DISCUSSION

The New Industrial State

or

Son of Affluence

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More than once in the course of his new book Professor Galbraith takes the trouble to explain to the reader why its message will not be enthusiastically received by other economists. Sloth, stupidity, and vested interest in ancient ideas all play a part, perhaps also a wish — natural even in tourist-class passengers — not to rock the boat. Professor Galbraith is too modest to mention yet another reason, a sort of jealousy, but I think it is a real factor. Galbraith is, after all, something special. His books are not only widely read, but actually enjoyed. He is a public figure of some significance; he shares with William McChesney Martin the power to shake stock prices by simply uttering nonsense. He is known and attended to all over the world. He mingles with the Beautiful People; for all I know, he may actually be a Beautiful Person himself. It is no wonder that the pedestrian economist feels for him an uneasy mixture of envy and disdain.

There is also an outside possibility that the profession will ignore The New Industrial State (Houghton, Mifflin) because it finds the ideas more or less unhelpful. The world can be divided into big-thinkers and little-thinkers. The difference is illustrated by the old story of the couple who had achieved an agreeable division of labor. She made the unimportant decisions: what job he should take, where they should live, how to bring up the children. He made the important decisions: what to do about Jerusalem, whether China should be admitted to the United Nations, how to deal with crime in the streets. Economists are determined little-thinkers. They want to know what will happen to the production of houses and automobiles in 1968 if Congress votes a 10 percent surcharge on personal and corporate tax bills, and what will happen if Congress does not. They would like to be able to predict the course of the Wholesale Price Index and its components, and the total of corporate profits by in-
They are not likely to be much helped or hindered in these activities by Professor Galbraith's view of Whither We are Trending. Professor Galbraith makes an eloquent case for big-thinking, and he has a point. Little-thinking can easily degenerate into mini-thinking or even into hardly thinking at all. Even if it does not, too single-minded a focus on how the parts of the machine work may lead to a careful failure ever to ask whether the machine itself is pointed in the right direction. On the other side, Professor Galbraith gingerly pays tribute to the little-thinkers whose work he has used, but it is evident that he has been exposed only very selectively to the relevant literature. There is no point squabbling over this: big-think and little-think are different styles, and the difference between them explains why this book will have more currency outside the economics profession than in it. It is a book for the dinner table not for the desk.

I shall try to summarize the main steps in Galbraith's argument, and shall then return to discuss them, one by one.

(1) The characteristic form of organization in any modern industrial society is not the petty firm but the giant corporation, usually producing many different things, and dominating the market for most of them. Nor is this mere accident. The complicated nature of modern technology and the accompanying need for the commitment of huge sums of capital practically demand that industry be organized in large firms.

(2) With few exceptions, the giant corporation is in no sense run by its owners, the common stockholders. The important decisions are made—have to be made—by a bureaucracy, organized in a series of overlapping and interlocking committees. The board of directors is only the tip of an iceberg that extends down as far as technicians and department managers. The members of the bureaucracy are all experts in something, possibly in management itself. Galbraith calls them the "technostructure," but that awkward word is probably a loser.

(3) It is the nature of the highly-capitalized bureaucratically controlled corporation to avoid risk. The modern business firm is simply not willing to throw itself on the mercy of the market. Instead, it achieves certainty and continuity in the supply of materials by integrating backward to produce its own, in the supply of capital by financing itself out of retained earnings, in the supply of labor by bringing the unions into the act. It eliminates uncertainty on the selling side by managing the consumer, by inducing him, through advertising and more subtle methods of salesmanship, to buy what the corporation wants to sell at the price it wants to charge. The major risk of general economic fluctuations is averted by encouraging the government in programs of economic stabilization.

(4) It would be asking much too much of human nature to expect that the bureaucracy should manage the firm simply in the interests of the stockholders. There is, therefore, no presumption
that the modern firm seeks the largest possible profit. Nor does it. The firm's overriding goal is its own survival and autonomy; for security it requires a certain minimum of profit and this it will try to achieve. Security thus assured, the firm's next most urgent goal is the fastest possible growth of sales. (Since firms grow by reinvesting their earnings, this goal is not independent of profits; nevertheless, once the minimum target in profits is achieved, the modern firm will expand its sales even at the expense of its profits.) There are two lesser goals: a rising dividend rate, presumably to keep the animals from getting restless, and the exercise of technological virtuosity.

(5) Modern industry produces mainly things, and it wishes to grow. Everyone will be happier if everyone believes that a growing production of things is the main object of the national life. People will be happier because that is what they in fact get, and the bureaucracy will be happier because they can feel that they serve the national purpose. This belief has been widely inculcated, but it takes effort really to believe it, because American society already has more things than it knows what to do with.

(6) The key resource in the modern industrial state is organized intelligence, especially scientific and managerial intelligence. One of the important things the government does to support the system is the extension of education to provide a supply of recruits for the bureaucracy, and the subsidization of scientific and technological research to provide something interesting for them to do. What Galbraith calls the "scientific and educational estate" therefore acquires a certain moral authority and even mundane power in the society. This is an important circumstance, because the scientific and educational estate—at least its youngest members—can see through the cult of the GNP and observe that it slights the claims of leisure, art, culture, architectural design, and even the innocent enjoyment of nature. Here is the most promising source of social change and of a rather more attractive national style of life.

There is a lot more in the book, much of it full of insight and merriment, but the main logic of the argument seems to be roughly as I have stated it.

It may be unjust and pointless to consider the degree of literal truth of each of the assertions that make up this argument. One would hardly discuss Gulliver's Travels by debating whether there really are any little people, or criticize the Grande Jatte because objects aren't made up of tiny dots. Nevertheless, it may help to judge the truth of Galbraith's big picture if one has some idea about the accuracy of the details. So, at the risk of judging big-think by the standards of little-think, I proceed.

(1) Professor Galbraith is right that modern economics has not really come to terms with the large corporation. Specialists in industrial organization do measure and describe and ponder the operations of the very large firm. Occasionally some of these specialists propound theories of their financial or investment or pricing behavior.
It cannot be said that any of these theories has yet been so successful as to command widespread assent. Perhaps for that reason, much economic analysis, when it is not directly concerned with the behavior of the individual firm, proceeds as if the old model of the centralized profit-maximizing firm were a good enough approximation to the truth to serve as a description of behavior in the large. But this is not always done naively or cynically. Professor Galbraith is not the first person to have discovered General Motors. Most close students of industrial investment or pricing do make room in their statistical behavior equations for behavior that is neither perfectly competitive nor simply monopolistic. (The long debate over the incidence of the corporate profits tax hardly suggests universal reliance on any simple model.)

There is, after all, a moderate amount of economic activity that is not carried on by General Motors, or by the 100 largest or 500 largest corporations. In fact, only about 55 percent of the Gross National Product originates in nonfinancial corporations at all. Not nearly all of that is generated by the giant corporations (of course, some financial corporations are among the giants). Nor is it entirely clear which way the wind is blowing. The giant corporation is preeminently a phenomenon of manufacturing industry and public utilities; it plays a much less important role in trade and services. If, as seems to be in the cards, the trade and service sectors grow relative to the total, the scope of the large corporation may be limited. Alternatively, big firms may come to play a larger role in industries that have so far been carried on at small scale.

Enough has been said to suggest that it is unlikely that the economic system can usefully be described either as General Motors writ larger or as the family farm writ everywhere. This offers at least a hint that it will behave like neither extreme. In any case, counting noses or assets and recounting anecdotes are not to the point. What is to the point is a “model” — a simplified description — of the economy that will yield valid predictions about behavior.

(2) The “separation of ownership from control” of the modern corporation is not a brand new idea. It is to be found in Veblen’s writings and again, of course, in Berle and Means’ The Modern Corporation and Private Property. Recent investigation shows that the process has continued; only a handful of the largest American corporations can be said to be managed by a coherent group with a major ownership interest. (The non-negligible rest of the economy is a different story.) I do not think the simple facts have ever been a matter for dispute. What is in dispute is their implications. It is possible to argue — and many economists probably would argue — that many management-controlled firms are constrained by market forces to behave in much the same way that an owner-controlled firm would behave, and many others acquire owners who like the policy followed by the management. I think it may be a fair complaint that this proposition has not received all the research attention it deserves. It is an error to suppose it has received none at all. Such evidence as
there is does not give a very clear-cut answer, but it does not suggest that the orthodox presupposition is terribly wrong. Galbraith does not present any convincing evidence the other way, as I think he is aware. The game of shifting the burden of proof that he plays at the very end of this book is a child's game. Economics is supposed to be a search for verifiable truths, not a high-school debate.

(3) The modern corporation — and not only the modern corporation — is averse to risk. Many economic institutions and practices are understandable only as devices for shifting or spreading risk. But Galbraith's story that the industrial firm has "planned" itself into complete insulation from the vagaries of the market is an exaggeration, so much an exaggeration that it smacks of the put-on. Galbraith makes the point that the planning of industrial firms need not always be perfect, that a new product or branch plant may occasionally go sour. By itself, therefore, the Edsel is not a sufficient argument against his position. His is a valid defense — but it is not one he can afford to make very often. No doubt the Mets "plan" to win every ballgame.

Consider the supply of capital. There is a lot of internal financing of corporations; it might perhaps be better if companies were forced more often into the capital markets. But external finance is hardly trivial. In 1966 the total flow of funds to nonfarm nonfinancial corporate business was about $96 billion. Internal sources accounted for $59 billion and external sources for the remaining $37 billion. Besides, depreciation allowances amounted to $38 billion of the internal funds generated by business, and much of this sum is not a source of net finance for growth. External sources provided about one half of net new funds. In 1966, bond issues and bank loans alone added up to about two-thirds of undistributed profits. Trade credit is another important source of external funds, but it is complicated because industrial corporations are both lenders and borrowers in this market. I don't know how the proportions of external and internal finance differ between larger and smaller corporations, but the usual complaint is that the large firm has easier access to the capital market. I do not want to make too much of this, because self-finance is, after all, an important aspect of modern industrial life. But there is, I trust, some point in getting the orders of magnitude right. There might also be some point in wondering if the favored tax treatment of capital gains has something to do with the propensity to retain earnings.

Consider the consumer. In the folklore, he (she?) is sovereign; the economic machinery holds its breath while the consumer decides, in view of market prices, how much bread to buy, and how many apples. In Galbraith's counterfable, no top-heavy modern corporation can afford to let success or failure depend on the unstructured whim of a woman with incipient migraine. So the consumer is managed by Madison Avenue into buying what the system requires him to buy. Now I, too, don't like billboards or toothpaste ad-
vertising or lottery tickets of unknown—but probably negligible—actuarial value with my gasoline. (Though I put it to Professor Galbraith that, in his town and mine, the Narragansett beer commercial may be the best thing going on TV.) But that is not the issue; the issue is whether the art of salesmanship has succeeded in freeing the large corporation from the need to meet a market test, giving it "decisive influence over the revenue it receives."

That is not an easy question to answer, at least not if you insist on evidence. Professor Galbraith offers none; perhaps that is why he states his conclusion so confidently and so often. I have no great confidence in my own casual observations either. But I should think a case could be made that much advertising serves only to cancel other advertising, and is therefore merely wasteful.

If Hertz and Avis were each to reduce their advertising expenditures by half, I suppose they would continue to divide the total car rental business in roughly the same proportion that they do now. (Why do they not do so? Presumably because each would then have a motive to get the jump on the other with a surprise advertising campaign.) What would happen to the total car rental business? Galbraith presumably believes it would shrink. People would walk more, sweat more, and spend their money instead on the still-advertised deodorants. But suppose those advertising expenditures were reduced too, suppose that all advertising were reduced near the minimum necessary to inform consumers of the commodities available and their elementary objective properties? Galbraith believes that in absence of persuasion, reduced to their already satiated biological needs for guidance, consumers would be at a loss; total consumer spending would fall and savings would simply pile up by default.

Is there anything to this? I know it is not true of me, and I do not fancy myself any cleverer than the next man in this regard. No research that I know of has detected a wrinkle in aggregate consumer spending behavior that can be traced to the beginning of television. Perhaps no one has tried. Pending some evidence, I am not inclined to take this popular doctrine very seriously. (It is perhaps worth adding that a substantial proportion of all the sales that are made in the economy are made not to consumers but to industrial buyers. These are often experts and presumably not long to be diverted from considerations of price and quality by the provision of animated cartoons or even real girls.)

Consider the attitude of the large corporation to the economic stabilization activities of the Federal Government. It is surely true that big business has an important stake in the maintenance of general prosperity. How, then, to account for the hostility of big business to discretionary fiscal policy, a hostility only lately ended, if indeed traces do not still persist? Here I think Professor Galbraith is carried away by his own virtuosity; he proposes to convince the reader that the hostility has not come from the big business bureaucracy but from the old-style entrepreneurial remnants of small and
medium-sized firms. Their fortunes are not so dependent on general prosperity, so they can afford the old-time religion. Professor Galbraith is probably wrong about that last point; large firms are better able than small ones to withstand a recession. He is right that the more Paleolithic among the opponents of stabilization policy have come from smaller and middle-sized business.

But up until very recently, the big corporation has also been in opposition. Even in 1961 there was considerable hostility to the investment tax credit, mainly because it involved the government too directly and obviously in the management of the flow of expenditures in the economy at large. It was only after further acquaintance with the proposal excited their cupidity that representatives of the large corporation came around. More recently still, they have generally opposed the temporary suspension of the credit as a counter-inflationary stabilization device, and welcomed its resumption. (This warm attachment to after-tax profits does not accord well with the Galbraith thesis.) There is a much simpler explanation for the earlier, now dwindling, hostility that would do no harm to the argument of the book: mere obtuseness.

(4) Does the modern industrial corporation maximize profits? Probably not rigorously and singlemindedly, and for much the same reason that Dr. Johnson did not become a philosopher—because cheerfulness keeps breaking in. Most large corporations are free enough from competitive pressure to afford a donation to the Community Chest or a fancy office building without a close calculation of its incremental contribution to profit. But that is not a fundamental objection to the received doctrine, which can survive if businesses merely almost maximize profits. The real question is whether there is some other goal that businesses pursue systematically at the expense of profits.

The notion of some minimum required yield on capital is an attractive one. It can be built into nearly any model of the behavior of the corporation. I suppose the most commonly held view among economists goes something like this (I am oversimplifying): for any given amount of invested capital, a corporation will seek the largest possible profits in some appropriately long-run sense, and with due allowance for cheerfulness. If the return on capital thus achieved exceeds the minimum required yield or target rate of return, the corporation will expand by adding to its capital, whether from internal or external sources. If the return on equity actually achieved (after corporation tax) is any guide, the target rate of return is not trivial. The main influence on profits in manufacturing is obviously the business cycle; for fairly good years one would have to name a figure like 12 percent, slightly higher in the durable-goods industries, slightly lower in nondurables. In recession years like 1954, 1958, 1961, the figure is more like 9 percent.

Alternatives to this view have been proposed. Professor Galbraith mentions William Baumol and Robin Marris as predecessors. Baumol has argued that the corporation seeks to maximize its sales
revenue, provided that it earns at least a certain required rate of return on capital. This is rather different from Galbraith's proposal that corporations seek growth rather than size. These are intrinsically difficult theories to test against observation. Some attempts have been made to test the Baumol model; the results are not terribly decisive, but for what they are worth they tend to conclude against it. Marris's theory is very much like Galbraith's, only much more closely reasoned. He does propose that corporate management seeks growth, subject to a minimum requirement for profit. But Marris is more careful, and comes closer to the conventional view, because he is fully aware, as Galbraith apparently is not, of an important discipline in the capital market. The management that too freely sacrifices profit for growth will find that the stock market puts a relatively low valuation on its assets. This may offer an aggressive management elsewhere a tempting opportunity to acquire assets cheap, and the result may be a merger offer or a takeover bid, a definite threat to the autonomy of the management taken over. Naturally, the very largest corporations are not subject to this threat, but quite good-sized ones are.

Professor Galbraith offers the following argument against the conventional hypothesis. A profit-maximizing firm will have no incentive to pass along a wage increase in the form of higher prices, because it has already, so to speak, selected the profit-maximizing price. Since the modern industrial corporation transparently does pass on wage increases, it can not have been maximizing profits in the first place. But this argument is a sophomore error; the ideal textbook firm will indeed pass along a wage increase, to a calculable extent.

There is, on the other hand, a certain amount of positive evidence that supports the hypothesis of rough profit-maximization. It has been found, for instance, that industries which are difficult for outsiders to enter are more profitable than those which are easily entered and therefore, presumably, more competitive. It has been found, also, that there is a detectable tendency for capital to flow where profits are highest. Serious attempts to account for industrial investment and prices find that the profit-supply-demand mechanism provides a substantial part of the explanation, though there is room for less classical factors, and for quite a lot of "noise" besides.

(5) Professor Galbraith does not have a high opinion of the private consumption of goods and services. "What is called a high standard of living consists, in considerable measure, in arrangements for avoiding muscular energy, increasing sensual pleasure and for enhancing caloric intake above any conceivable nutritional requirement. . . . No society has ever before provided such a high standard of living as ours, hence none is as good. The occasional query, however logically grounded, is unheard." One wonders if that paragraph were written in Gstaad where, we are told, Professor Galbraith occasionally entertains his muse.
It is hard to disagree without appearing boorish. Nevertheless, it is worth remembering that in 1965 the median family income in the United States was just under $7000. One of the more persistent statistical properties of the median income is that half the families must have less. It does not seem like an excessive sum to spend. No doubt one could name an excessive sum, but in any case the reduction of inequality and the alleviation of poverty play negligible roles in Galbraith's system of thought. His attitude toward ordinary consumption reminds one of the Duchess who, upon acquiring a full appreciation of sex, asked the Duke if it were not perhaps too good for the common people.

(6) I have no particular comment on Professor Galbraith's view of the role of the scientific and educational estate as an agent of social and cultural improvement. But this is perhaps a convenient place for me to state what I take to be the role of this book. Professor Galbraith is fundamentally a moralist. His aim is to criticize seriously what he believes to be flaws in American social and economic arrangements, and to make fun of the ideological myths that are erected to veil the flaws. More often than not, in such expeditions, his targets are well chosen and he is on the side of the angels—that is to say, I am on his side. I trust that readers of his work will acquire some resistance to the notion that any interference by the government in a corporation's use of its capital is morally equivalent to interference in the citizen's use of his toothbrush. I share his belief that American society is under-provided with public services and over-provided with hair oil. I agree with him that men ought to be more free to choose their hours of work, and that this freedom is worth some loss of productivity.

But Professor Galbraith is not content to persuade people that his values ought to be their values. I don't blame him; it's slow work. He would like an elaborate theory to show that his values are, so to speak, objective, and opposition to them merely ideological. He would like to do, in a way, for the scientific and educational estate what Marx and "scientific socialism" tried to do for the proletariat. The ultimate point of the basic argument is that the economy does not efficiently serve consumer preferences—first because industrial corporations evade the discipline of the market by not seeking profit anyway, and second because the preferences are not really the consumer's own.

As theory this simply does not stand up, a few grains of truth and the occasional well-placed needle notwithstanding. There are, however, other powerful arguments against laissez-faire: the existence of monopoly power, inadequate information and other imperfections of the market, the presence of wide divergences between private and social benefits and costs, and a morally unattractive distribution of income. These need to be argued and documented from case to case. It is a kind of joke, but if Professor Galbraith would like to see more and better public services, he may just have to get out and sell them.