The Corporate Juggernaut

Losing Steam?

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About eighteen months ago we penned a piece entitled *The Corporate Juggernaut: Can It Be Stopped?* In the article we highlighted the very strong upward trend of corporate profits in the U.S. as a percentage of Gross Domestic Product (GDP), the same chart we produce below in updated form. Note that the upward trend that has persisted over time has been interrupted recently. Furthermore, while giving corporate America credit for generating this very favorable trend, we also noted that a large part of the momentum of this trend has been a result of diminished worker power.*

The term worker power is synonymous with bargaining power. Recently there seems to be an uptick in bargaining power as major settlements have occurred to the benefit of labor in strikes against United Parcel Service, the automakers, Hollywood studios, and others. There seems to be some momentum building on the labor side of the equation. Considering all of this, we felt an updated discussion of the issues surrounding the distribution of income in the economy would be appropriate. After all, corporate profits are the primary force in driving stock prices higher over time. We note that during the recent time that corporate profits have been correcting, stocks in general have provided very pedestrian returns.

Source: Federal Reserve Bank of St. Louis: Corporate Profits After Tax with Inventory Valuation Adjustment (IVA) and Capital Consumption Adjustment (CCAdj), Billions of Dollars, Quarterly, Seasonally Adjusted Annual Rate; Real Gross Domestic Product, Billions of Chained 2017 Dollars, Quarterly, Seasonally Adjusted Annual Rate (Data through: Q2 2023)

Think about the total amount of profits that can be achieved within the economy. Those profits are split between capital (companies) and labor (workers). The competition for the apportionment of these profits comes from three forms of economic power: monopoly, monopsony, and worker.

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Monopoly power. This form of power comes from the ability to own certain markets to the exclusion of competition. Formidable barriers to entry and product superiority, often in the area of exclusive technology, are monopoly characteristics that can produce pure profits.

Monopsony power. This form of economic power arises when a company dominates a city or region as the principal employer to the exclusion of others, thus giving the company unusual power over its workers and their compensation.

Worker power. This form of economic power can be derived in various ways. The primary one is in the form of unionization and the potential to strike for higher wages. It may also occur in companies that are run partly in the interests of workers as stakeholders. Finally, worker power is enhanced by tight labor conditions.

It is safe to say that worker power in this country has been on the decline for decades. The recent spate of labor victories in strikes could be seen as a turning point in this trend. However, gains in unionization strength are belied by the fact that union membership nationwide has been on the decline since at least 1983, falling from 20% that year to 10% in 2022. There has been no uptick in recent years; instead, the membership rate resides at its multi-decade low.

We noted the recent decline in corporate profits as a percentage of GDP. Absent a turn in worker power, which would represent a change in one of the dominant structural trends in our economy, we assume the recent downtrend is not unlike other interruptions in the upward trend of corporate earnings. Our guess is that it is cyclical, not secular.

The secular case for corporate dominance is supported by several factors. Over recent decades there have been broad shifts that have worked to the benefit of corporations versus labor. Governmental policy toward unionization has tended to undermine the threat of unionization and its credibility. And with the minimum wage being fixed for so long, inflation has diminished the real value of the minimum wage. There has also been a shift toward more shareholder power and activism in the corporate sector. The surge in private equity activity is at the heart of this factor, resulting in more pressure on companies to cut labor costs at the expense of workers. Finally, globalization was one more aspect of the shift in favor of capital as competition from low-labor-cost foreign economies reduced domestic labor power.

The combination of these broad shifts and the use of monopoly and monopsony power has been a major factor in the dominance of capital over labor. Is it a permanent situation? Structural or secular trends certainly can end. They tend to not end suddenly, but begin to fray around the edges, often beneath the surface or in minor ways that are not decipherable until later. Taking note of recent gains by labor and some de-globalization shifts, we do not discount the possibility that in the future the corporate juggernaut will be challenged in a more significant way.

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One possibility that could favor labor going forward is recognition that there have been permanent changes in the labor force. Covid brought many changes, one of which might be a permanently tight labor market, thus empowering workers. Wage gains in general have been fairly significant in the wake of the Covid inflation surge, and while they are now moderating, perhaps labor has been given a taste of success that will be emboldening.

All of the structural shifts that we have noted as contributors to the dominance of capital over labor has been to the benefit of owners of common stocks. In the long run, the growth of corporate earnings is the single most important factor in driving the value of stocks upward. Valuation changes can also have a major effect, at least over shorter periods, but it is the increasing accumulation of earnings that is the most powerful driver of investment returns.

From a macroeconomic perspective, we also add our belief that a somewhat more equal distribution of economic profits would produce a healthier economy. Corporate dominance accentuates income and wealth inequality as more and more of profits flow to the wealthy. Because their propensity to consume is less, overall demand is affected negatively. Unfortunately, we perceive only minor adjustment to this major economic problem.

Back to the original question: is the corporate juggernaut losing steam? This is a question to keep asking because of its importance for future stock returns. For now, on a cyclical basis there has been a loss of momentum by the corporate juggernaut, but on a secular basis, we believe not. The forces of monopoly and monopsony are too strong. As corporate profits rise, we expect stocks to do so also, especially over the long term.

*See Stansbury and Summers: The Declining Worker Power Hypothesis, from which we have drawn for this article.
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