Type of Inflation*

When I turn to the role of corporate power in the marketplace during recent years, I find that the creeping increase in the role of administrative competition has created a new dilemma. Concentration has passed a critical point in changing the structure of the free market system and has suddenly brought us a new type of inflation with prices rising sharply in recession.

The conventional wisdom holds that any sustained inflation "always and everywhere comes from too much money chasing too few goods." If this were true it would mean that simultaneous inflation and recession would be impossible. One could not have too much demand for goods in general and too little demand for goods in general at the same time.

Yet in each of the four substantial recessions in the last dozen years, prices rose while demand fell. In the 1969–70 recession the index of

industrial prices rose 5 percent while the index of industrial production fell 7 percent. In the 1974–75 recession, industrial prices rose 11 percent while industrial production fell nearly 13 percent. In the 1980 recession, industrial prices rose 6 percent while industrial production fell 8.5 percent. And in the current recession, industrial prices have risen over 5 percent while industrial production dropped over 10 percent.

In the second and third of these recessions the oil cartel contributed somewhat to the price increase. The 1969–70 recession, however, occurred before the cartel was formed, and oil prices have declined in the current recession. Most of the inflation in these four recessions represented not “too much money chasing too few goods” but “too little money chasing goods on well stocked shelves.” Obviously, in these recessions, more prices by weight were rising than falling.

At the time we wrote *The Modern Corporation* we did not foresee the possibility that the exercise of pricing discretion could lead to simultaneous recession and inflation. In my 1934 paper on a stabilizing policy, it was enough to show that the inflexibility of industrial prices could explain the failure of the classical automatic corrective. But my statistics showed that while roughly half of the prices in the wholesale price index behaved nonclassically in the 1929–32 recession, 10 percent of the latter actually rose. In a new preface to a 1967 revised edition of *The Modern Corporation*, I pointed out that “in the economy of the modern corporation, a wholly new type of inflation is possible: a rise of administered prices without a general excess in demand.”⁶ I also added that “just such an inflation occurred between 1953 and 1958” and gave figures showing that the 8 percent rise in the wholesale price index for the preceding five years occurred in administered prices and that the average of flexible market prices as a group did not rise at all. This is shown in Figure 3. I called this “administrative inflation” to distinguish it from demand inflation. There can be no question of the reality of this new kind of inflation.

Once the reality of simultaneous inflation and recession is accepted, three major questions are posed: What makes it possible? Why did it come suddenly? And how can it be overcome within the framework of the free market system?

B. Sources of Inflation in Recession

Here I will consider only four sources of inflation in recession.⁷ I will

⁶ Berle & Means, *The Modern Corporation* (2d ed. 1967), at xxxii.

⁷ I would point out that even conventional theory recognizes that if all production were carried on under conditions of classical competition, a rise in price would occasionally occur

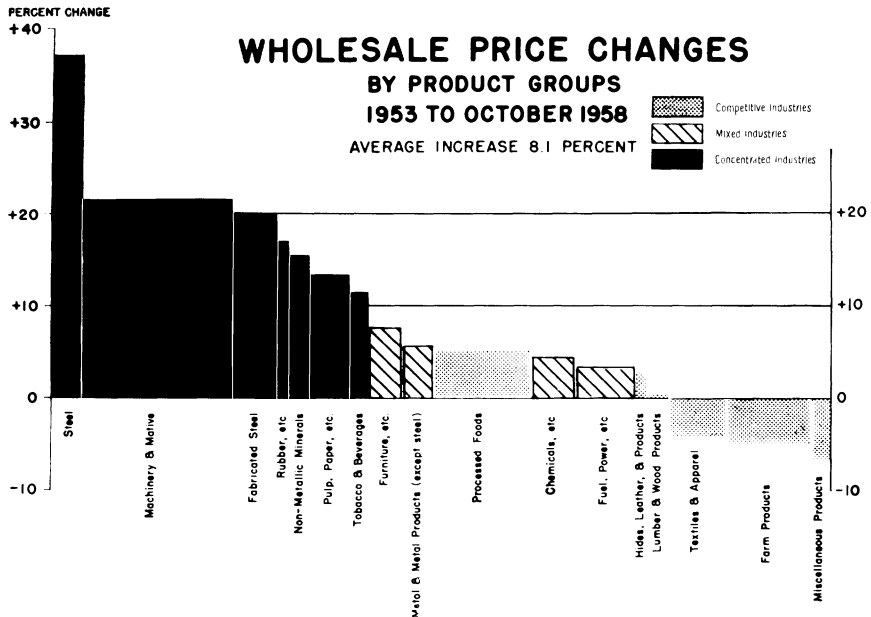


FIGURE 3.—Wholesale price changes by product groups, 1953–October 1958; average increase 8.1 percent. (Gardiner C. Means, *Administrative Inflation and Public Policy* [Washington, D.C.: Anderson Kramer Assoc., 1959], chart 4, p. 14.)

call them all cases of “perverse pricing” and limit them to cases in which a fall in demand leads a management to raise a price. They include (1) full-cost pricing, (2) the risk of entry, (3) arbitrary wage increases, and (4) the expectation of inflation.

Full-cost pricing takes various forms, most of which can produce perverse pricing. In principle, probably the most common is that in which a seller works with three basic concepts—variable cost, total fixed cost, and a total profit target—which are combined to give a target price.

Variable cost covers such input items as raw materials and operating labor, the quantity of which goes up or down with the quantity of output. So long as the prices of these input items remain constant, the variable cost per unit in the target price remains constant even when demand falls.

for specific products when demand falls so low that out-of-pocket costs per unit rise as the volume of output falls. This is usually disregarded in the general statement that under conditions of classical competition a fall in demand produces a fall in price. It will also be disregarded in the following analysis.

Fixed cost covers those items of cost—such as supervisory labor, depreciation, interest, and property taxes—that do not vary because of changes in current output and under the target-pricing formula are treated as constant in total but are spread over total output to give a fixed cost per unit to be included in price. This treatment means that under the target-pricing formula when demand falls the fixed cost per unit rises because the total fixed cost has to be spread over a smaller number of units.

The profit target included in price is also treated as if it were a fixed cost of doing business. It aims to provide a targeted return on equity capital invested in producing the product, and applies a total chosen rate of return on equity capital to arrive at a total profit target. This total, like the total of fixed costs, is then spread over the total expected output to give a target profit per unit to be included in price. Also, as in the case of fixed cost, a fall in demand means that, with a fixed stock of capital, the total profit target would have to be spread over a smaller volume of sales and require a larger profit per unit.

Where this target-pricing technique is strictly adhered to, the net effect of spreading the total fixed cost and the targeted return on capital over a smaller volume of sales can explain a rise in price when demand falls. In detail it can take various forms but, with one exception to be discussed later, it can explain why a firm using the method will price perversely. It also plays a part when a single producer modifies the price it sets in the light of an expectation of how its few competitors will react if it sets one price rather than another.

A second source of perverse pricing arises where competition is among a few and the risk of encouraging new entries to the industry is reduced by a fall in demand. If an industry is operating at 90 percent of capacity, there can be considerable risk that each producer's share in the coming market will be reduced by new entrants to the industry if target rates of return are set too high. But when only 70 percent of capacity is in use, this danger is much less and individual firms can risk aiming at a higher target rate of return on their equity capital.

The third possible source of perverse pricing is the arbitrary raising of wage rates. It is well recognized that increases in real productivity justify an increase in real wage rates. But there tends to be confusion over what is a legitimate wage increase in other circumstances, such as a rise in living costs. For example, the Kennedy guideposts were quite unfair to labor. They allowed for increases only in productivity and took no account of the legitimate rise in classically competitive prices in a period of recovery as demand expanded toward full employment. In those days a perfect recovery would bring classically competitive prices up into balance with inflexible prices and produce a rise in the cost of living, which

was legitimately passed on in higher wage rates. The net effect of this complex recovery would be a compound of increased real demand and a rise in the average of prices. To distinguish this legitimate price rise from "too much money chasing too few goods," it has often been referred to as "reflation": the Kennedy guideposts should have taken it into account.

In the presence of administrative inflation, the distinction between legitimate wage increases and excessive wage increases becomes much more complex, and here I will suggest only that I have seen little evidence that the wage increases of recent years have been more than a catching up in legitimate wage increases. The matter deserves more careful examination and my perception should not be given too much weight.

The fourth source of perverse pricing when there is "too little money chasing goods on well stocked shelves" is a widespread expectation of inflation. It bears little relation to the classical "flight from money." Rather, it grows out of the market power of firms that can exercise significant pricing discretion.

In the case of classical markets, an individual firm that expects inflation in the near future can speculate, first adding to demand in the market and then adding to supply in the market by the same quantity when it cashes in, thus canceling out its net effect for a period as a whole.

But in the case of administrative markets, the individual firm can react to an expectation of inflation by using its pricing discretion to raise its price directly with no offsetting inventory effect. Where competition is among a few and those few all expect general inflation, if one raises its price, it would be natural for others to follow. If government forecasts an inflation of say 5 percent, the likelihood increases. And to the extent that firms with significant pricing discretion give way to the expectation of inflation, this expectation becomes self-fulfilling.

There may well be other sources of perverse pricing, but those above are sufficient for present purposes. They raise two major questions: What is their relation to concentration? and, Why did the new type of inflation appear suddenly?

C. Perverse Pricing and the New Measure of Concentration

So long as the price level tended to fall in recession, the measure of concentration used by Berle and Means served well. It focused on nonfinancial corporate assets and showed nearly half of such assets controlled by the 200 largest corporations in 1929. But this included a significant number of corporations whose prices were regulated and were relatively inflexible. When the problem of measuring changing concentration involves *perverse* pricing, the appropriate measure should exclude

the government regulated prices. An appropriate measure of concentration under the new conditions would be the index of the assets of the 200 largest manufacturing corporations given by Professor Weiss in his Table I.⁸ There he shows the top 200 manufacturing corporations controlling 45.8 percent of all manufacturing corporation assets in 1929, and 59.9 percent in 1980. From 1974 to 1980, the concentration is shown as increasing from 57.6 to 59.9 percent, or significantly faster in percentage points than from 1929 to 1974. Clearly, the concentration has been continuing at a significant rate.

D. Structural Change and the Great Divide

Once one accepts the idea that structural change has been gradually increasing the relative role of perverse pricing, it is easy to see why the appearance of administrative inflation has been sudden. So long as the balance between the two types of competitive market favored classical competition, it meant that in recession more prices would go down than would go up, so that the price level as a whole would go down and the constructive program of monetary and fiscal measures already described could operate effectively. But once a critical point has been passed in this gradual structural change, the role of perverse pricing will have so greatly increased that more prices will go up than will go down and we will have the new type of inflation with the level of prices rising in recession.

This critical turning point is a new conception, and I will christen it the "Great Divide." It seems to have occurred without fanfare somewhere in the 1950s and it is well behind us now. Passing this Great Divide has presented us with the basic problem of eliminating the new type of inflation in a way consistent with the free market system and the optimum use of resources.

E. The Double Dilemma

Once the Great Divide has been passed, we are in unknown territory and are faced with two major dilemmas. First, the monetary and fiscal measures that can be used to control aggregate demand when the economy is on the good side of the Great Divide cannot control the new kind of inflation; and second, the expectation of inflation tends to become self-fulfilling when the economy is on the wrong side of the Divide.

The impotency of monetary and fiscal measures in the new circumstances is beginning to be recognized even by laymen. For example, a tight money policy that limits demand in the hope of controlling inflation

⁸ Leonard W. Weiss, *The Extent and Effects of Aggregate Concentration*, in this issue.

can be expected not only to increase idle machines and workers but also raise prices. And an expansion in the money stock to stimulate demand will also stimulate both inflation and the self-fulfilling expectation of inflation.

As I see it, the basic source of this double dilemma is not perverse pricing as such but only the fact that structural change has carried the number of prices set perversely beyond the critical point. The big problem is to bring our economy back to the good side of the Divide so that monetary and fiscal measures can again become effective and perform the function of the classical flexible price corrective.

In theory there are various ways by which this could be done. If enough big companies were pulverized, the amount of perverse pricing could be reduced to the necessary extent, but this would mean a great decline in efficiency. If enough prices were regulated by government, perverse pricing could be limited to the necessary extent, but this would displace the efficiency of the free market system.

A third possibility is to get a sufficient number of big corporations to change their methods of pricing. I think this is the most promising to explore.

F. Toward a Free Market Solution

Ever since I recognized the significance of administration inflation I have spent a great deal of time trying to find a way of eliminating it that would be consistent with the free market system and would not require the breakup of big business.

Then, quite recently, I found a conceptual solution by bringing together a basic concept underlying Adam Smith's optimum use of resources and a special form of target pricing used by several large corporations before the expectation of inflation became general.

Adam Smith drew a sharp distinction between the two concepts "market price" and "natural price." In the short run, equating current supply and current demand would clear the current market, but only by chance would it provide prices that result in optimum use of resources. In the longer run, shifts in market prices would occur which would stimulate an expansion in capacity and production in some directions and reduce them in other directions, so that in addition to equating current supply and demand, market prices would tend to direct resources into optimum uses. Prices that succeeded in performing both functions he called natural, and this strong tendency to optimum use of resources was the crowning feature of his free market system, governed by competition among the many.

The special form of target pricing uses a long-run formula rather than

the customary short-run procedure that leads to perverse pricing. This formula starts with figures for variable cost, fixed costs, and a total target profit as in short-run target pricing. But instead of dividing the figures for fixed cost and target profit by the current volume of production, it uses a long-run figure based on the average use of capacity over a period of years. The resulting price tends to approximate Adam Smith's natural price and thus eliminate a major source of perverse pricing when demand falls. If enough firms currently pricing on the basis of short-run techniques shifted to a long-run pricing technique, the economy would be returned to the good side of the Great Divide and monetary measures could again be effective. This long-run target pricing technique deserves to be explored as a possible way to eliminate administrative inflation.

G. Factors Favoring the Needed Shift in Pricing Behavior

At first glance it might be thought that such a shift in the use of market power would be difficult to bring about without regulation. But there are conditions now existing which would facilitate such a shift, once the need for the shift is accepted. These conditions will be discussed under the following heads: (1) The Relative Newness of Administrative Inflation, (2) Corporate Experience with Long-Run Pricing, (3) The Self-Interest of Big Business, (4) Corporate Power and Corporate Responsibility, and (5) Flexible Foreign Exchange Rates.

1. *The Relative Newness of Administrative Inflation.* Because of the slowness of the progressive change in the structure of the free market that has made administrative inflation possible, and because the Great Divide was passed only thirty years ago, it is unlikely that, in the present structure, the overbalance of prices in recession will be very great. This suggests that if a few hundred big companies now pricing for short-run profits were to shift to long-run pricing, this might be sufficient to eliminate administrative inflation without interfering with the freedom of business action. This does not seem at all an impossible goal.

2. *Corporate Experience with Long-Run Pricing.* A second reason for thinking that the task is not too difficult is that before the expectation of inflation became general a number of big corporations had successful experience with long-run pricing. The pioneer in long-run target pricing appears to be Du Pont. It adopted 80 percent of capacity as its standard rate of operation and a 20 percent return on its stockholders' equity capital as its profit target. Then, for each type of product, it divided its fixed cost and targeted profit for that product by 80 percent of capacity in arriving at its full-cost price. But U.S. Steel has an even longer record of what it calls its "public utility approach" to pricing, using 8 percent

return on equity capital as its target. A special tabulation by the Federal Trade Commission (FTC) gives the actual profit experiences of these two industrial leaders and three others that also used long-run pricing techniques in the years 1953–68. The results for the whole fifteen-year period are given in Table 1, which shows the rates of return on stockholder's equity after deducting taxes.

As can be seen from the table, in these five cases the long-run profit targets were fairly closely approximated, while the rate of profits in individual years varied greatly. Because in each case both fixed costs and total profit targets were divided by the standard rate of operation, not by the current rate, total profits varied more than they would have with short-run pricing, while perverse pricing was greatly reduced or eliminated. The profit targets aimed at differ because of the variation in the role of borrowed capital, the competitive position of the corporation, and accounting methods.

3. *The Self-Interest of Big Business.* Where firms have a choice between pricing for short-run profits and pricing for long-run profits, the dictates of self-interest are peculiar. The conditions of the free market do not point to either alternative as clearly more or less profitable. But if the preceding analysis is accepted, it would clearly be in the interest of most firms to have enough other firms price for long-run profits to shift the balance to the favorable side.

4. *Corporate Power and Corporate Responsibility.* A fourth factor is that the increase in the power to choose between short-run and long-run pricing is largely a product of the corporate revolution. In the absence of the power to act as a corporation, it is doubtful that the Great Divide would have been passed. Yet the power to act as a "legal person" comes from government. When Keynes denigrates the long run by saying "In the long-run, we are all dead," he is obviously not speaking of the corporation. It can live as long as the state and should be expected to carry responsibilities which are beyond those required of actual persons. A public attitude toward the use of pricing power could be expected to induce some voluntary shifts from short- to long-run pricing once the importance is understood.

5. *Flexible Exchange Rates.* A fifth factor is the existence of flexible exchange rates between the dollar and the money units of other countries. If the United States and its major trading partners were still on the traditional gold standard, administrative inflation arising abroad would tend to be transmitted to this country.

In the presence of these favorable conditions it seems not impossible to find ways to return to the favorable side of the Great Divide.

TABLE 1
RESULTS OF LONG-RUN TARGET PRICING, 1953-68 (%)

Profit Rate	Du Pont	U.S. Steel	General Motors	Alcoa	Standard Oil of New Jersey
Targeted rate	20.0	8.0	20.0	10.0	12.0
Average actual	22.2	8.4	20.2	9.5	12.6
Maximum year	34.1	14.8	30.5	18.7	16.6
Minimum year	13.3	4.9	12.6	4.5	9.4

SOURCE.—John Blair, *Economic Concentration* 487 (1972).

H. A Challenging Precedent

I am encouraged to think that the necessary change in business practices can be worked out as I recall the success of business leadership in altering the outlook of business at the close of World War II. At that time there was widespread expectation of a big recession similar to those following other wars. Faced with this problem, a group of progressive business leaders formed the Committee for Economic Development (CED) to consider this threat. Their sampling showed an enormous gap between prospective employment one year after the end of the war and the peacetime labor force, unless a radical change in business attitudes was brought about. To effect such a shift, the CED persuaded the Department of Commerce to make estimates, industry by industry, of the real production that would result if real demand were at the level that would give full employment. These estimates were then published as *Markets after the War* and were very widely distributed.⁹ Then CED representatives visited key industrialists to persuade them to be prepared for a much larger demand than they had envisaged. Largely as a result of the shift in business attitudes thus brought about, business was ready to expand its peacetime capacity. The nation avoided a recession.

In the present situation, the needed shift in business attitudes is more complex but could be facilitated by the preparation of current estimates of "markets at full employment" and a similar drive on the part of progressive business leaders to persuade enough enterprises to adopt long-run behavior that will not contribute to the new type of inflation and will not perpetuate the self-fulfilling expectation of inflation.

The estimates of markets at full employment would be stated in real terms and to be most effective would need to be supplemented by a set of guidelines to distinguish between price and wage behavior that would generate inflation and that would not.

This is my present perception of the problems raised in our 1932 book. I must reiterate our conclusions that: "Competition has changed in character and the principles applicable to present conditions are radically different from those which apply when the dominant competing units are smaller and more numerous"; and that "New concepts must be forged and a new picture of economic relationships created."

These words ring as urgently today as they did fifty years ago.

⁹ U.S. Department of Commerce, *Markets after the War* (1944).