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The Corporation as a Command Economy

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Introduction

Most of us spend more than one-third of our waking lives working for large, modern corporations: organizations where we do not know personally either those at the top or the bulk of those at the bottom of the organization's administrative hierarchy. This is a striking change from two centuries ago, when a productive organization of more than thirty was unusual, and one of more than three hundred an extreme oddity.

Why do so many of us work for large modern corporations? And what impact does working for large modern corporations have on our lives? The second is much too broad a question, and is moreover a question that I--a narrow-minded professional economist--feel unqualified to address. So I am going to focus on the economic side of the modern corporation. I am not going discuss the political or sociological or ethical implications of large modern corporations. I am not going to discuss their historical development, or the contrasts between different countries' styles of corporate life.

I am going to focus on the issues of *corporate control.* A corporation is a hierarchical organization. It has a boss--today the he (almost always a he) called the CEO, whose theoretical power is autocratic throughout the scope of the corporation, and subject only to the periodic continued approval of the Board of Directors and the annual meeting of the shareholders. But we were all told a decade ago, when the Soviet Union collapsed, that hierarchical organizations simply did not work as modes of organizing economic life--that you needed a market in order to achieve anything better than low-productivity, bureaucracy-ridden economic stagnation.

What, then, are all these large corporations--ATT and IBM, General Motors and Toyota, Microsoft and USX--doing? What methods of corporate control have saved them from turning into smaller versions of the unproductive Soviet economy?

That our economy is populated by large corporations shapes how we live. Our social being cannot but be shaped by the one-third of our waking lives spent at work. Our politics would be very different without corporations both as sources of pressure an influence on politicians and as intermediaries serving the purposes of politicians.

It should not be surprising that the continued existence and, indeed, economic dominance of large corporations is due to a number of different forces. Very, very few things in this world have a single cause. The corporation flourishes because it is useful to (and thus favored by) the government, because we have a set of institutions to govern corporations that greatly limit the power of the forces that destroyed the Soviet planned economy, because our technology requires increasingly fine coordination of different aspects of the production process, and because our corporations are embedded in a market economy that imposes a substantial amount of competitive pressure on corporations. Even small lapses relative to its competitors in a corporation's efficiency as a productive organization can destroy the corporation as a profit-making organization--and corporations that are not profit-making organizations do not survive.

The balance among these four factors is next to impossible to assess. But all are strong and growing stronger. The past two centuries have seen the growth of the modern corporation from next to nothing to its present size and strength. There are no signs that the next century will see the modern corporation as an insitution shrink.

A Market Economy?

Our economy is a market economy: on that everyone agrees. What economists call the "price mechanism" controls the allocation of labor, the production of goods and services, and the distribution of commodities. Wherever demand is higher than supply for some particular product prices fall, and some of those making or supplying it head off for other lines of business; whenever supply is higher than demand prices rise, and new producers and sellers enter the market.

To have a market economy is by and large a good thing: the price mechanism acts as a gigantic social calculating machine to organize our economy and to direct the division of labor and the allocation of production: an invisible hand, as it were (Smith, 1776; p. 423).

It is a commonplace that any society that aspires to be even a half-good society must allocate labor to different branches of industry and organize production through the market system: there is no other realistic option. The collapse of the Soviet Union was the result not of its moral or political failures (although those were great) but of its economic failures: the inability of its Communist Party-run centrally-planned and heavily-industrialized economy to deliver even the standard of living of Mexico or Malaysia. Levels of labor productivity east of the Iron Curtain were less than a quarter and probably only a tenth those of similarly-situated neighboring countries lucky enough to avoid Communist rule.

Thus Communism's collapse has brought about near-universal agreement that the central planning-oriented alternative to the market economy was simply unworkable (for anything other than mobilization for a relatively short war) (Ericson, 1991). If history is--as Marx and Engels (1848) believed--about struggles over systems of economic arrangements, then we have indeed reached at least a temporary end of history (Fukuyama, 1992).

But do we really live in a market economy? When we look at the pattern of economic transactions in our modern market economy, the striking thing is how large a proportion of transactions do *not* pass through anything like a market.

In any given year more than three out of every four workers do not go on the labor market: they keep working for the same organization that they had worked for the prevous year, doing much the same thing, at much the same wage. When they do change jobs, they are at least as likely to change jobs within the same organization as to get bid away by another offering them a higher wage (or fired by the first as not worth their pay).

Within the production side of the economy the overwhelming proportion of movements of goods and the provision of services takes place within a single corporation: one branch or division providing something of value to another branch or division, with no money changing hands. Microsoft's application developers do not sell their products to its marketing division. Different branches do not bid for and buy the daily services of the corporation's top managers. Within each of the corporations in our economy there exists not the spontaneous division of labor produced in an unplanned fashion by the invisible hand of the market, but a *planned* and organized division of labor.

To get an idea of the size of the segments of economic activity not planned and coordinated by the market system but guided and directed by the managerial hierarchies of modern corporations, consider General Motors. General Motors is still the largest American industrial corporation. It has 710,000 employees. It has total annual sales of some $169 billion: more than one half of one percent of the total world's economic product. The recorded net value of its plant and equipment is some $220 billion. And its total profits in a good year (like this on) exceed $7 billion a year. Only nineteen nations in the world today have an gross domestic product larger than GM's total sales.

Considered as an economic unit, the piece of the world's economy strucured and coordinated by General Motors is roughly one-third the size of Canada.

General Motors is one of the biggest of a large extended family of mammoth modern corporations. Go down *Fortune* magazine's "Global 500" list. The last U.S.-headquartered corporation on the list is ITT Industries--formerly International Telephone and Telegraph. It is perhaps one-twentieth the size of General Motors. But its annual sales are some $9 billion, and it employs some 30,000 people. The total annual sales of the world's 500 largest corporations are some $11.4 trillion--compared to roughly $8 trillion for the annual Gross Domestic Product of the United States.

There is a sense in which these large modern corporations do indeed live in the market economy: the prices at which they buy materials and sell goods are to a large degree those that balance supply against demand. They are set to match the marginal resource cost of the last unit of any commodity produced to the utilitarian benefit to its consumer. And when large corporations negotiate with one another, the terms and conditions they agree on are reached in the context of the threat to break off negotiations and buy what is needed on the open market if the trading partner does not provide a good enough deal. The transactions by which a corporation buys materials and supplies from and sells products to the outside world are "market" transactions (Williamson, 1981).

But there is a strong sense in which *we* do not live completely in this market economy. As consumers we do. But as producers and employees may of us live in an economy that is better thought of as a *corporate* economy: an economy in which patterns of economic activity are organized by the hands of bosses and managers, rather than a one in which the pattern of activity emerges unplanned by any other than the market's invisible hand.

It has long been obvious that *management* and the planned divisons of labor within the enterprise for it to manage play an important role in what are called market economies. We can see management at work even in Adam Smith's (1776) *Wealth of Nations,* which has for more than two centuries provided intellectual foundations for the market economy. Adam Smith begins his book by extolling the benefits of a finely-divided and highly-productive division of labor. And the example of a high-productivity division of labor that Adam Smith gives is of a pin-making factory, in which:

> one man draws out the wire, another straightens it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head; to make the head requires two or three distinct operations; to put it on, is a peculiar business, to whiten the pins is another;

> it is even a trade by itself to put them into the paper; and the important business of making a pin is, in this manner, divided into about eighteen distinct occupations...

And one boss hires the workers, sets them their tasks, designs the workflow, and watches over all. The productivity benefits of the division of labor are there, but they are there because the owner of the pin factory *planned* them.

In Adam Smith's day it was a large enterprise that employed more than 200 people. Today General Motors employs 700,000. The past two centuries have seen a more than thousand-fold multiplication of the power of what Alfred Chandler (1977) called *The Visible Hand* of corporate management as the planner, director, and organizer of the pieces of the economy.

Productive Efficiency

It is natural to look at the fall of the Soviet economy alongside the continuing flourishing of mammoth corporations and to be puzzled. Just what is going on here?. General Motors' total sales amount to forty percent of Russia's total national product: roughly all of the civilian economy in the 1980s. Didn't the fall of Communism prove that central planning simply does not work as a way of organizing economic activity? Yet isn't the internal division of labor within General Motors (or Adam Smith's pin factory) a *planned* division of labor. Doesn't the internal economic organization of General Motors look a lot like the internal economic organization of the Soviet Union? So how does General Motors survive and make $7 billion in annual profits? How can the organization of large pieces of the economy through *management* be a success when their organization through *planning* is such a failure?

So how is it that our modern, large corporations are efficient production and distribution organizations? What mechanisms keep them from the fate of ever-rising bureaucracy, ever-increasing inefficiency, and technological stagnation that overcame the Soviet Union? This is the problem of *corporate control*. And people have proposed four answers: they have appealed to industrial evolution; to economies of coordination; to the success of the mechanisms of corporate governance; and to the government's desire to support the modern corporation as an intermediary that it can use for its own purposes.

Industrial Evolution

Almost forty years ago Ronald Coase (1960) gave an answer to those who wondered how it could be that our economy with its large corporations was still relatively efficient at organizing production: he appealed to economic evolution--that through evolutionary processes the market economy would generate efficient productive organizations, and so the large corporations that had been produced by the market economy were efficient.

Suppose a firm was too small to be an efficient producer in its line of business. Then, Coase argued, it would go out of business: either it would be so inefficient as to keep losing money, and so go bankrupt, or sooner or later some financier would scent the profits to be earned by merging it into a larger firm that could realize the economies of efficient scale (see Alchian and Demsetz, 1972).

Suppose, on the other hand, that a firm was too large to be an efficient producer in its line of business. It would tend to shrink: its low profits (or losses) would make it difficult for it to find funds to keep its capital from depreciating. Some financier might scent the profits to be earned by breaking it up into smaller, more nimble competitive pieces. Thus Coase argued that a market economy that (like ours) contains large corporations must contain *efficient* large corporations: otherwise they would have been eliminated by the market's competitive forces long ago.

From one perspective this is dangerously close to a tautology, like the mythical biologist who claimed that the population of a species grew because of its evolutionary fitness, and that the thing that proved that the species was evolutionarily fit was that its population grew. Coase essentially tells us that thosee large corporations that have survived in our economy have largely escaped the process of bureaucratization and ossification that doomed the Soviet economy.

But we knew that already: we wanted to know *why*.

From a second perspective, however, the evolutionary argument does give a piece of the answer. In the Soviet Union nothing bad happened to an inefficient industry, or an unproductive factory. Perhaps there were episodes of blame-pointing, plans for reform, and turnover of selected managers, but the organization's deficit would be covered by the central government and people would continue to go to work.

By contrast, in our economy very bad things threaten to happen to large corporations. In the automobile industry both Chrysler and General Motors approached the edge of destruction in the late 1970s and early 1980s, respectively. Apple Computer is now unlikely to survive its current crisis.

One in ten of Fortune's 500 largest non-financial corporations lost money last year: after they had sold their products, there was not enough for them to pay their suppliers and workers, and so they had to dip into their capital. The discipline that market competition exercises over corporation actions appears to be fierce and severe from inside all but the luckiest corporations. Every manager is aware that a series of lapses that has only a small damaging impact on a corporation considered as a productive organization will nevertheless have a large damaging impact on the corporation considered as a profit making organization.

Shareholders and financiers have little patience with businesses that do not make profits: better to take their resources and turn them over to a corporation and a managerial organization that can make a profit. So corporations that are unable to make profits do not survive. They rarely go through formal bankruptcy and liquidation, but they often go through informal bankruptcy and partial liquidation. They are almost always swallowed up by other corporations, with much of their productive resources shut down and abandoned and the rest added onto a different organization

In any set of organizations some will be good and some will by lousy. In the Soviet economy getting rid of a lousy productive organization was a very big deal, requiring a mammoth political fight and the making of many enemies for the future, so there was little tendency for the sun to set on factories and industries that were not doing well. This is the core of truth in the "industrial evolution" argument: a properly functioning market economy enforces "sunset" on unproductive corporations. Moreover, the threat that five unprofitable years mean the disappearance of the corporation raises the goal of increasing productivity to a priority much higher than in the Soviet Union.

Economies of Coordination

A second answer to the question of what keeps modern American corporations under control--what keeps them from succumbing to the death spiral of bureaucratization and inefficiency seen in the former Soviet Union--is to appeal to economies of scale and of coördination. There are times and places in which the market is a better social calculating mechanism for directing the division of labor than a bureaucratic hierarchy; and there are times and places when a planned division of labor is better. Our corporate economy allows large hierarchical organizations to fill those niches in which planning is appropriate, and is thus preferable to alternatives that either leave no role for the market or no role for large organizations.

Economists believe that a a centrally-planned and administratively-allocated organization of production is likely to be most efficient when the costs of failing to produce the exact right amount of a commodity are high (Weitzman, 1974). If you have made twenty-two V-8 engines, you had better have ordered twenty steering wheels from your supplier. If when you go to the market you find that you can buy only twenty steering wheels, your production of the twenty-first and twenty-second V-8 engines was a waste of effort.

Thus the large corporation has its place wherever the waste from failing to *exactly* coordinate the quantities produced is relatively large. It may not be necessary to have such exact coordination. In much of the economy substitutes for a good are common, alternatives are available, and efficiency is best pursued by trying to match the value of the last unit of the product produced to its cost in terms of resources. But whenever the cost of producing one too few is large, and the value of the one too many that is produced is zero, then administrative coordination of production is very valuable indeed.

Corporate Governance

The third answer is that modern corporations are efficient because they are by and large well-governed: the mechanisms that are supposed to keep corporations focused on reducing costs and improving quality so as to make profits by and large work. These mechanisms of *corporate governance* are a peculiar combination of formal, legal duties and processes with less formal modes of operation in the financial markets.

The Legal Structure

Begin with the law. In law, the Chief Executive Officer--the CEO--of a corporation is not its boss. The CEO is, himself (and in large corporations it is almost always a himself), simply another somewhat special employee of a corporation. In law the real corporation is made up of the stockholders: they are the "body," the "corpus." They have assembled, committed their money to entering this joint business together (or bought stock from those who committed their money to this joint business), and hired employees to conduct the details of the business while the shareholders attend to the reast of their affairs.

Once a year at the corporation's annual meeting its members--the shareholders--gather (or send in their proxies). They review the progress of the business. They periodically choose through election (one share-one vote) the principal employees to manage the business: the CEO and a few more. They also choose a Board of Directors to meet periodically to watch over how the business is conducted, to consult with and review the decisions of the CEO, and to exercise some of the shareholders' collective powers of ownership until the next annual meeting.

Subject to the power of the stockholders and the Board of Directors to remove him, the CEO of a corporation has extremely broad discretion. The corporation has suppliers, workers, executives and customers. It has informal agreements with them about how business will be conducted. It has contracts with them, which are the corporation's formal promises of what it is going to do and how it is going to do it. If the corporation breaks its contracts, it will have to settle with the aggrieved party on pain of being dragged through the courts.

But the CEO is the boss. He can break the corporation's contractual obligations when he feels it appropriate. And where explicit contracts do not tie his hands the short-run power of the CEO is nearly absolute. Workers and managers are employed at will: except as restrained by labor-management agreements, the CEO and those to whom he delegates his power can fire workers on whim, for no reason at all. Except as guaranteed by explicit contract, the claims of suppliers who have dealt with the corporation for decades are only as strong as the CEO wishes. Long-time customers have no right to the continued availability of the goods they are accustomed to buy if the CEO thinks things should be otherwise.

Thus the legal structure of a modern corporation grants the CEO (and those to whom he delegates managerial authority) extraordinary autocratic power. This power is confined to the economic sphere: they decide who has a job with the corporation and who does not, and what the corporation makes and what it does not. But within the economic sphere modern tools of administration and communication make their power look stronger than that of the most absolute monarchs. This power is checked and governed by the fact that the CEO is, ultimately, simply another employee of the corporation. The owners are the shareholders (usually working through their representatives, the members of the Board of Directors), who exercise their control through one-share one-vote majority-rule democracy.

Theory and Practice

However, there is in this case a larger than usual gap between the legal theory and actual business practice (see Allen, 1992).

First, it is next to impossible for shareholders to spontaneously rise up at the annual meeting as one and to dismiss the CEO. A typical company will have at least as many shareholders as employees once you take account of the ultimate ownership interests of those who have their money in mutual or pension funds that own shares of hte corporation. This diversity of ownership helps to limit risk: widespread diversification is *the* way to make investment portfolios safer, and thus better for the investor. But such widespread diversification makes collective action by shareholders through the legal mechanisms of "shareholder democracy" very difficult.

Exercise of shareholders' formal powers of ownership through votes at the annual meeting is overwhelmingly difficult because very few of the shareholders have a significant stake at risk in any one particular corporation. It is hard to become an informed voter: it takes a lot of time and thought to sift and evaluate alternative proposals for the future direction of the corporation. Few of us are satisfied with the turnout and the level of engagement of America's voters in political elections. And in politics all of the emotional resonance of patriotism is deployed on the side of becoming an informed voter, going to the polls, and casting one's ballot. Things are infinitely worse in corporate elections, where voting is not a duty of a good citizen and where information about the costs and benefits of alternative leaders and courses of action is difficult to assemble.

So when you look at turnout in corporate elections, it is low. Most of those who bother to vote have simply sent in their proxies authorizing whatever course of action was proposed by the CEO. Thus many of the members of Boards of Directors are in practice be candidates proposed by the CEO--people who know that they owe him a favor for getting them this particular well-paid part-time job. Organizing a shareholder democracy campaign--a proxy fight--against the existing management is expensive and unlikely to succeed.

Adolph Berle and Gardiner Means (1932) pointed out nearly two-thirds of a century ago that shareholder democracy simply did not work: that political democracy is a so-so mechanism for exercising political control, and that corporate shareholder democracy worked considerably less well because of the absence of the emotional force of patriotism. Their *Modern Corporation and Private Property* argued that the top managers of modern corporations had become "entrenched": they made up a self-reproducing oligarchy that could choose its own successors, could not be dislodged from control, and administer the corporation in their own interest--not in the interest of shareholder profitability or economic efficiency.

In the past generation it has become more and more clear that Berle and Means overstated their case. They were correct in claiming that shareholder democracy did not work in practice as the formal legal doctrines envisioned. But they were wrong in claiming that the self-reproducing oligarchy of top managers had become so entrenched as to have effectively turned the corporation into their own property.

So what are the--alternative--mechanisms that control corporations' CEOs in practice?

The first and most important such mechanism is peer pressure. It is not much fun to be CEO of a money-losing corporation. A higher salary or more perquisites of office does not repair the psychic injury: there is a point beyond which a higher salary is valued not because of the things it can buy but because it announces that you are a winner, but no one thinks that the highly-paid CEO of a money-losing corporation is a winner. Because success in the games CEOs play with and among themselves is defined by a large positive bottom line, they would continue to chase economic efficiency and cost reduction even if they were a completely insulated self-reproducing oligarchy.

Voting-with-the-Feet and Corporate Takeovers

The second such mechanism is that shareholder democracy has a small amount of life in it. Although it is next to impossible to organize tens of thousands of small shareholders into a majority coalition to unseat the existing managers, it is very possible for one--very large--shareholder who owns a majority of shares to use the formal procedures of corporate governance to replace the managers.

When will such a single majority shareholder appear? When the price of the stock is cheap enough to make the profits from such a corporate takeover worth the risk. Thus the votes of individual shareholders matter, but the votes that matter are not ballots cast for an annual meeting but instead the votes-with-the-feet made when shareholders exit the corporation: when they lose confidence, sell their shares, and push down the corporation's stock price (see Hirschman, 1970).

Thus when individual shareholders lose confidence in a corporation's management, they sell their shares. And at some point the price drops low enough that a group of financiers who think they can do a better job buy up shares, and offer to buy up more until the achieve a majority and take control of the corporation. This market for corporate control works, and works well enough to terrify the managers of America's corporations. Today you are more likely to hear--especially from CEO's--that top managers too little discretion to invest in long-term projects good for the corporation as an on-going entity, and that our system forces top managers to pay more attention than is healthy to shareholder views and desires.

It is still not completely clear what the wave of corporate takeovers that America has seen in the past two decades actually did to the economy. (I) Some argue that it was largely a device for merging competitors with one another, and that the profits earned through the takeover boom were either the benefits of realizing growing economies of scale or achieving greater monopoly power (see Bhagat, Shleifer, and Vishny, 1990). (II) Others see it as little more than a wave of financial manipulation to (successfully) reduce corporations' income tax bills (see Blair, 1995). (III) Still others see the takeover boom's replacement of one group of managers by another as a way to break a corporation's implicit and explicit promises on salary levels and operating procedures to its workers and suppliers (see Shleifer and Summers, 1989). (IV) And others see the wave of takeovers and threatened takeovers as a genuine improvement in the way in which the market system disciplines executives who take their eyes off of the bottom line (see Jensen, 1989).

The most judicious (and probably the most correct) view is that of Steven Kaplan and Jeremy Stein (1993), who see (IV) as the most important element in the takeover battles of the early 1980s, and increasing elements of the other three--along with simple speculative excess caused by Wall Street's herd mentality leading it into deals that did not make financial sense--as the decade of the 1980s drew to its close.

Fifteen years ago it was fashionable to hold up the Japanese corporation as an example, to say that its managers regarded shareholders as only one stakeholder interest among many, and to say that the Japanese corporation was a superior organization and the wave of the future. Now it is fashionable to praise the American form of organization, with an active market for corporate control and with strong pressure on managers to do whatever they can to boost stock prices now. If there is anything certain, it is that fifteen years hence some other organizational twist on the corporate form will be fashionable in its place, and discussion will focus around the flaws of existing American (as well as Japanese) institutions of practical corporate governance.

But in the meanwhile it is important to recognize that CEOs--for all their near-autocratic power to fire workers by the tens of thousands, close lines of business, and shift the strategic direction of their corporations--see themselves as tightly constrained, and with surprisingly little freedom to act otherwise. What looks to us like near-absolute and near-untrammelled power looks to them like tight discipline enforced not just from the market for corporate control--the takeover game--but from other markets as well.

For most workers in most years (and for nearly all customers, and for most suppliers), there is another corporation that they could work for, buy from, or sell to located just down the street. Labor unions are weaker now than they have been at any time in the past sixty years. Nevertheless a modern corporation must treat its workers at least as well as their perceived alternative employment, or they will walk. A company that is contracting has some but limited power to demand that its employees accept lower wages and harder working conditions. A company that is expanding must pay prevailing market or above market wages, or it simply will not expand.

Moreover the fact that a CEO can command does not mean that other employees will obey. Instructions can be given, but they need to be obeyed enthusiastically by others for them to mean anything. CEOs have tools to win the enthusiasm of their subordinates: the rhetoric of shared accomplishment of action and vision; the carrots of promotions, salary increases, and bonuses; the sticks of demotion and dismissal. But even with these tools, managing a large bureaucratic organization is a difficult task. And changing its direction away from that of mere business-as-usual requires great skill and luck.

The Government and the Corporation

Still a fourth reason for the flourishing of the modern corporation is that the government finds the large corporation very valuable. Thus all kinds of benefits--from the limited exposure to liability of those who commit their equity capital to the corporation, to the fact that corporations that pay their employees in the coin of social insurance benefits do so tax-free, to the fact that corporations realize economies of scale in dealing with the government and its paperwork (whether the IRS or the FDA)--give the modern large corporation a government-sponsored competitive edge.

The corporation in America is valuable to the government because it can be called upon to do more than its own private purely economic tasks. From the perspective of the modern government, the corporation is the government's principal tax collector. The corporation collects the government's income and sales taxes for it. Withholding for income taxes and point-of-sale collection for sales taxes make the paying of taxes largely automatic. The government would have an infinitely more difficult time collecting anything if it had to deal with each individual for his or her entire tax bill either for income or for sales taxes.

Indeed, there is no one that the Internal Revenue Service fears more than the independent contractor: the person who does not work for a corporation, and with whom the government *must* deal directly in order to collect taxes. So the IRS tries as hard as it can to force independent contractors into being someone's employees. It desperately wants collecting, withholding, and monitoring compliance with the tax law can be their employers' job--and not the IRS's.

The corporation provides an increasingly large share of social insurance benefits--largely at the government's behest. Large majorities of Americans and their politicians believe--at least after the end of political advertising campaigns--that American citizens ought to have social insurance services and benefits: health insurance, dental insurance, pension benefits, and so forth. But large majorities of Americans and politicians also fear--at least after the end of political advertising campaigns--big government: for most politicians, proposing to socialize medicine or proposing large increases in social security taxes is a quick ticket out of one's office in the Capitol or the White House and into a better-paying but much lower-status job arguing that oil companies are overtaxed or that Bengalis are selling an unhealthily large amount of textiles to U.S. customers.

So how can politicians and voters both have big government-like social insurance programs without having big government? By inducing or ordering corporations to provide them. Pensions? The government promises to reduce the total taxes paid by corporations and by workers by roughly thirty-three cents for every dollar that corporations and workers shift out of current wages and into invested funds to provide post-retirement benefits. Health? The government offers the same deal: if corporations and workers will shift two dollars out of current wages and into purchasing health insurance for the workers' families, the government will contribute a third dollar by reducing the total taxes paid.

It is no surprise that corporations have responded. Even the paperwork they must fill out to deal with the government is not a heavy burden for a large corporation, for the paperwork is highly repititious. So more than eight out of ten of those with health insurance who are not covered by the government's Medicare and Medicaid programs receive their insurance through their employers.

Thus our modern social insurance state is to a large degree a *corporate* social insurance state: the corporation is the intermediary that delivers the benefits that the government believes citizens ought to have to its employees. Such a corporate social insurance state does not work very well. What good is employer-sponsored health insurance if you have no employer? What if your employer is a small corporation, and does not take the bait the government has set because the tax subsidy the government offers insufficient to cover the administrative burden of becoming the government's local social insurance agent?

Conclusion

In the past century and a half large corporations--business organizations in which those at the top do not personally know those at the bottom of the hierarchy at all--have grown from exceptional oddities into extremely visible and widespread economic institutions. How have corporations managed to grow and survive in view of the obvious economic inefficiencies of bureaucratic and hierarchical organizations--inefficiencies of which we are now very conscious because of the fall of the Soviet Union? People have proposed four answers: they grow because those that are inefficient died and disappeared; they grow because the increasing complexity of technology has created more and more places where the benefits of planned coordination outweigh the inflexibilities of bureaucratic hierarchy; they grow because over the past century and a half we have hit on modes of corporate organization that are actually quite good at providing pressures for cost reduction and efficient production; and they grow because the government needs them--could not function without using them as intermediaries--and so rewards large corporations and punishes other forms of organization in subtle ways.

All four of these are surely somewhat correct. Deciding how important each is is next to impossible. We cannot rerun history with different forms of financial and legal organization to see how much of the growth in corporations is the result of improved forms of organization, or with different technologies that provide different economies of coordination.

We can, however, note that all of the pressures continue to be on the side of an expanded role for the large corporation. The social insurance state will continue to need the corporation as an intermediary. The evolution of financial and commodity markets is in the direction of increased market discipline and international competition. Technologies grow more sophisticated and complex. Individual corporations will grow and shrink. The very, very largest may turn out to have positive or negative synergies and increase or decrease their own shares. But the modern corporation will be here for a long time to come.

And the presence of the modern corporation will affect how we live along many dimensions, for the corporation is not *just* a private economic entity. Consider the corporation as collector of taxes and dispenser of benefits. It is hard to imagine our modern government without the corporation as its agent. Before the rise of the corporation governments would strain their tax-collecting capacities to the breaking point to lay their hands on even fifteen percent of national income through excise taxes, real estate taxes, window taxes, luxury taxes, and trade taxes. Today industrial country governments collect up to three times as much without producing clear and visible reductions in rates of economic growth.

Or consider the corporation as a sociological entity: a place where you see your friends, engage in your status games, and first learn and then express your culture: what it is that your kind of people like to do. Your workplace is more than a third of your waking life. To lose or to change one's job is an event of much more importance than deciding to go to a different grocery store because you like its loss leaders.

Economists want to treat the two as the same: a change of where you sell your labor analogous to a change of where you buy your groceries. Sociologists point out that when you change your grocery store you do not change a large part of your circle of friends (and enemies) as well. But they have done little more than note a potentially unhealthy tension between an employment relationship that on the individual's side becomes invested with a large share of the individual's identity and that on the corporation's side remains a matter of the bottom line.

The modern corporation has drifted far indeed from its origins, when it was a way for the king to create a collective identity for merchants and their towns--those who were neither lord, knight, peasant, priest, or monk--so that they could be fitted into the feudal system.

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