Notes from the Dismal Science:

ARE CORPORATIONS EVIL?

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Friends and acquaintances have opined that the corporation, oriented to make profits, is inherently evil. Such comments led me to read the book, *The Corporation*, by a Canadian law professor, Joel Bakan, and to view the movie of the same name, both of which described the corporation as constructed to be evil. These experiences inspired me to write to the contrary, based on my work experiences in the last 30 years. I have long studied nonprofit and for-profit firms as part of my research in health economics. Some people say, and I agree, that the health industry, where nonprofits and for-profit firms compete, offers an ideal laboratory in which to study the nature of both types of firms.

"Not a Dime's Worth of Difference"

This headline quotes the subtitle of a prominent health economist's published report comparing nonprofit and for-profit hospitals. They differ little in quantity or quality of care provided, nor in the amount of unpaid care provided. For-profits are somewhat quicker to make investments, while nonprofits have some advantages in public relations and in freedom from

certain taxes. Michigan has no for-profit hospitals, but despite our state laws, it is clear that for-profit hospitals are no more "evil" than their nonprofit cousins. To many people I talk to, as well as to people in the film I mentioned, the pursuit of profit leads corporations to harm society. The evidence from the health sector turns this view on its head.

Is The Pursuit Profit A Bad Thing?

The populist view that pursuit of profit is inherently bad for society comes apart on analysis. Few people want money for its own sake; we all want money for the things it will buy; it is a medium of exchange. The profit of a corporation entails the same sort of incentives as the salary of a professor or the wages of a laborer. To say that any of these are evil is to say it is evil to buy a house, send your kids to college, or for Starbucks to build a store on your block. I'll come back to corporate behavior. Profits don't have to be gigantic to become a strong motivation factor. U.S. corporate profits are less than 6% of GDP according to the Bureau of Economic Analysis.

Twentieth Century history presents numerous unpleasant examples of attempts to run an economy without the profit motive. These attempts almost without exception threw up brutal dictators. We will never know in a scientific sense whether the elimination of the profit motive caused the repression that followed. But any neutral analyst would recognize the common association of the Communist states with repression. The profit motive may not be really wonderful, but it is the best motive force for an economy that we know of.

Are Corporations Criminal?

Many these days claim that the profit motive leads corporations to commit crime; the film claimed this too. But this isn't a good theory, because it doesn't discriminate between corpo-

rate crime and any other; all crime is done for some kind of "profit." A better question is whether corporations commit a disproportionate amount of crime; among all groups of people there will be some that commit crime. Google (the verb) "corporatecrimereporter top 100" and you will find a list of the top 100 corporate criminal fines during the 1990s. Each corporation is noted by the type of crime, the amount of the fine, and the country of the corporate headquarters. I entered these 100 into an Excel file and found the following:

Table: The Top 100 Corporate Crimes Convicted by U.S. Courts in the 1990s

Total of the top 100 corporate fines	$ 2.344 billion
Total value of goods and services created by corporations in the 1990s	$ 56.069 trillion
Ratio of total fines to value of total goods and services created	0.0000481
Portion of the fines due to foreign headquartered firms	54.47%
Types of Crime:	
Portion of fines due to antitrust violations	54.09 %
Portion of fines due to environmental violations	13.77 %
Portion of fines due to fraud	21.78 %
Portion of fines due to other violations	35.6 %
Total all portions	100.00%

The purpose of the first three lines is probably clear; it is to show that the criminal fines charged to corporations in the 1990s were dwarfed by the value of goods and services created by U.S. corporations. I estimated the value of goods and services created by U.S. corporations by assuming that the private sector produced 88% of current GDP and that the corporate sector produced 85% of privately produced goods and services, numbers from recently published sources. Although Enron's fraud case produced super headlines in our new century, these data from the 1990s suggest that fraud is a minor in-

stance of crime. Finally, if you guessed that foreign firms accounted for the lion's share of antitrust crime, you guessed right.

Historically, the U.S. has been the more vigorous in prosecuting antitrust violations. Some countries, for example, Japan, have even treated networking by banks and corporations as the appropriate way to conduct an economy. Some foreign countries treat the bigness of their corporations as a matter of national pride, whereas we treat bigness as a potential "restraint on trade" and harm to consumers (Note: The widespread U.S. perception that monopolies are harmful can be considered a success for U.S. economics professors, who have long taught this).

The United States is an honest country as countries go. Some years ago, I read a sociological study comparing personal honesty across countries. The study used the technique of surreptitiously dropping valuable personal items around each city and them counting how many were returned to authorities. The U.S. did well, similar to other developed countries. The emerging economies did more poorly, no doubt partly because of the more pressing need to survive, but sadly also because corruption is a major factor keeping many poor countries poor. The most painful thing to see is how political corruption in Africa dilutes health care efforts in Africa, a truth I learned from reviewing journal articles on health in developing countries.

I wish I had data to compare the degree of corruption in all walks of American life; I am sure that all areas of life have their share of it. See if these newspaper items from the last 15 years spark a memory: A physician falsifies his Medicare charges to increase his income; a baseball player bets against his own team; public school teachers in Chicago falsify their students' NEAP scores; a US senator defrauds an Indian reservation; a former Detroit schools superintendant is charged with accepting bribes; the central office of the Nature Conservancy is involved in a land deal fraud; and finally, a university treats its athletes with cash, gifts and a free ride in the class-

room. I emphasize that all of these sorts of things are done for some sort of profit, and, of course, all are indeed wrongful behavior.

Certainly, powerful temptations have something to do with these lapses, yet most of us resist such temptations on moral grounds. You might enjoy this anecdote of an event some three decades ago. A government agency organized a sting operation for U.S. Senators. They hired actors to play wealthy Arab businessmen, who contacted four senators sequentially. They offered each a substantial "campaign contribution" if the senator would support a certain piece of legislation. Of the first three, one just said "sure thing!" while the other two made appointments to discuss this "serious business proposition." Only the last senator, Larry Pressler from South Dakota, demurred. Pressler simply said "no." Since his answer turned out to be sort of special, he was later asked why he turned down the bribe. He said "because it would have been wrong." Pressler may have been a rube, but you have to admire a man who not only gets the answer right but does it so succinctly.

A Corporate "Crime" That Is Basically Legal

We have seen that corporate criminal damage to the environment is a minority portion of corporate fines; however, it is a lot of money and even more so, it represents a classic problem. This damage, called a "harmful externality" in economics, is one that even "good corporations" would commit unless properly regulated.

This externality is simply a side effect of the corporation's operations, usually the production side. For example, the firm pollutes air or water in making its product. Another example: The firm produces cars that pollute "excessively." It is society through its political process that determines what degree of pollution is excessive; environmental crime, perhaps more than other crimes, is socially determined.

So what? The biggest corporate problem behavior, in my view, is that they have too much power in the political process that determines corporate regulations. Their big money lobbyists in Washington have too much influence. Please note right away that industry's money power is met by big political power politicians who share the fault—a marriage made not-in-heaven. It is a corruption of the U.S. political process.

Economists have long had a word for this kind of legal corruption, "rent-seeking," which means people lobbying for special pot-of-gold favors from government, such as more lax pollution control laws. We would be better off if we could eliminate this rent-seeking power, but it proves difficult to do. Corporations have relevant data, especially to the industrial costs and benefits to society of pollution control. Once you acknowledge the need to include them in the debate, once they are in the door, corporate influence returns.

Do Corporations Have Unfair Advantages?

Corporations do have advantages over other forms of business. Two of these stand out. First, corporations by law have limited liability, which means that they cannot be sued or fined for more than the value of their stock, called the company's "wealth." What Joel Bakan's film tells us goes far beyond this; he says that their limited liability is unfair to victims of bad company behavior, and that it induces corporations to take undue risks with their customers and the society around them.

There is good reason to doubt, however, that limited liability has this effect in practice. The fines in the Top 100 Crimes list typically amount to only a modest portion of the company's wealth. For example, Exxon's oil spill in the 1990s brought a huge $125 million fine, but Exxon's value of stock (here I have used its current value of stock for my convenience, though this will indicate the magnitude) is $519 billion. Hyundai's fine for campaign violations was $600,000, but its wealth is $140 billion. The top fine was for antitrust violations

by a Swiss company, Hoffman LaRoche; the fine of $500 million, though, was a modest portion of the company's wealth, $210 billion. Some court cases, especially the antitrust cases, can shake a company to the bone, as happened to SGL Carbon. But usually the fines, even the "huge" is some cases, are quite survivable.

The other major advantage of corporations is their ability to raise large amounts of capital by issuing stock. Historically, this opened up formerly financially daunting expeditions to the "stock companies." The new merchant class could now do what before only the monarch could do. New and bigger ventures often brought big returns, but they were risky, too, and often enough fortunes were destroyed. The merchant class, however, could now attempt astonishing things. Who needs Queen Isabella when you've got say the Acme Adventures and Beyond Stock Company?

But besides these two advantages, corporations also face a substantial disadvantage: double taxation. U.S. corporations must find high return investments to overcome this tax treatment. "Double taxation" means that stockholders are taxed first when their corporation pays corporate taxes, and then these stockholders also pay individual income taxes on their dividend income. This treatment creates a genuine efficiency problem, and most Americans do not cry for stockholders especially when corporations seem to survive anyway. But how?

In addition to having a crack at ventures no one else (save government) could afford, corporations often find advantages in their big size. First of all, economies of scale in production may enable them to make goods and services more cheaply. Economies are also found in warehousing, shipping and inventory control. Economies in marketing, such as broadcast television, are realistically available only to companies beyond some threshold size. Finally, economies are found in the decision making function.

Our U.S. president says of himself: "I am the decider." He apparently believes in the importance of choosing a good decider. The critical role of top managers is not lost on corpora-

tions, ball teams, political campaigns or symphony orchestras either. Corporations can achieve decision making economies by picking a new CEO with the right touch and a winning record. The CEO needs not just raw intelligence or necessarily expertise in literature and the arts, though many have these; but he needs to have "it." It is the ability to steer a course through risk to opportunities others don't see, as well as the ability to know when to seek a safe harbor time. Even though corporate boards may sometimes pick "duds," it is a vigorous competition to find the "winner." It's no wonder that top CEOs make salaries almost comparable to rock stars, top movie actors and top professional athletes.

Corporations, of course, do not behave just like some drawing on the economic classroom blackboard, not even the models that I draw. Instead, they are organic, evolving, messy, human imperfections. But they do a lot of good. It's just trendy to see corporations doing good only when they are donating to their workers or to the community. Corporations do their most good when they are making groceries, automobiles, entertainments, housing, heating, clothing, banking, gasoline, food, fast food, bicycles, radios, TVs, newspapers, magazines, eyeglasses, hospital care, and more. What seems to get forgot is the fact that we are willing to pay for these goods and services, and that this is evidence that they are valuable to us. And U.S. corporations make 85% of the goods and services made and provided by the private sector, by far the biggest sector in the economy.

So Are Corporations Evil?

Fundamentally, corporations are groups of people organized for a business purpose within a regulated environment. There are thousands of them, and it's not surprising that regularly many are caught breaking the law. But the criminal fines they must pay are dwarfed by the value of the goods that they provide. Many Americans want them to do more "good," which

usually means being more socially conscious, environmentally friendly or kinder to labor.

Robert Reich's (former Secretary of Labor) new book, *Supercapitalism: The Transformation of Business, Democracy and Everyday Life*, argues that such well-meaning hounding and badgering of corporations does little or no good, and I agree. In a competitive environment, such as globalization has brought us, corporations can't afford to "do good" beyond what is profitable; for example, environmental friendly acts bring dollars through good PR. This is also what I tell my students. If you want to change corporate life in America, says Reich, you have to go to Washington, break up the power of the lobbyists and change the rules. The interface between politicians and lobbyists is the place to start.

My bottom, bottom line is that it is a misconception to believe that corporations are inherently evil, that the profit motive inevitably leads them to wrongful actions, or that they are innately greedy and sharp dealing with their customers. Looking around us we see that America generally approves of its corporations by witness of our purchasing choices. But there can be no "laissez faire," government cannot (and never really did) leave the firms a free "hands off" to do as they please. We citizens have the right, and in principle the opportunity, to revise corporate regulations to suit the society that corporations serve. In other words, Reich has a point. But don't hold your breath. Politics is a thicket of its own. If you believe that it will put all fears behind you, just wait until you get to Washington.