OPINIONSUR
VIRTUAL PUBLICATION

Competition among Firms – Who Benefits?

Neva Goodwin

Free Monthly Publication Issue N°51
November 2007

There has been an excessively wide divergence between common sense and economic theory. Economists have been characterized as suffering from "physics envy," and they do seem to have adopted the stance of mid-twentieth-century physics, that science is only about what can be observed objectively, and measured. But physics is a physical science, and economics is about people. In trying to create an objective human science, economists have made "heroic" simplifications about human nature, describing "economic man" as motivated only by selfishness and greed.

We, as the human topics of economic science, not only have insights into the subject matter – ourselves; we also affect the patterns of economic behavior that the theory tries to describe. A culture that believes that only selfishness is rational, and that limitless greed is a universal human characteristic, will define success in strictly material terms and ask few questions as to how it is achieved. As this plays out, the culture will accept as normal energy scams and cooked books, tax fraud and tax havens, dirty politics and the exploitation of child labor. We have seen this happen over the last few decades. Enron and WorldCom, with their tragedies for workers and retirees, investors and customers, are symptoms of such a culture.

I don't blame all of this on economic theory, but I believe it has played a significant role in shaping our economic culture – which spills over into our broader social culture. We need a new look at economic realities – a new way of talking about what is economically important – based on a clearer understanding of economic behaviors and human well-being. A good area to start with is the topic of competition, where corporate reality seems to have been changing dramatically, first in one direction, then in another, over the past hundred and fifty years or so, but where the theory has, with just a few nods to reality, overall become increasingly refined and narrow.

One of the major lessons a student learns when starting to study economics is that competition is a good thing. It's good because it increases efficiency. Efficiency is normally just considered good in itself, but if you insist on knowing what it's good for, you will be told that it increases consumption opportunities by making it possible to obtain more output from a given level of inputs. Other things being equal, that sounds like an excellent idea. From an environmental point of view, less materials and energy are used for a given output. From the workers' point of view, efficiency gains usually result in increased output per worker, which could result in higher wages, or shorter working hours, or both. Of course, that doesn't always happen; in the boom years of the 1990s labor productivity increased dramatically, but almost all of the benefits went to shareholders, in the form of profits, or to managers, in the form of soaring salaries at the top, and to consumers, enjoying lower prices. From the consumers' point of view this is what is good about efficiency – that it lowers prices.

Another way economists talk about efficiency is to say that it is about using society's resources to maximize production of the most valued outputs, while using less of the more valued inputs, and more of those on which society places a lower value. So how are we to decide what society values most highly? Some people might think society's most valuable products include good nutrition, good education, good health, and good neighborhoods. But the market values for these things doesn't equate very well with what we might call human value. A piece of jewelry or a mansion can cost a lot more than a year's food, care, education, and housing for a child, or for many children. You can explain this by the basic lesson from Economics – that prices are determined at the intersection of what suppliers can supply, under existing market circumstances, and what consumers want that they are willing and able to pay for. Beneath this story there is, in fact, a lot of circularity; the market circumstances that affect supply are a result of prices, as well as being a partial determinant of prices. The most independent variable in this picture is on the demand side: what consumers want that they are willing and able to pay for. The price system is ultimately a system of "one-dollar, one-vote."

Since, in fact, efficiency is about producing more of the outputs that people want and can afford to buy, that means that rich consumers get many more votes than poor people do. An efficient system, to put this in the crudest terms, is one that is highly responsive to the desires of the rich. If, along the way, a process uses a great deal of an input that is highly valued by many people who have few dollar-votes, that doesn't make the process inefficient, in economic terms. Standard economic theory has no way of formally recognizing the validity of needs and wants that cannot achieve market expression through purchasing power.

It's curious, by the way, that the concept of efficiency is not applied, in the standard approach, to either consumption or distribution: might there not be important ways that well-being could be enhanced by efficiently consuming things that actually make us happy, rather than things that are designed only to make us want more? There is a growing body of literature that shows that there are dramatically different classes of consumption goods: more status goods in a society do not make the whole society better off, while an increase of certain other types do contribute consistently to happiness.

I hope this has made you a little skeptical about the values that are implicit in standard economics. I said that competition is considered good because it increases efficiency. Having indicated some doubt about the value of efficiency, as it is understood in economic terms, I'm now going to express my doubts about competition.

At the heart of the standard economic theory that is taught in universities around the world there is a model of perfect competition. For a long time I was very skeptical of the reality of that model. It seemed pretty obvious that the world is not supplying the conditions that are necessary for perfect competition to exist. For one thing, competition is usually assumed to occur between rival firms, but in fact an enormous proportion of the economic transactions that take place today are within-firm transactions where there is no market to enforce competition –

when the Hong Kong arm of IBM sells parts to the US company, the transaction can be priced by mutual agreement, or by a company manager, with reference to such things as tax rates, and where they want profits to show up, rather than based on competitive market forces. Ignoring the huge area for cooperative, within-firm economic transactions, standard theory describes perfect competition as a result of a series of formal requirements. For example:

• You can't have perfect competition in a market in which products are differentiated – you can't have brand names!
• There must be no barriers that would make it hard for small firms to enter a market and compete with large ones that are already there.
• All economic actors must have, if not perfect information, at least fully adequate and equal information. For example, consumers must know as much about what they're getting into as the sellers do, so that there is no power inequality.
• Technology must not create ongoing economies of scale that would allow firms to grow big enough to have market power – that means the ability to set the prices at which they buy and sell.
• And there must be no externalities. (I'll return to this in a next article)

When all of the conditions for perfect competition are met, the idea is that every firm is forced to be a cost-minimizer, because any firm that tries to sell above the lowest possible price will lose all its customers. And this is a good thing because consumers can make their money go farther, to get more stuff. For most of the 20th century most large firm behavior didn't even come close to this model. Wal-Mart is the outstanding counter-example to my skepticism.

Wal-Mart really does behave as if it existed in the text-book world of perfect competition. It has, to a remarkable extent, created the cost-minimizing competitors that it projected to start with. In doing so, Wal-Mart has significantly affected the efficiency of its economic environment. A report from McKinsey has estimated that some 15-25% of the productivity gains in the U.S. in the late 1990s came from Wal-Mart's drive for efficiency, and further credited it with some responsibility for the low inflation rate of the decade. This decision to act as if the real world was the maximally competitive world of the neoclassical economic model was adopted voluntarily, as far as I can tell, by Sam Walton. The result was in many ways just what the textbooks would have predicted.

Other companies have been forced to behave like competitive cost-minimizers because they were losing customers to a company that was phenomenally successful at minimizing its own costs. The result has been – again, just as predicted – to burn the fat out of the system. Every unnecessary cost is under scrutiny in the numerous spheres where Wal-Mart has become a major player – from household goods to apparel, from music and magazines to computers. Every unnecessary cost…

The result that might not have been fully anticipated by the most ardent proponents of competition is that the costs first identified as "unnecessary" have included many of the aspects of economic life that had previously been hailed as progress. Our notions of progress have included the idea that wages should be sufficient to support workers and their families at a fairly high standard of living – very high in the US, in fact, compared to the rest of the world. Progress meant that there was a social agreement about hours of work: people with pretty exciting jobs, in the top echelons, are welcome to work as much as they want, but for less exciting jobs the 35-40 hour week became standard, and it was agreed that extra work should be paid in overtime. There were strict laws banning child labor. Conditions of work, especially indoor work, were expected to be safe, sanitary, and not too uncomfortable. And there was a general agreement that all but the smallest companies should contribute to programs to assist their employees with health care and retirement benefits. All of this progress comes into question when unregulated competition is unleashed on the world.

The competitive pressure is felt, to begin with, by the Wal-Mart employees who work as salespersons, cashiers, or janitors. You may remember reading news stories of night-time lock-ins, unpaid overtime, and massive resistance against unions. Some of the hottest competition has been between Wal-Mart and unionized supermarkets, where the latter were, on average, providing wage-and-benefit packages worth about $10 an hour more than that received by comparable workers at Wal-Mart. Stores that paid these “unnecessary” costs couldn’t compete with Wal-Mart’s low, low prices.

The average wage for Wal-Mart’s sales clerks in the U.S. is well below the federal poverty line for a family of three. Some Wal-Mart employment centers have hot-lines to the state welfare offices to help their workers get access to food stamps, public health services and other services for which they qualify because of their poverty status. In this respect, Wal-Mart is subsidized by the public, which makes it possible for them to provide what are, in the U.S. context, below-subsistence wages.

If U.S. wages have been depressed by the kind of competition that Wal-Mart excels at – and there is considerable evidence that they have been – the situation in poorer countries is even worse. The stories out of Honduras, Bangladesh, China, and Vietnam include unsafe, unsanitary and inhumane working conditions, child labor, egregiously long hours, and pitifully low pay.

There is, of course, another side to the Wal-Mart effect. Aside from its impact on wages, Wal-Mart has pioneered innovative efficiencies in management and in merchandise handling that has contributed to lowering costs. The company has used its extraordinary ability to find efficiencies in some truly beneficial ways, reducing its energy use and other impacts on the natural world. And a lot of people are able to buy more things than they could have bought without this super-low-cost retailer. According to a 2002 study by UBS Warburg, on average, a Wal-Mart supercenter offers prices 14% below its rivals. (Other studies, however, have shown that once Wal-Mart is well-entrenched in an area, and has driven out its competitors, then the prices tend to rise, so that this advantage to consumers may be lost.)

Wal-Mart also provides a lot of jobs. In fact, it is the world’s largest non-government employer. And not all of the jobs are bad. There are opportunities for advancement, in a corporation that promotes two-thirds of its managers from the sales floor. But this depends on continual expansion; if a time comes when Wal-Mart can no longer open at least one new store every week, upwards mobility for the workers will stall. Meanwhile, the overall effect has been to roll back the standards for compensation and working conditions. The turnover rate in the U.S. is the strongest evidence of this: every year Wal-Mart has to replace 44% of its hourly workers.

The major take-away message is that when unregulated competition takes place it pits the welfare of workers against the welfare of consumers. As consumers, we find it irresistible: 82% of American households made a Wal-Mart purchase in 2002, and 2 out of every 5 American women make a weekly visit to a Wal-Mart store. Chinese consumers treat a Wal-Mart outing like a party, and are thrilled with the quality and variety – not only of Western goods, but also of Chinese specialties that were previously available only in isolated parts of the country. But as workers we're hurting. Roxana Kahn who conducts factory audits for Levi Strauss, Tommy Hilfinger, and other U.S. companies that are taking seriously the need to ensure that their overseas suppliers provide decent working conditions, summarized: "It's the workers who suffer when entrepreneurs have to survive by cutting corners."

The picture I have drawn so far is of a case where the market seems to have worked just as it should, at least in the sense of approaching the ideal of perfect competition. There is an ideology that George Soros calls "economic fundamentalism," according to which there is nothing of economic importance that is not best achieved through markets. Adherents to this view contend that any problem you find in our economy is probably caused by some entity, usually the government, monkeying with the market; and if we could just get the market un-monkeyed – free it up from regulatory or do-gooder interference – we would attain the best of all possible worlds. This simple-minded, economistic approach is, unfortunately, promoted in most economics departments. But if you want to make an economist think again, try using the word: Externalities. This will be the subject of the next article of this series published by Opinion Sur.

::: Buenos Aires ::: Salguero 2835 7B (C1425DEM) ::: (54 11) 4801-8616 ::: Argentina ::: sur-norte@surnorte.org.ar