The Castle or the Tipi: Rationalization or Irrationality in the American Economy

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DURING a 1957 Notre Dame conference entitled "What America Stands For," Karl De Schweinitz, Jr., examined the "contemporary problems of the American economy." His major themes should be familiar: the effect of concentration of power and production on the functioning of the economy; the instability which the economy exhibits from year to year; and the continuing tension in the economy between individual preferences and economic imperatives.

The writer of 1972 shares the same concerns. For a time in the 1960's, it appeared that some or all of these problems were in the process of solution. By 1972 they had reasserted their existence and importance. In addition, a new dimension had been added to our view of the problems of the economy. Since 1957 changes have taken place whose implications for the functioning of the economy would justify terming them "structural." In addition, these structural changes have called into question the global stability of the American economic system. Are such changes simply adaptations to new circumstances, which can be easily incorporated into the economic structure and which may actually be system-preserving? Or are these changes of a very different sort, autonomously generated and contradictory to the system; does their continuance threaten that economic system with breakdown and fundamental change? There are strong views on both sides of the question, but an approach to an answer can be made only by close examination of the structural changes and their interrelations.

The paper will focus on three institutions which played a role in that structural change: the growth and extension of the domestic conglomerate firms; the growth in size and importance of the United States multinational enterprises; and the persistence, and perhaps growth, of the "economic counterculture." Several considerations lead to their selection. First, in terms of increase in importance over the recent period, no other economic developments are at all comparable with these three. No one of them was considered important in the 1950's, and their growth was not at all foreseen. But by 1972 all of them play major roles in the functioning of the economy. Secondly, they appear to be autonomous changes which were not directly results of economic adjustments to maintain stability. Thus they seem most likely to provide the system with an internal contradiction. Finally, they and their interrelations embody the sense and feeling of contradiction which seems prevalent. Vine Deloria describes this well:

> The contest . . . is between a return to the castle or the tipi. The difference between the castle and the tipi is immense, yet there are such great similarities that it is difficult to distinguish between them. Each offers social identity and economic security within a definite communal system. But the leveling process of the tribal form prevents the hereditary control over a social pyramid, and the feudalistic form has the efficiency to create and control technology.[1]

In economic terms, the rationalization process represented by the conglomerates and the multinational firms is a movement toward greater concentration and hierarchical control, the castle of Deloria's quote. The economic counterculture is a movement in the opposite direction, toward the tipi, a type of economic existence which must seem irrational by our traditional economic standards. Does the continuation of these two tendencies provide the economy with a contradiction that will eventually result in fundamental change?

The Castle: Economic Rationalization

The conglomerate is not an entirely new phenomenon in the United States, but it was during the 1960's that the increase in number and importance of these firms brought them and their operations into the public eye. A conglomerate is a firm which is engaged in more than one line of activity and which operates with several distinct products and in several distinct geographical areas. By this general definition, all but the smallest firms are conglomerates. In technical usage the term refers to the new type of firm whose primary goal is expansion and whose primary mechanism for this expansion is not the traditional growth through internal investment, but growth through the acquisition of and merger with other companies already in operation. Examples of active acquirers

[1] Vine Deloria, *We Talk, You Listen* (New York: Macmillan, 1970), p. 16.

are Teledyne with 124 acquisitions between 1961 and 1968 and Litton Industries with 79 in the same period. An example of the resultant diversification is Gulf and Western; what started out as an auto supply company, through acquisitions now finds itself involved in motion-picture making, production of sugar, zinc, cigars, fertilizer, and paper, and operation of insurance, investment, publishing, and real estate companies.

The explanation offered for conglomerate growth is that they are involved in a process of rationalization of the economy. They claim to possess a special expertise in the management of firms and particularly in the management of their investment funds. They call this "synergism" or "asset management economies." Acquisition of existing firms allows improvement in these areas and thus rationalizes the economic process by allowing greater efficiency of operation. At the same time of course it results in further centralization of control and power and less direct control of individuals over their economic lives, a movement toward the castle.

To assess the impact of the conglomerate on the economy, it is necessary to describe their growth since 1950. The spate of acquisitions began around 1950. Until 1958 the number of acquisitions ran at less than 500 per year, a figure somewhat higher than the average over this century. The pace quickened after 1958 until it hit a historic high in 1968 when 2,400 acquisitions were consummated. The pace has slowed by about 100 per year, but by historical standards it remains quite high.

Seemingly the effects of this movement on the structure of the economy have not been extreme. The share of assets owned by the top 200 corporations has risen from 45 per cent in 1947 to 60.4 per cent in 1968, an average of about 7.5 per cent per decade. From 1958 to 1968 the rise was only 5.2 per cent, from 55.2 per cent to 60.4 per cent of total assets. So the conglomeration movement simply continued a tendency to concentration which existed in the economy. Examination of concentration in individual industries shows the same pattern. In some industries, concentration rose significantly, but in others it did not; conglomerates were active in both groups. Other measures would show similar patterns of continuity.

Behind these seemingly stable surface phenomena, conglomerates were causing significant change. The main structural effect which the conglomerates have fostered is a change in the pattern of "rationalization" which accompanies corporate growth and development. The contrast between the present conglomeration movement and previous merger movements in these terms will highlight this.

There were two periods of major merger activity prior to the present one. Around the turn of the century, there was a great consolidation of the production apparatus in the country, giving rise to such giants as Standard Oil. The economic basis of these mergers was rationalization of production through the implantation of better production techniques. The outcome in many cases was a growth in monopoly, but there were benefits to the entire economy since the rationalization of production increased the amount of goods and services which were available. This was "production rationalization." The second merger movement, in the 1920's, had the same type of result, in this case due to the utilization of large-scale plants. In the era of the assembly line, to compete with Henry Ford a company had to have the ability to produce on a large scale. This was the reason that a number of small auto companies joined together to form the General Motors Corporation. Other mergers were similarly motivated. Once again there was rationalization in terms of production, and the economy got more output for its resources.

Underlying the present conglomeration movement is an economic goal and effect of a somewhat different sort. To be sure, there are elements of the same type of rationalization that occurred before, but they are far less important. There are some gains in managerial efficiency, though in many cases of acquisition the actual managerial changes go little beyond letterheads. The dominant consideration in conglomeration behavior is financial, and acquisitions are carried out for their effect on the financial reports of the firm. In particular, the price/earnings ratio of the firm becomes a crucial variable in firm operation, for a high value is a key factor in the assessment of the firm by the financial market.

This concentration on financial considerations gave a particular character to much of the acquisition movement of the 1960's. Finances are quite affected by tax and accounting considerations, and it was to take advantage of their stipulations that the conglomeration movement took on its particular pattern, at times a bizarre pattern. For example, the Penn Central was quite a good merger partner because it had been chronically unprofitable and thus had significant tax losses which could be written off against profits of the merged company.

The economic effects of this type of expansion are interesting. In the first place, conglomeration did lead to some increase in monopoly power in various markets. Such power is rational from the standpoint of the firm which can much more completely determine the outcome of its operations. However, in the economy the major effect is the restriction of output and a consequent loss of jobs. The losses from all monopoly power have been variously estimated at from $15.6 billion to $100 billion per year. Earlier merger movements had the same type of effect, but their output rationalization offset the loss to the economy to a great extent. It allowed output to continue at a high rate at the same time as concentration and monopoly increased. But synergism has a somewhat different result. In the first place, it can be questioned whether such rationalization actually occurs. The Penn Central debacle and the recent poor performance of such conglomerates as LTV cast some doubt on its existence. Even if rationalization does occur, a prime difference remains. The effect of conglomerates is not to maintain output nor to improve production techniques, rather it is to generate a higher amount of financial profit from the firm and to distribute this to the stockholders of the firm. So the results of whatever rationalization there might be accrue not to the economy as a whole in terms of increases in output, but to the individual stockholders of the firms, that is, to those who own a piece of the castle. There is no direct gain in terms of output and jobs such as occurred in earlier merger movements.

The conglomeration movement may appear to be a quirk of the 1960's, having by now slowed because of the exhaustion of attractive opportunities and changes in some of the tax and accounting procedures which had facilitated it. But it continues, and even more importantly, it occurred; and the economy has changed in a significant way.

The second realm of rationalization contains the multinational firm, commonly defined as a firm which has subsidiaries in six or more countries. An examination of the top 500 firms in the United States in terms of asset size shows that by this definition 187 of them are multinationals.

The multinational firm has a long history also, but the growth in the number of multinationals and their foreign subsidiaries has been extremely rapid since 1955. Peter Drucker indicates that prior to 1955 all but a handful of American companies were that, *American* companies.[2] By 1967, 187 of the 500 largest firms were multinational; since 1955, the foreign manufacturing subsidiaries of these firms increased from 786 to 1,442; and from 1960-1970 their sales more than tripled, from $24 billion to $77 billion and the book value of their subsidiaries increased from $11 billion to $29 billion. This is a far higher rate of increase than occurred domestically where sales increased by only 69 per cent over the same period and the book value of assets by only 30 per cent. Once again, the growth of such firms must be accounted for in any treatment of the economy.

Again the explanation offered for the growth of the multinationals is economic rationalization. In this case the rationalization operates on two fronts. First is output rationalization brought about by the transfer of technology and technical expertise to the subsidiary country. Such implants allow greater output from the same resources and thus are output creating. The second effect is managerial and financial. There seem to be significant economies in managing several enterprises from one central point, and the ability to operate in the international capital market makes financial management rewarding as well.

When looked at in terms of their effect on the economy, however, the results of multinational operation are very similar to those of conglomeration. They have little effect on output in the United States. There may be some increase in exports of components by our manufacturers with resulting gains in scale economies. But the major effect is really in the opposite direction, output and jobs are exported from the country and are carried out in other parts of the world. The one domestic benefit is again the generation of higher money profits for stockholders of the multinational firm.

This brief examination of the impact of the development and growth of the multinational firms illustrates again the effect of the structural changes of the 1960's. While the castle is in the international realm, its effect on the economy and on economic lives is very similar to that of the conglomerate. Most importantly, the type of rationalization which occurred is very different from that which the economy has traditionally seen. No longer is the domi-

[2] Peter Drucker, "The New Markets and the New Capitalism," in Daniel Bell and Irving Kristol, eds., *Capitalism Today* (New York: Signet, 1971), p. 66.

nant motif output rationalization with gains in jobs and efficiency domestically, rather, the impact is financial and is limited to a relatively select segment of the country.

The Tipi: Irrationality

At the time that the corporate sector was undergoing a process of concentration and rationalization, a seemingly contradictory development was occurring in the private sector. The economic counterculture was developing, experimenting with new organizational and economic forms, failing, renewing, but always persisting and apparently growing. The dominant theme of this culture was a rejection of traditional economic forms and institutions and the search for alternatives, all of which would seem quite irrational by our traditional economic standards. The search for the tipi is an apt characterization.

The definition of the economic counterculture is difficult. However, several groups seem objectively important and their economic effects are of sufficient homogeneity to allow their aggregation. Among these are the hard-core alienated who reject the work culture and seek to return to some sort of subsistence existence; the urban or rural communal or cooperative group which endeavors to establish a separate economic base independent of the behavior structure of the dominant economic system; the ecologist who attempts to severely limit the amount of consumption carried out and particularly the resources expended in that consumption; and the ethnic or racial group which attempts to increase its self-sufficiency while existing in close involvement with the dominant society.

It is difficult to assess the impact of these groups in economic terms, though it is certain that their numbers are small and fluid and the viability of their institutions is unproven. But two types of influences on the economy seem likely nonetheless. The first is the possible effect on the cultural basis of the capitalist structure, best described by Daniel Bell:

> The social structure today is ruled by an economic principle of rationality, defined in terms of efficiency in the allocation of resources; the culture in contrast is prodigal, promiscuous, dominated by an anti-rational anti-intellectual temper. The character structure inherited from the nineteenth century—with its emphasis on self-discipline, delayed gratification, restraint—is still relevant to the

> demands of the social structure; but it clashes sharply with the culture, where such bourgeois values have been completely rejected . . .[3]

So Bell finds a contradiction between the culture and the economy. He concludes that "culture has become supreme." In other words, the economic system will soon begin to dance to the tune of the counterculture. While such a likelihood cannot be dismissed, the case is not completely convincing. In the first place, it is equally plausible that the causal factor in these developments is the same rationalization that was mentioned before, that its effect on the work experience and the economic experience is affecting the culture in significant ways. A second objection is more fundamental. The economy, and particularly its corporate sector, has its own culture which shows very few signs of losing its viability. There have been examples of betrayals of that culture such as *Up the Organization,* but they are so few as to illustrate the point. More direct evidence comes from one major attempt to confront the corporate sector with the new cultural themes. This was an effort by the Los Angeles County Museum of Art to place contemporary artists with business firms for 12 weeks or more for an "encounter between art and technology." Spawned by the encounter were progeny such as the suggestion to the Rand Corporation that it shut off its phones for a day and have a picnic in the patio, or "Giant Icebag," a 16-foot sculpture resembling a salmon-colored icebag which does a 20-minute dance number. Perhaps the best expression of the impact of the experiment was by Herman Kahn of the Hudson Institute when he heard his artist's suggestion to produce an edible book with the world's 100 greatest quotations. Said Kahn, "Why are we bothering with Jim? After all, I want the organization to run right."[4] If this experiment is any indication, the corporate culture is hardly experiencing catatonia in reaction to the onslaught of the counterculture.

There is another level, however, on which the economic counterculture may definitely affect the overall economy. The members of this culture are in some sense a part of the economy and their

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[3] Daniel Bell, "The Cultural Contradictions of Capitalism," *Capitalism Today,* p. 30.

[4] Earl Gottschalk, Jr., "What's That Thing Resembling a Giant, Salmon-Hued Ice Bag?," *The Wall Street Journal,* May 6, 1971, p. 1.

economic actions will affect its functioning. Looked at in this light there are two areas of behavior where the effect will be greatest. The first is the relation of the members to the economic labor market. In almost all of its manifestations, the economic counterculture rejects the usual participation in the job market. Production line jobs are to be avoided at all costs, and if any labor beyond subsistence labor is required, it should be of a nonalienating sort. In economic terms, this reduces the effective supply of labor and our models suggest that consequently the rate of growth of the economy should slow with resultant tendencies toward stagnation and economic strain. Counterculturalists also play another role in the economy, that of consumers or nonconsumers. It is again a fairly uniform characteristic that traditional consumption patterns are rejected, partly out of the cultural norms themselves and partly as a result of the work attitude. Looked at in terms of usual economic concerns, such a fall in the aggregate demand of the economy could have very detrimental effects on its operation. The continually astounding success of the economy in avoiding "secular stagnation" has been largely a result of the growth of consumption demand. In a fundamental way the economy is a consumer economy, and disruptions at this level could lead to economic instability.

The thesis which Bell expounds is interesting and may eventually be important for the economy and its functioning. However, at this point it seems that the contradiction of rationalization and irrationality, of the castle and the tipi, could very well exist at a purely economic level. The rejection of the traditional participation in the labor market, coupled with the attempt to break the pattern of consumption which has traditionally buoyed the economy, could well place a severe strain on that economy and could indeed lead it to a fundamental transformation.

The Interrelations

While the above developments were individually notable in their rapidity and importance for the economy, it is their interrelations that reflect most directly on its overall stability.

The relation of conglomerates and multinationals is quite direct, for many of the conglomerates are also multinational firms. Of the 25 most active conglomerates in terms of their acquisitions from 1961-1968, nine would also be classified as multinational enterprises.

This close relationship promises to become even closer in future years. Evidence comes from the data on multinational expansion through acquisition of existing firms in other countries. During the first year that data were available, 1963, there were 228 such acquisitions. But by 1968 the number had risen to 800 and in 1969 it reached 847 acquisitions, a number which is over one-third of the acquisitions within the United States by the conglomerate firms. Stronger evidence of the importance of this trend comes from examining the mode of institution of subsidiaries. For manufacturing subsidiaries in foreign countries, we find that of those founded before 1946, 40 per cent were instituted through acquisitions; of those beginning between 1946 and 1957, 44 per cent were through acquisitions; but 60 per cent of the foreign subsidiaries formed between 1957 and 1967 came about by the acquisition route, a substantial increase. So what may be developing is a new form of organization, the "multinational conglomerate."

Some recent occurrences may accelerate the tendency of overseas expansion through acquisitions. ITT notwithstanding, there is evidence that the Justice Department is discouraging domestic conglomeration efforts. Changes in tax and accounting practices have had somewhat the same result. At the same time, there are recent changes in accounting procedure that have made overseas involvement more attractive to firms seeking improvements in earnings. This adds plausibility to the widespread prediction that by 1985 virtually all of the output of manufactured products will come from some 300 multinational corporations, producing a wide variety of products in a wide variety of locations.[5]

Some direct effects of these developments on the stability of the economy may already be apparent. First, the dollar crisis of 1971 can be laid partially at the door of these enterprises. A major constituent of the United States payments deficits has been the capital funds flowing overseas, and a major reason for this flow has been investment by our companies in other countries. Recently the situation has been made more acute by the United States trade position, where our exports haven't kept pace with our imports. This again is partly a function of business expansion overseas, for overseas production can substitute for domestic production and subsequent export. Also, many subsidiaries now actually ship goods to the United States, increasing our imports. Thus on all of these fronts the multinational conglomerate played an important role in our

[5] Drucker, *op. cit.*, p. 67.

dollar crisis and is likely to continue doing so. Secondly, growth of the conglomerates has led to an increase in the coordination of their activity with government policy. ITT can truthfully say that government restraints on its activity will upset the entire economy. It can also make a convincing case that actions taken by the government of Chile will have similar effects. Thus the pressure on policymakers is significant. The multinational conglomerates' need for government sanction is partly because they are at the frontier of the law, and developments in the law will affect their well-being more than they would the older, more established types of firms. But their dependence is also because of the nature of these firms whose involvements span several industries or countries and whose financial situation can be severely strained by disarray in any one of these. Thus general economic order is essential, and political power is the most effective means of obtaining it. Previously, cartel-like agreements might have been effective, but this is no longer true. Now government aid is necessary for stability.

Given this tendency to instability caused by the rationalization movement, the effect of the economic counterculture on the economy could indeed represent a basic contradiction through its effect on consumption and on the job market. The members of the economic counterculture are not good consumers, and the effect of its growth is to reduce aggregate demand. This would seem to be an added disruptive influence on the corporate sector, for such a decrease in final demand could cause a slowdown in economic growth and rationalization, with resulting pressure on the operation of business. However, the earlier analysis suggested an important reason for doubting a fundamental contradiction on the level of consumption. It was noted that the dominant consideration and effect of expansion by multinational conglomerates is financial and is divorced from the output questions of earlier years. As long as there are opportunities for financial gains through acquisition and merger, the process can continue. Of course stagnant aggregate demand would eventually limit financial maneuvers. However, the rapid growth of overseas sales indicates that this area may provide adequate growth in demand to forestall any such eventuality in the proximate future. Thus the conclusion is that in economic terms, the effect of the economic counterculture on consumption does not provide the system with a basic contradiction.

The second link is in the area of jobs. One implication of the relative independence of multinational conglomerates from domestic aggregate demand is that their interest in internal expansion and job creation is greatly lessened. Expansion of production facilities provides jobs, but the conglomerate mode of operation is primarily financial expansion. The multinational firm also operates in a fashion that will slow the creation of jobs domestically. This could be a source of extreme instability in the domestic economy, but it is here that the economic counterculture may have its most important effect. To the extent that the job becomes less important to a viable life style, the less need there is for the economy and its firms to create jobs. Thus in the extreme, the economy would not be damaged at all if there were no new jobs created, as long as enough persons were willing to leave the job market and to enter the economic counterculture. It is difficult to say how important this factor is at present, let alone how important it will be in the future; but suffice it to say that the present disarray in the labor market, best seen in the wage-price freeze, and the difficulties economic policy is having in that area suggest that such an outlet valve may be essential for the continued functioning of the economy. This may become even more the case as conglomerate expansion continues. So once again no contradiction is visible.

The Castle or the Tipi?

The dominant structural changes in the economy of the 1960's and beyond were the tendency to rationalization in the conglomerates and multinationals and the development of a viable economic counterculture, irrational by usual standards. The view is widespread that these were contradictory trends which might force fundamental change on the economy. An initial examination of these two tendencies seemed to support this view, but closer examination yields a different conclusion. The economy will not be forced to a new basic structure, the castle or the tipi. Rather, the operation of the economy may well depend on the continued coexistence of these two competing but basically complementary spheres. With the substitution of financial motives in expansion and the shift in concentration of energy to the multinational sphere, the ability of the economy to incorporate the entire populace seems severely hampered. Such a failure would have had severe repercussions in previous periods, but with an alternative approach to economic life now available and attractive, such is not the case. In the final analysis, castle and tipi interrelate in a fashion which yields stability to a system which would otherwise be unstable.

This does not imply, however, that there is complete consistency in the economy, only that the contradictions are not internal. The analysis suggests contradiction from a different side. If the possibilities of international expansion open to the multinational conglomerates were to be significantly narrowed, the effect of the economic counterculture would no longer be beneficial. Its effect on the consumption front and on the job front would quickly begin to cut into the dynamic of the corporate sector, forcing a type of adjustment that might be impossible for a multinational conglomerate. So it is in the international sphere that the potential for instability exists; it is there that the contradiction may lay. Changes internationally might finally force a decision between the castle and the tipi.