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THE FOOD CONGLomerates

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Introduction

The existence of market power has been a central feature of economic discourse since Adam Smith published his Wealth of Nations in 1776. Economic theories developed in the early 1930s brought greater realism to this inquiry and triggered a vast empirical examination of the sources, extent, and consequences of economic power in a capitalist economy. Though economists have since learned much about the performance of imperfectly competitive markets, this new knowledge has not fully explained the huge conglomerates that inhabit today's industrial landscape. The presence of such conglomerates has also been witnessed in the food industries, the focus of this essay.

This is not to imply we have learned nothing about the nature, extent, and uses of market power in the food industry. Empirical inquiries on the subject date from A. C. Hoffman's seminal work in the 1930s, culminating in Large-Scale Enterprise in the Food Industry, a monograph prepared at the request of the Temporary National Economic Committee. Because Hoffman's "central thesis" was that "business patterns are largely determined by material factors such as the prevailing mode of production," he believed that "recent corporate developments in the food industries as well as elsewhere represent the natural and inevitable adjustment of economic institutions to the basic factors which condition them." Despite his deep roots in economic determinism, as a student of John K. Galbraith, Hoffman believed it would be an oversimplification
to attribute all industrial restructuring to technological forces. He acknowledged that some "mergers and combinations have been engineered for purposes of financial manipulation and extortive gain and have no real basis in operating advantage or economic efficiency."

Hoffman's study traced the origins, evaluated the significance, and predicted the future directions of the food manufacturing industries. He examined large firms within individual industries as they existed in 1930s: meat packers, dairy processors, and other large corporations mainly confined to specific food product lines. Hoffman's thesis and empirical analysis led to the conclusion that most food industries would become dominated by relatively few large corporations, a prediction supported by subsequent developments. However, the subsequent growth in market concentration was not primarily due to the technical economies of large scale that Hoffman viewed as being so important. Instead, the food-manufacturing industries became increasingly concentrated in those areas lending themselves to large-scale advertising.

As shown in Table 1, between 1958 and 1977 concentration remained virtually unchanged for products that had advertising-to-sales ratios below 1 percent whereas the most highly advertised products became concentrated in a few hands. Empirical analyses have found that the increases have been especially prominent in industries lending themselves to television advertising. Although these increases reflect advantages of large-scale advertising, they also reflect the special capacity of food conglomerates to engage in advertising warfare, a subject to which we shall return.
### TABLE 1

Weighted Average Market Share Held by the Leading Four Firms in 85 Food and Tobacco Products, 1958 to 1977

<table>
<thead>
<tr>
<th>Year</th>
<th>All Product Classes N=85</th>
<th>0% (0) N=29</th>
<th>&gt;0% to 1% (0.5%) N=21</th>
<th>&gt;1% to 3% (1.7%) N=20</th>
<th>Over 3% (6.2%) N=15</th>
</tr>
</thead>
<tbody>
<tr>
<td>1977</td>
<td>47.1</td>
<td>35.4</td>
<td>32.8</td>
<td>61.0</td>
<td>70.2</td>
</tr>
<tr>
<td>1972</td>
<td>46.5</td>
<td>37.3</td>
<td>32.0</td>
<td>61.4</td>
<td>65.0</td>
</tr>
<tr>
<td>1967</td>
<td>44.2</td>
<td>35.7</td>
<td>32.6</td>
<td>57.7</td>
<td>59.1</td>
</tr>
<tr>
<td>1963</td>
<td>42.9</td>
<td>35.1</td>
<td>32.1</td>
<td>54.7</td>
<td>57.2</td>
</tr>
<tr>
<td>1958</td>
<td>43.0</td>
<td>36.4</td>
<td>33.4</td>
<td>54.3</td>
<td>54.2</td>
</tr>
<tr>
<td>Change</td>
<td>1958-77</td>
<td>+4.1</td>
<td>-1.0</td>
<td>-0.6</td>
<td>+6.8</td>
</tr>
</tbody>
</table>

1/ Figures in parentheses are average advertising expenditures for the products in the category.

In examining issues of market power, Hoffman relied on the then recently published theories of Robinson and Chamberlain, though he never embraced them entirely. To him, market power had only one source: control over the supply of a single product.

Despite his considerable prescience, Hoffman did not anticipate the emergence of the food conglomerates that are now the dominant business form of food manufacturing and distribution. Here we shall first examine the origins of these enterprises and then analyze their significance.

THE ROLE OF MERGERS IN CREATING THE FOOD CONGLOMERATES

Mergers have played a central role in creating today's food conglomerates. Although the contribution of mergers varies among corporations, the relative size of virtually all conglomerates is the product of mergers made during one or more of the merger movements that have left their imprint on all of American industry: the great merger movement around 1900, the merger wave of the 1920s cresting in 1929-1930, and the persistent post World War II merger activity that reached frenzied proportions in 1968-1969 and that promises to achieve new heights in the 1980s.

Merger activity around the turn of the century involved mainly combinations among direct competitors. Manufacturers of agricultural products were among the most active participants. American Sugar Refining Company acquired 55 companies and by the turn of the century controlled 6/70 to 90 percent of industry sales. 6/ By absorbing 150 companies between 1890 and 1904, American Tobacco achieved control of 90 percent of the tobacco industry sales. 7/ The distilled liquor industry was consolidated
by Distillers Security Corporation (National Distillers Corp.), whose 93 acquisitions gave it control over 60 percent of industry sales. 8/

By the time the great combination movement came to a virtual halt in 1904, in large part because of a landmark antitrust decision, many industries had been irreversibly restructured into oligopolies.

The stage for the second merger movement was set by a favorable antitrust environment that reflected the nation's desire for a "return to normalcy" in the 1920s. The result was an accelerating merger pace that went unchecked until the Great Depression engulfed the nation and shook the very foundations of capitalism, especially the financial institutions that had lubricated so much merger activity.

The merger movement of the 1920s swept across industries left untouched by the earlier movement. Among the most active participants in this period were today's leading dairy processors. 10/ The newly created (1923) National Dairy Products Corporation led the way. Its acquisition itinerary raced across the land gathering in its wake over 300 small and large dairy processors, e.g., the Kraft Phoenix Cheese Company. In just eight years National Dairy Products surpassed other leading dairy processors, even though the Borden Company and Beatrice Foods Company also acquired hundreds of independent companies.

The food-retailing industry also experienced its first great merger movement in the 1920s, as most of today's industry leaders acquired other food retailers. 'In contrast to the dairy and food-retailing mergers, which involved firms within the same industries, some food manufacturers made conglomerate-type mergers. The leader was General
Foods, which acquired many companies in different food industries. Many of the brands it acquired in the 1920s remain familiar household names: Jello-O, Swans Down Cake Flour, Minute Tapioca, Log Cabin Syrup, Sanka and Maxwell House coffees, LaFrance and Satina laundry aids, Calumet Baking Powder, Certo, and Bird's Eye Frosted Foods. By 1930 General Foods had become the most conglomerated food manufacturer, though not as large as Proctor and Gamble, which had expanded into a variety of non-food grocery products.

Although some food companies had become fairly conglomerated by the beginning of the post-World War II merger movement, food conglomerates did not come to full flower until the 1960 and 1970s. In the first decade after the war mergers among competitors were still quite commonplace. Picking up where they left off in 1930, the leading dairy processors went on a merger spree, with the four largest corporations acquiring about 500 other dairy processing companies during 1950-1955. All of these acquisitions were challenged by the Federal Trade Commission in 1956 under the newly enacted Celler-Kefauver Act of 1950, which greatly strengthened the antitrust law as it applied to horizontal mergers. With their foreclosure from acquiring competitors, the large dairy processors turned instead to conglomerate mergers.

By the single act of merging with McKesson-Robbins in 1967, Foremost Dairy was transformed from a specialized dairy company to a large conglomerate. In 1980 -- and about 50 mergers later -- total food sales accounted for only about 25 percent of Foremost-McKesson's sales, with another 40 percent in drugs, 21 percent in wine and spirits, and 14 percent in chemicals and miscellaneous products.
Beatrice Foods followed another merger route. It has become the most conglomerated food corporation by acquiring about 200 companies in such diverse fields as baking products, nuts, cookies and crackers, soft drinks, organic chemicals, plastics, sporting goods, primary metals, boat building, household furniture, trailer coaches, fur goods, plumbing fixtures, luggage and wood products -- to name only a few of its products. By 1980 Beatrice Foods had sales of $8.3 billion, a 419 percent increase over 1970.

National Dairy Products was the last large dairy processor to go conglomerate. Indeed, as recently as the late 1970s it changed its name to Kraft Corporation, which seemed to reflect a commitment to continue in the food manufacturing industry. Then, in 1980, it took a giant step into the world of conglomerates by merging with Dart Industries which had sales of $2.4 billion and made numerous nonfood consumer products. Dart & Kraft had sales in 1980 of $9.4 billion, a 235 percent increase over Kraft's sales in 1970.

The above conglomerate mergers were not exceptions. Many other large food corporations have been parties to conglomerate mergers in recent years. The most notable feature of recent mergers has been the acquisition of very large companies. In 1981, alone, three $1 billion-plus food manufacturers were acquired -- Oscar Mayer Company ($1.8 billion); Standard Brands ($3.0 billion); and Iowa Beef Packing ($4.6 billion). This was as many billion dollar food company acquisitions as occurred during the preceding three decades.

The result of the continuing merger activity has been to concentrate the assets of corporations engaged in food manufacturing among a relatively
few huge conglomerate corporations. Available data do not permit precise measurement of this concentrating process, but the change clearly has been large. Between 1965 and 1976, of those corporations whose primary line of business was food or tobacco products manufacturing, the 100 largest increased their share of food manufacturing assets from 59 percent to 73 percent. Although data for subsequent years are not available, the upward trend doubtless has continued, so that today the 100 largest food conglomerates' share of these assets very likely exceeds 75 percent.

Before examining the significance of these developments, it is appropriate to ask why firms make large conglomerate mergers? (Most small mergers, horizontal or conglomerate, pose no public policy problems; many of these are dictated by the need of family-owned companies to liquidate their assets.) A popular answer among critics of the antitrust laws is that corporations have turned to conglomerate mergers because they have been prohibited from making horizontal ones that would give them monopoly power. (This explanation is largely irrelevant because even before the law toward horizontal mergers became effective, most large mergers involved conglomerate combinations.) Antitrust policy has channelled merger-prone corporations toward conglomerates, but even conceding this leaves unanswered the fundamental question: What motivates such corporate growth in the first place?

For a time many persons rationalized the increasing popularity of conglomerate mergers as the inevitable result of enormous managerial and organizational efficiencies. But a review of over 50 years of research into merger motives and results provides precious little evidence that
conglomerate mergers result in greater efficiency. On the contrary, there is considerable evidence that conglomerate mergers result in no greater efficiency. More reasonable explanations are found in the drive for personal aggrandizement of empire builders, the profits reaped by investment bankers and other third parties promoting mergers and distortions in capital markets, particularly by a depressed stock market that makes it more profitable to buy companies than new machines and buildings that are needed when expanding internally. Hoffman's observation 40 years ago that often mergers are motivated by "financial manipulation and extortive gain" rather than "economic efficiency" very likely applies to more mergers today than in the 1920s, the period he was describing.

Since the available evidence does not warrant an inference that conglomerate mergers are motivated by economic efficiency, it is imperative that we understand the economic and other consequences of growing conglomerate. We begin by examining the adequacy of existing economic concepts in understanding these matters.

THE NATURE OF CONGLOMERATE POWER

The structure and performance of much of the food industry cannot be adequately examined by economists' time-honored theories of competition and monopoly. To appreciate this requires comparing accepted theory with actual markets and the business enterprises occupying them. Imperfect competition or oligopoly theory posits that firms operate in a single market. These theories received widespread acceptance after 1933, the year Joan Robinson and E. H. Chamberlain published simultaneously their classic treatises on "imperfect" and "monopolistic" competition.
The theories predicted that when a few firms control most of the output in a market, these firms achieve discretion in making price and other decisions affecting the industry's destiny. Subsequent empirical testing of the theories contributed much to our knowledge of the costs of oligopoly. For example, one study has found that oligopoly in the food-manufacturing industries resulted in annual monopoly overcharges of about $12.5 billion (1975 dollars).  

Although oligopoly theory helps us to understand market power that is determined solely by the characteristics of a particular market, it tells us little about the huge modern corporation typically operating across a host of separate economic markets: it sells many products, it is vertically integrated in the production-distribution channel and it operates across many geographic markets, both nationally and internationally. It is these multi-market firms that we call conglomerates. Their economic hallmark is that their operations extend across several economic markets.

The power of the conglomerate enterprise transcends that attributable to its position in particular markets. As a consequence, traditional theories that focus on individual markets cannot capture the power of the conglomerate enterprise. And, alas, there is a tendency among economists to ignore that which traditional theory cannot explain.

None is more aware of the deficiency of existing theories that explain market power than Joan Robinson who made such rich contributions to them. In the preface to the 1969 edition of her seminal work, Robinson observes that growing conglomeration has made her theory of imperfect competition largely obsolete: "My old-fashioned comparison between
monopoly and competition may still have some application to old-fashioned restrictive rings [cartels] but it cannot comprehend the great octupuses of modern industry."  

Robinson's point is that the organizational characteristics of huge conglomerates confer power that differs from the market power of the single-market monopolist or oligopolist that exploits its customers by raising prices well above costs. Although the conglomerate typically enjoys such monopoly power in some markets, it also enjoys conduct options not open to the non-conglomerate. These options include the practices of cross-subsidization and reciprocal selling. Conglomeration also widens the scope of mutual interdependence among large firms and leads to greater competitive forbearance among them. Although these options manifest themselves in economic power, the uses of power may extend beyond economic affairs into the entire socio-political milieu of a democratic-capitalistic society. Space permits only brief examination of these matters; while concentrating on economic phenomena, we acknowledge that these often are less significant for our system than the noneconomic consequences of conglomerate power.

Cross-Subsidization

The food-manufacturing and distribution industries are asymmetrically structured: a relatively few huge conglomerate firms and thousands of smaller ones. As noted above, 100 food conglomerates control about 75 percent of the assets of all corporations classified as food and tobacco manufacturers; the remaining 25 percent is divided among about 15,000 smaller corporations. Not only do the largest firms over-shadow in size
their thousands of smaller competitors, but they generally occupy the most concentrated industries and hold leading positions in these industries. Both of these characteristics, high market concentration and dominant market position, confer market power conducive to supra-competitive profits.

The food conglomerate can use such profits to engage in competitive tactics not available to a specialized firm. Most important, the conglomerate can engage in cross-subsidization, the practice of using profits earned in one market to subsidize competitive adventures in other markets. If sales in a subsidized market are small as compared to the overall operations of the conglomerate, subsidization will have little impact on overall profitability. This is often the case, as revealed by examination of the possession and use of conglomerate power by individual corporations.

Although not usually identified in the public's mind as a food company, the International Telephone & Telegraph Corporation (ITT) is one of the nation's largest food manufacturers. (Its 1980 food sales exceeded $1.8 billion.) This huge conglomerate corporation has acquired a number of food companies, the largest of which, the Continental Baking Company, was acquired in 1968. Although Continental is the nation's largest baking company, its sales represent under 5 percent of the sales of its conglomerate parent. ITT's other food businesses represent even smaller parts of its total revenues.

There is rich evidence that not only does ITT-Continental possess enormous conglomerate power, but that it has also used this power against its more specialized competitors. It has sold below cost in many markets, incurring huge losses that have had the effect of destroying its single market competitors, even when these competitors were more efficient.
During 1971-1974, ITT-Continental lost $5.3 million in the San Francisco area alone. In 1973 an ITT-Continental manager explained the consequences of these actions: "[W]e are gaining more market domination for our products and as we do so, our competitors fall back, and grow weaker." Not surprisingly, the baking industry has become increasingly concentrated with Continental holding 20 percent to 50 percent market shares in individual metropolitan markets.

Perhaps the most powerful grocery product conglomerate is the Proctor & Gamble Company (P&G). With total sales of $10.8 billion in 1980, P&G had net earnings of $643 million, making it the most profitable grocery conglomerate. With advertising outlays of $621 million, P&G outspent all other American corporations in persuading consumers to prefer its products over those of its competitors.

Illustrative of P&G's capacity and willingness to engage in massive and sustained cross-subsidization are its efforts to capture a large share of the $2 billion potato chip market. In 1968, P&G introduced a processed potato chip that it sold under the Pringle's brand in tennis ball-shaped containers. Despite a massive advertising blitz and marketing push extending over the next 13 years, P&G has failed in persuading a massive switch to the new product because, as a former P&G executive put it, "Pringle's tasted more like a tennis ball than a potato chip."

The losses from P&G's marketing miscalculations were enormous. P&G's failure in marketing its ersatz potato chip resulted in losses exceeding $200 million, which is comparable (in nominal dollars) to those incurred by Ford Motor Company in its Edsel debacle. Despite this enormous loss, P&G has not given up; in 1981 it planned to spend
yet another $8 million advertising Pringle's, claiming that the operation had become profitable despite a market share of only 5.5 percent.

Some may interpret the Pringle's experience as persuasive evidence that conglomerates are not invincible because they do not win every battle, a point that should be readily acknowledged. But the main lesson taught by the Pringle's misadventure is that conglomerates can invest (some would say waste) enormous sums developing and promoting products that consumers do not want, or at least have not demanded. This illustrates the insensitivity of a determined conglomerate to the "market test" that is presumed to discipline business decision-making in a competitive market.

More important, the Pringle's experience is the exception, not the rule, in P&G's use of conglomerate power. More typically, P&G will identify a profitable market segment and pursue strategies aimed at achieving a dominant market position in the segment. Its experience in the coffee-roasting industry illustrates this approach.

Following its acquisition of the Folger Company in 1963, P&G pursued an aggressive expansion policy rooted in cross-subsidization. When acquired, Folger's operations were confined almost totally to the area west of the Mississippi River. Commencing in 1972, after the expiration of an FTC consent decree designed to limit P&G's use of its conglomerate power, P&G-Folger swept eastward from city to city. The expansion employed a carefully planned combination of marketing techniques, including deep price discounting, heavy television advertising, and couponing. In 1977, alone, P&G suffered losses of $60 million on its coffee operations, attesting to its willingness and ability to incur enormous short-term losses to gain a long-term market position. Between
1977 and 1980, P&G accelerated its efforts, expanding advertising outlays on coffee from $14 million in 1977 to $51.4 million in 1980. Industry sources say that these advertising budgets were matched by an equal amount spent on coupons, discounts, and other promotions.

P&G's expansion in coffee illustrates the special competitive fallout that occurs when one conglomerate engages in subsidized expansion in an industry already occupied by another conglomerate. General Foods Corporation, another large food conglomerate and the long-time leader in the coffee industry, was unwilling to yield the field to P&G without giving battle. It upped its coffee advertising from $38.4 million in 1977 to $107.3 in 1980. In the ensuing clash between these two conglomerate giants, the only fatalities were the smaller single-product companies. Between 1972 and 1977, 29 independent coffee roasters went out of business; casualty rates are not available for the 1977-1980 onslaught. General Foods and P&G currently make 63 percent of total United States coffee sales. The end result seems predictable: higher prices to consumers once the conglomerates have restructured the industry. Indeed, it appears that consumers are already feeling the result of the decline in competition. The Wall Street Journal reported that recently coffee roasters have not been responsive to supply and demand conditions: "Roasters lately have been reluctant to lower their prices in line with the price of raw coffee beans. Through most of 1981, bean prices have fallen; the last reduction in prices of processed coffee was in December 1980. Instead of cutting prices, analysts say, roasters have used their savings to expand their promotional war chests."

The beer industry provides perhaps the most dramatic example of a large industry that has been restructured by the application of conglomerate
power. From World War II until the early 1970s, the beer industry experienced substantial changes, caused largely by economies of scale. Despite the changes that had occurred and the portent of further restructuring, students of the industry were confident that economies of scale did not dictate a highly concentrated industry. During the 1960s, Ira and Ann Horwitz's studies predicted that it was "unlikely that concentration in the brewing industry, at least with regard to the leading five firms, will increase to any great extent..." In 1973, Kenneth Elzinga, a long-time student of the industry still spoke confidently that competition would triumph: Shakespeare's empty tigers and roaring seas, giantism in brewing is not inexorable...There is not evidence [that] there are significant multiplant economies of scale...The industry [can] support at least 30 efficient and independent firms."

Seldom have the predictions of prominent economists been proven wrong more quickly. The reasons for the errors in the predictions are to be found in events not present when the industry was being examined.

The critical change in the industry dates from 1970 when Philip Morris, Inc. completed its acquisition of the Miller Brewing Company. Miller was the seventh largest brewer nationally and had experienced a good growth and profit record prior to its acquisition. But compared to its acquirer, Philip Morris, Inc., Miller was a financial midget. Whereas Miller was a specialized brewer with sales of $198 million, Philip Morris was a multinational conglomerate with sales of $1.5 billion. In 1980, Phillip-Morris-Miller (PM-Miller) had greater net profits than the combined net profits of all other U.S. brewers.
The PM-Miller merger created a potential for anticompetitive effects because of the vast disparity in its size and market power compared to that of other beer companies. Of special significance, the fortunes of other brewers depended almost entirely on how they fared in the beer industry. The only other brewer with substantial conglomerate power was the industry leader Anheuser-Busch (A-B), which had a number of strong brands and held strong market positions in various geographic markets. In these respects, A-B was a conglomerate with which PM-Miller had to contend.

Shortly after acquiring Miller, Philip Morris initiated an aggressively orchestrated strategy of demand creation and capacity expansion. In 1972 it acquired Meister Brau, Inc., including its "Lite" brand. PM-Miller accelerated advertising outlays for the Lite brand from $525,000 in 1973 to $33 million in 1980. This effort not only gave PM-Miller a dominant position in the low calorie beer market, but it represented a triumph for modern advertising: selling at a higher price a product that is less costly to make. At the same time, PM-Miller stepped up advertising of its already well known High Life brand and, beginning in 1977, mounted an advertising blitz for its "domestic import," Lowenbrau.

In total, PM-Miller's measured media advertising budget (which is the only publicly reported part of its total promotion outlays) rose from $8.4 million in 1972 to $70 million in 1980. Simultaneously, Philip Morris poured about $1 billion into expanding Miller's brewing capacity.

This enormous expansion program was especially noteworthy considering Philip Morris lost about $120 million on its brewing operation during
1971-1975 and has earned only modest profits since. Clearly, a specialized brewer with such an earnings record could not have successfully gone to the capital markets for $1 billion for expansion.

Not surprisingly, practically all brewers gave ground before the PM-Miller "juggernaut", as it became known in the trade. The first to be overrun were the regional brewers. Whereas 12 leading regional brewers had expanded sales every year for two decades, beginning in 1975 they began a steady decline and by 1980 all but six had been acquired.

But the impact was not limited to the regional brewers. Between 1975 and 1980 all of the eight largest brewers except PM-Miller, A-B, and Heileman lost ground; Heileman's growth was attributable largely to acquisitions.

As a result, whereas in 1970 the top four brewers made 45 percent of all sales, by 1980 they made 65 percent of all sales. Most important, by 1980 the two leaders, A-B and PM-Miller, held 28 percent and 21 percent of the beer market, respectively, and during the first half of 1981 their combined share exceeded 50 percent.

To date, only A-B has withstood the PM-Miller offensive. During 1977-1980, A-B responded with massive advertising campaigns of its own, raising expenditures from $26 million in 1976 to $99 million in 1980. Its chairman, August A. Busch III, recently announced his company's goal is to gain a 40 percent market share by the late 1980s. Miller's chairman had previously announced his goal as becoming number one in the industry.

The struggle between these two powerful giants has thrown the rest of the industry into disarray because survival came to depend not only
on economic efficiency but also on economic power. The only chance for survival of the remaining larger regional firms is to consolidate into four or five firms that can ultimately achieve national status. (Small local brewers may survive by capitalizing on the advantages of serving a metropolitan area.) The competitive struggle involving the two industry leaders and all the other brewers is reminiscent of the elephant that shouted "every man for himself" as he danced among the chickens.

These unprecedented structural changes in the brewing industry occurred in less than one decade. Although concentration may well have increased in any event, there is little question but that the conglomerate power of PM-Miller and A-B's response to it greatly accelerated the increase and will cause further concentration in the 1980s. Although the Justice Department recently threatened to block a proposed merger between the 3rd and 4th largest brewers, Heileman and Schlitz, it appears that Justice is reconciled to further consolidations in the industry.

The above case studies illustrate the possession and use of economic power by individual food processing conglomerates. A large food retailing chain also possesses conglomerate power when it operates across many geographic markets and possesses market power in some markets because of high concentration and/or because it holds a dominant market position. Statistical analyses of large food chains have demonstrated that some have systematically and effectively used such power to restructure the markets in which they operate. One study showed that when large chains enter a new metropolitan area, especially by merger, they trigger a chain of competitive actions and reactions that destroy weaker competitors.
thereby increasing concentration. In my judgement, the conglomerate market power of large food chains has played an important role in the persistent rise in concentration in food-retailing markets. The leading four chains' share of sales in metropolitan areas rose from an average of 45 percent in 1954 to 52 percent in 1972; preliminary data for the 1977 Census of Retailing indicate the average share of the top four chains rose another 5 percentage points between 1972 and 1977.

The preceding illustrates how cross-subsidization may injure competition. It should be emphasized, however, that this is not always the case. When an industry is already dominated by powerful conglomerates, the only sources of effective entry are conglomerates in other industries. In this setting, entry by a conglomerate, either by internal growth or by acquiring a small and ineffective competition may promote rather than stifle competition.

**RECIPROCITY AND COMPETITIVE FORBEARANCE**

The multimarket character of the conglomerate enterprise enables it to practice reciprocal selling. This strategy is captured by the salesperson's promise, "I'll buy from you if you will buy from me." While it may be only human nature to do business with one's friends, consolidation greatly enlarges the corporation's circle of "friends." Whereas specialized firms seldom have potential suppliers that are also potential customers, the number of customer-supplier opportunities increases as a firm adds new business lines. Industrial experience demonstrates that as firms become more conglomerated, they are inclined to engage in systematic reciprocal selling.

An example will illustrate how the practice works among food conglomerates. Consolidated Foods Corporation is a large food manufacturer,
wholesaler, and retailer. After it acquired Gentry, Inc., a maker of dehydrated garlic and onion seasonings, Consolidated was able to persuade many food-manufacturing suppliers to buy their seasonings from Gentry, Inc. The alternative, of course, was to lose the Consolidated Foods wholesale and retail accounts.

Widespread reciprocal selling among conglomerates forecloses markets to smaller, specialized businesses and thereby enhances oligopoly. Fortune made the following gloomy forecast concerning the effects of increasing reciprocity opportunities: "[T]rade relations between the giant conglomerates tend to close a business circle. Left out are the firms with narrow product lines; as patterns of trade and trading partners emerge between particular groups of companies, entry by newcomers becomes more difficult." Fortune went so far as to predict that our economy might eventually become "dominated by conglomerates happily trading with each other in a new kind of cartel system."

Though growing reciprocity opportunities may seem troublesome enough, they actually are symptoms of an even more serious problem, the problem of conglomerate interdependence and forbearance. Oligopoly theory teaches that sellers in a highly concentrated industry tend to behave interdependently. However, this theory, does not address the inter-dependence that occurs when huge conglomerates meet in many markets as competitors, buyers, or suppliers of each other. Empirical evidence indicates that growing conglomeration broadens and extends the community of interests among oligopolistic firms. The result is that the conglomerate may respect not only the views of competitors in a particular market; its views regarding appropriate strategies in one market may
depend on what is happening, or what may happen, in other markets
where it encounters conglomerate rivals.

Insights into this practice are provided by another incident involving
Consolidated Foods, the practitioner of reciprocity discussed above. As
already noted, Consolidated is a large food manufacturer as well as a
large food distributor. As such, it is both a supplier and a competitor
of food chains. This situation led to a confrontation between it and a
large multimarket food retailer, the National Tea Corporation. In
1965 Consolidated initiated a vigorous price campaign in its retail food
stores in Chicago, National's largest market. National responded imme-
diately by warning that if Consolidated's price campaign continued there
would be fewer Consolidated products on National's shelves. Consolidated
not only capitulated by ending its price campaign in Chicago, but it
further accommodated National by selling off the Chicago stores that had
offered such aggressive price competition.

This illustrates the potential competitive consequences of conglomerate
interdependence. Not only did Consolidated stop the aggressive pricing
that National found so offensive, but Consolidated removed itself as a
competitor. Had Consolidated been engaged only in food retailing, there
would have been no reason for it to dampen its competitive efforts
toward National. This confrontation might best be viewed as an extreme
form of reciprocity, the exchange of reciprocal favors.

This result of conglomerate is particularly significant in the
food industry because the main hope for greater competition in many
highly concentrated food industries is the entry by powerful firms with
the wherewithal to compete effectively. But when a potential entrant is
already competing with the established firms in some other market, the entrant will be discouraged from doing so since its entry may trigger a retaliatory response in one of its other markets. Thus, conglomerate tends to encourage the quiet life among large corporations, an attitude of live and let live.

**CAPITAL-LABOR RELATIONS**

Conglomeration increases the corporation's power beyond the industrial markets in which it operates. One such out-of-market effect is the way conglomerate may change the balance of power between capital and labor. So long as a corporation is specialized, its outcome in bargaining with labor depends on its operations in a single industry. But this is no longer true once a corporation spreads across many industries.

As one of the leading food conglomerates, ITT illustrates this point. The conglomerate and multinational nature of ITT's operations means that its profitability does not depend on any one line of business. This fact has important implications for collective bargaining. First, nearly half of ITT's income originates outside the United States. Second, many of its domestic employees are not affiliated with any union, particularly employees in such service operations as insurance and mutual funds. Third, even ITT's organized employees are members of many different unions in different industries.

Even a partial listing of the unions that bargain with ITT is long. It includes IUE, IBEW, Communications Workers, Auto Workers, Machinists, Steelworkers, Molders and Allied Workers, Plumbers, Teamsters, Bakery and Confectionery Workers, Hotel and Restaurant Employees, Pulp and Sulphite Workers, Chemical Workers, and Paper Workers.
Clearly, the creation of ITT has shifted the balance of economic power between ITT and the numerous labor unions representing its workers. For example, Continental Baking, the nation's largest baking corporation, was a formidable bargainer before merging with ITT. But today, since it accounts for less than 5 percent of ITT's net income, if the Bakery and Confectionery Workers go on strike for a full year and completely shut down the domestic portion of ITT's baking operations, ITT's overall profit margins would not be critically affected. Strikes by unions in ITT's other food businesses would have an even smaller impact on ITT's overall operation.

Conceivably, multinational conglomerates could become essentially strike-proof in dealing with unions in individual nations. Some unions have responded to the conglomerate corporation by attempting "coordinated bargaining" which is designed to bring together all the major international unions dealing with a conglomerate. To date these efforts have proved ineffective.

**CONGLERERATES AND THE STATE**

Imbalances in power created by conglomerate extend beyond those discussed above; they extend to relations between the large modern corporation and the state. These changes are most readily seen at local and state levels, though they extend to the national level as well.

A critical source of change has been the shift in corporate headquarters resulting from the thousands of mergers occurring in recent decades. Typically, the large acquiring conglomerates are headquartered in just a
few states, hence the geographic pattern of business ownership and top level decision making has been drastically rearranged.

Local communities may lose autonomy over economic and political decisions when business ownership and decision making are centered outside the community. Although this is not a new phenomenon, the organizational transformation of the last few decades and the likelihood that it will continue poses problems transcending those of the past. The evolving organizational structure promises an economic system wherein key decision makers located in a few huge metropolitan areas influence intimately the economic, social, and political fates of entire states or regions of the nation.

Each decade we move further from a system wherein the scope of business enterprise is coextensive with units of local or at least state governments. The exceptions, of course, are the small business sectors of the economy, including most farms. On the other hand, the enormous conglomerate corporation straddles many industries and operates plants in all regions of the nation and in many nations of the world. Hence, the boundaries of the massive multinational corporation extend beyond the scope of any nation, let alone an individual community. The experience of the last decade demonstrates that even nations, including the U.S., are incapable of coping effectively with many facets of the multinational corporation that knows no national boundary and often shows little national allegiance.

A key characteristic of the multinational conglomerate is its great flexibility in transferring capital across national boundaries, entering
new industries and abandoning old ones. Such flexibility demonstrates the conglomerates great discretion in allocating resources when and where it considers it is in the corporation's interest. One of the most important consequences seen by Stephen Hymer is "the tendency of the multinational corporation to erode the power of the nation-state...in a variety of ways, in addition to its effect on taxation powers. In general, most governmental policy instruments (monetary policy, fiscal policy, wage policy, etc.) diminish in effectiveness the more open the economy and the greater the degree of foreign investments." 32

In many ways the economic and political power of the modern corporation vis-a-vis particular communities or regions within the United States is greater than their power over other nations. Some nations have compelled multinational firms to locate plants within the country by imposing trade barriers, or they have threatened to expropriate or have actually expropriated the corporation's properties. In contrast, the American economy permits corporations freely to migrate across state boundaries, thereby severely limiting the sovereignty of government units that are not coextensive with the corporation's domain. The most obvious manifestation of this disparity is the inability of local communities and even states to pursue independent tax and other policies aimed at controlling corporate behavior.

In sum, the emerging conglomeration of American industry increasingly places many communities and entire regions of the country in positions of economic subservience comparable to that of the developing nations.
As decisions controlling their fate are transferred outside their political sphere, increasingly large portions of the rural economy could come to live under what my colleague, Dan Bromley, has called "domestic colonialism."  

Paragraph: Historically, increasing centralization of economic power in one sector of the economy has triggered responses elsewhere. The most direct and observable response to "domestic colonialism" has been a steady enlargement of the authority of the federal government as the only polity large enough to cope with the giant corporation. (This is not to imply, of course, that this is the only reason for the growth in the central government.) The enactment of Federal corporate income taxes, minimum wage laws, national pollution and safety standards, and national antitrust laws are leading examples of the federalizing efforts first attempted by individual states. But merely federalizing such efforts does not guarantee solution. For concomitant with the enlarging role of the central government has been the emergence of a corporate state wherein key public decision-makers are often more responsive to corporate than to public interest. Thus, unless control of the federal government is lodged in the hands of the people it may become the instrument for protecting corporate interests.

PUBLIC POLICY OPTIONS

The preeminence of conglomerate enterprises has, at least in part, made obsolete institutions that contemplated economic power deriving
from a corporation's position in a particular market. This is true of the antitrust laws in general and the anti-merger law in particular. Conglomerate mergers are virtually immune under existing law; nor do the antitrust laws cope adequately with other dimensions of conglomerate derived market power. And even where such laws can cope, most public-policy officials view the appropriate remedy as being too drastic. For example, the Federal Trade Commission challenged the predatory pricing behavior of ITT-Continental Baking discussed above. In May 1981, an FTC Administrative Law Judge found that ITT-Continental had violated the law. In his decision, the judge recommended that the Commission consider ordering ITT's divestiture of Continental and the restructuring of Continental into financially autonomous regional bakery units. This, of course, is the sort of remedy implied by acknowledging the existence and use of ITT's conglomerate power. While the judge is to be commended for his insight and candor, it can be predicted with virtual certainty that the Commission will not accept this recommendation. Indeed, given the views of its new chairman, James C. Miller III, it is questionable whether the Commission will even find the predatory acts illegal, much less provide adequate relief.

Shaping policy alternatives for dealing with conglomerate power must begin with the assumption that little can or will be done to reduce existing levels of conglomerate. This assumption limits the options to policies that slow further conglomerate and that place restraints on the use of conglomerate power.

Future conglomerate could be slowed appreciably by strengthening the existing anti-merger law. This could be accomplished by a law that
placed an absolute prohibition on large mergers except where it can be demonstrated that the merger would increase competition. Such legislation was introduced in the last two sessions of the Congress by Senators Edward Kennedy, Howard Metzenbaum, and others. To date this proposal has received scant support, nor is support likely in the near future in view of President Reagan's belief that such laws are "arbitrary, unnecessary, and economically unsound." \textsuperscript{35/}

Second, steps should be taken to remove the cloak of secrecy surrounding the huge corporation and to make it more responsible in its dealings with others. This could be accomplished with a statute requiring large corporations to receive their corporate charters from the Federal government rather than from state governments. Federal chartering, alone, offers no solution unless a new chartering statute expanded the accountability of large corporations by spelling out their responsibilities as well as their rights. High priority should also be given to provisions that would open the large corporation to greater public scrutiny by requiring, among other things, public disclosure of its various lines of business. \textsuperscript{36/}

These kinds of actions acknowledge the obvious: Huge conglomerate corporations are largely public, not purely private institutions. The late Justice William O. Douglas made this observation four decades ago: "Enterprises... which command tremendous resources... tip the scales on the side of prosperity or on the side of depression, depending on the decisions of the men on the top. This is tremendous power, tremendous responsibility. Such men become virtual governments in the power at
their disposal. In fact, if not in law, they become affected with a public interest."
NOTES

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1/

2/
Id., pp. 34.

3/
Hoffman was one of Galbraith's first graduate students.

4/
Id., p. 4.

5/

6/

7/
Id.

8/
Id.

9/

10/
Weston, op. cit., p. 143.

11/

12/
Id, p. 48.


Robinson, op. cit., p. ix.

The following discussion of ITT-Continental is based on the findings of fact in the initial decision In the Matter of ITT Continental Baking Company, Inc., Federal Trade Commission, Docket No. 900, May 1, 1981.

Id. p. 56.


Id. p. 25.


24/ McKay-Smith, op. at.


30/ Fortune, 71 (June 1965): 194.


