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## Preface

John Weeks

Over the last three decades an ideological clique took control of the economics profession, rather as if the alchemists seized chemistry, the astrologers ruled astronomy, or creationists captured the field of genetics. These ideologues lack the equivalent of the designated Inquisitors that policed the purging of Jews and Muslims from Iberia in the fifteenth century only for lack of needing them, so hegemonic and myopic has our erstwhile profession become.

Where these ideologues dwell the competition among producers in a market society means one thing, Walrasian General Equilibrium. Stray beyond the confines of the Walrasian world and one moves beyond orthodox redemption. The chapters in this volume not only stray beyond, they explicitly and flagrantly abandon the Walrasian fantasies to develop competition as an operational tool of analysis.

Alternatives to the general equilibrium approach to competition represent a fundamental challenge to the orthodox ideology, and the basis for the reconstruction of the scientific content of economics. General equilibrium, especially what is interpreted as the Walrasian version, represents a major barrier to understanding market economies. The presumption of full employment is both essential to the analysis and its fatal flaw. It is essential because all neoclassical microeconomics derives from nominal demand not effective demand. To mention the most obvious implication, in the absence of full employment an economy is demand constrained. A demand constraint implies no analytical difference between the quality supplied and demanded, because prices are not “parametric”. At the macroeconomic level the infamous parable of money neutrality fails to hold out of general equilibrium, not even in a full employment disequilibrium.

The neoclassical approach to competition should not be granted the dignity of the word “theory”. It is no more than a shopping list of necessary conditions. Almost without exception, when asked for a definition of competition, a neoclassical source begins with “perfect competition” as the benchmark (this can be verified by typing “competition” into an internet search tool). This fanciful concept is assigned certain characteristics, rather like unicorns and griffins are described in myths.

The chapters in this book show that those characteristics, varying between the improbable and the absurd, produce no analytical insights. Nor does “relaxing” the general equilibrium assumptions help. This achieves no more than what the neoclassicals once called “imperfect competition”, which leads nowhere except theoretical and empirical dead ends. The terminology itself, "perfect" and "imperfect", and the dreaded "market failure", indicate an unscientific romanticism masquerading as analysis.

If the competition of neoclassical general equilibrium takes us nowhere, what is the alternative? The alternative is here, provided by some of the most outstanding thinkers in the field, scholars of long standing in the profession and those beginning their careers. Indeed, if the economics profession deserved its claim of scientific content, the mainstream would not be the purveyors of general equilibrium nonsense, but the authors in this book.

Almost every generalization produced by the neoclassical treatment of competition is refuted in practice. The most obvious is the analytical conclusion that in competitive markets only one price prevails. In effect this conclusion implies that price is not an instrument in the competitive struggle, which is contrary to the operation of real markets. The goal of this book is to provide a treatment of the phenomenon central of competition that is empirically relevant and testable, through analytically inspecting all the forms it takes. In doing so it provides more than the beginning of an alternative view. It provides the guidelines for investigating competition in its many market manifestations in capitalist societies.

## Chapter 7

# The Fallacy of Competition: Markets and the Movement of Capital

### Introduction

Of central importance in the entire neoclassical theory of production, exchange and distribution is "competition". "Competition" ensures that "consumers" receive "value for money", "competition" forces producers to lower costs, and thus generates the ultimate benefit of the market system, "choice". By realizing these benefits, competition generates the best of all economic outcomes, Pareto Optimality.

In the absence of "competition" benefits fade and markets wither. In neoclassical theory, competition is more than just a good thing, is the Philosopher's Stone of the theory. Touch it to a market and efficiency prevails. When "competition" holds sway in the neoclassical sense, the working of the economy approaches the sublime; when it is imperfect all necessary steps must be taken to purify it.

In the economics profession and in the press, the truth of these arguments is taken as self-evident. Not even the financial crisis of the late 2000s undermined faith in the magic of competition. On the contrary, the major proposals to prevent re-occurrence of the crisis included steps to market financial markets more "competitive". Rare is the progressive writer who does not argue that the evils of markets derive from monopoly power and would be eliminated or at least reduced by increased competition. This was famously argued by the most prominent American Marxists of the twentieth century, Paul Baran and Paul Sweezy (1968).

It is common for progressives, similarly to the neoclassicals, to attribute the inefficiencies, inequities and outrages of capitalism to the absence of "competition". Quite uncommon is when the term is clearly defined and its characteristics specified. Stiglitz, rightly or wrongly considered by most of his colleagues to be a political progressive, states in his introductory book (jointly authored with Walsh), "One of the most fundamental, and perhaps surprising, ideas in economics is that competitive markets are efficient" (Stiglitz and Walsh 2006, 39). Somewhat ambiguous is the position of another Nobel Prize winner considered progressive, Paul Krugman. In

his work on trade theory he does not uncritically endorse competition, but his analysis of trade with increasing returns to scale derives clearly from the perfect competition benchmark (Krugman 1985).

Of prominent economists of the twentieth century, few explicitly rejected the neoclassical romanticism of competition, the most notable being John Kenneth Galbraith. Along with his skepticism about the benefits of competition, Galbraith insightfully identified it as inextricably linked to the use of mathematics in economics. Referring to the takeover of economics by mathematics, Galbraith wrote, "In the real world perfection competition was by now leading an increasingly esoteric existence, if indeed, any existence at all, and mathematical theory was, in no slight measure, the highly sophisticated cover under which it managed to survive" (Galbraith 1989, 260). His book *The New Industrial State* (1967) can be read as devastating critique of the myth of benign competition. However, to describe John Kenneth Galbraith's view on competition as rare overstates its frequency among economists, left, right or centre.

In this chapter I argue that the benign view of competition is fundamentally wrong. The positive role of competition derives from a purely theoretical construction in which competition is an analytical black box. Neoclassical competition is a fictitious phenomenon constructed with a narrow focus on exchange that is divorced from capitalist relations of production. Placing competition in its appropriate context, as the manifestation of the movement of capital, reveals the analytical poverty of the neoclassical approach, as well as its absurdities. In essence the neoclassical theory of competition is nothing more than a mathematical rendering of the petty commodity production of the nineteenth century romantics of political economy.

## Romanticism of Competition

### Competition in Partial equilibrium

Almost two hundred and fifty years ago, Adam Smith wrote:

In general, if any branch of trade, or any division of labor, be advantageous to the public, the freer and more general the competition, it will always be the more so. (Smith 1937: 329)

Reading these words literally without nuances, neoclassicals conclude that more competition by their definition is always good. Smith's approach to competition was a product of the specific historical phenomenon, the Scottish Enlightenment during the early development of capitalism. For Smith and other writers, such as his friend David Hume, "competition" meant the end of feudal institutions such as guilds and a range of communal and landlord rights that constrained the alienability of land (.<sup>1</sup>

Notwithstanding its historically specific context and meaning, Smith's enthusiasm for competition remains as strong as ever among economists and the person in the street. Not even the financial crisis of the late 2000s undermined faith in competition. It is part of the folklore of economics and business journalism that while perfect competition is impossible, more competition is better than less, just as Adam Smith asserted. A generation ago the flaw in this argument was demonstrated by mainstream economists Lipsey and Lancaster (1956-57). As surprising as it may

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<sup>1</sup> Marx argued that what the economists of his day called competition was the dissolution of the feudal-mercantile society of Britain and the emergence of capitalism.

Because competition appears as the dissolution of compulsory guild membership, government regulation, internal tariffs and the like within a country...[I]n short, as the negation of the limits and barriers peculiar to the stages of production proceeding capital...it has [therefore] never been examined even for this merely negative side, this, its merely historical side, and this had led at the same time to the even greater absurdity of regarding it as the collision of unfettered individuals who are determined only by their own interests...and hence as the absolute mode of existence of free individuality in the sphere of consumption and of exchange. Nothing can be more mistaken. (Marx 1973: 649)

seem to the non-specialist, neoclassical theory provides no rule for systematically analyzing whether more competition is better than less.<sup>2</sup>

As explained in the next section, the agnostic conclusion about degrees of competition reflects the lack of an analysis of competition as process. The standard economics textbook presentation typically defines perfect competition to be the result of a large number of relatively small buyers and sellers, each acting on the belief that he or she cannot affect the market price.<sup>3</sup> In other words, the market participants consider themselves to be price constrained, not quantity constrained. This common statement about numbers of rivals and the price constrained result is a logical muddle. The number and size of enterprises are characteristics. Whether the firms have an impact on market price is an outcome. The two must be linked by a process. It may seem "common sense" that many buyers and sellers would believe themselves unable to affect price, but theoretical insights do not derive from laboring the obvious.

I begin the critique of neoclassical competition with the simple presentation one finds in introductory and intermediate microeconomics textbooks. After showing the obvious inadequacies of that approach, I move to the realm of high theory, Walrasian general equilibrium analysis. The typical textbook presentation presents competition in a single market or as a partial equilibrium phenomenon. At this level of analysis the existence of competition depends on the specification of the relationship between costs and outputs for the enterprises that produce a product. At the risk of laboring the obvious, it is necessary to go to first principles in order to understand that the neoclassical approach to competition is theoretically vacuous.

In the theory the existence and sustainability of competition among enterprises depends on whether production and market conditions allow for the continuous presence of many independent enterprises. For this to happen, it must be

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<sup>2</sup> Though never refuted, textbooks rarely mention the theory of the second best. The ideological nature of neoclassical economics is demonstrated in the profession's practice of discarding what is inconvenient for the theory.

<sup>3</sup> This is stated succinctly in an online economics dictionary, where perfect competition is defined as follows: "The existence within a market for some good or service of a sufficient number of buyers and sellers such that no single market participant has enough influence to determine the going price of the good or service; opposite of monopoly". <http://www.investorwords.com/5467/competition.html>.

that no enterprise can expand to a market share that would allow it to manipulate the market for the commodity the enterprises produce. A necessary condition to prevent this is that production units have their minimum unit cost at an output level that is a small fraction of market demand when the market price equals that minimum. To achieve this result, unit costs cannot be constant with respect to scale of operation. If that were the case, enterprises would expand until only a few remained. Nor could it be the case that unit costs fall or rise with increases in scale. The former would also result in a non-competitive market and the latter would imply an optimal scale of no output.

It is obvious that the only possibility consistent with competition is that increases in scale of operation cause an initial decline in unit costs, followed by a rise. A further condition for competition is that the same cost pattern should apply to management and administration, to prevent the control of several least cost production units by one or a few owners. It is for this reason that neoclassicals use the word "firm", which refers to the "decision unit". It is difficult to justify why such a unique minimum unit-cost point should be the general case, other than pursuing some variation of Adam Smith's famous cliché that the owner ("master") of an enterprise cannot watch everything all the time.

It would appear that Jacob Viner was the first to formally specify the necessary conditions for a unique minimum cost (Viner 1931), and this is shown in Figure 1. The lines identified as SRAC are short run average costs curves. These derive from a production function in which the capital stock is fixed, the amount of labor varies, and there are no other inputs. Therefore, total cost equals wages plus interests. Neoclassical firms do not produce products, they generate a flow of homogeneous value added, an analytical simplification ridiculed by Keynes (Weeks 1988).<sup>4</sup>

Assume that initially the firm operates with cost curve SRAC1, implied by some fixed capital stock  $k_1$ . Where the "deciders" to expand the scale of operations,

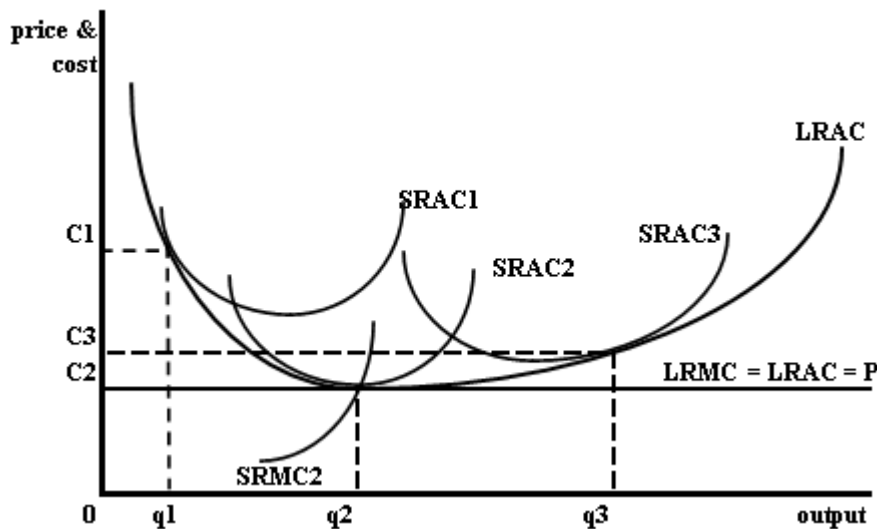
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<sup>4</sup> It is beyond the scope of this chapter to demonstrate the inconsistencies created by excluding non-labor inputs at the level of enterprises. See Weeks (1989: 237ff), Weeks (2011: Annex to Chapter 4) and Keynes 1936: Appendix on User Cost). In formal logic, excluding non-labor inputs renders redundant the assumption of a homogeneous product.

the unit costs would decline until they reach a minimum at unit cost  $C_2$  and output  $q_2$ . There are scales of operation smaller and larger that could produce the same output, but the unit cost would be higher. Should the deciders optimistically construct operations corresponding to  $SRAC_3$  in hopes of seizing a large market share, they would discover to their grief that smaller scales of operation had lower unit costs. All firms converge on the scale of operations corresponding to  $SRAC_2$ .

The long run average cost curve,  $LRAC$ , is the locus of the point on each short run curve that is the lowest unit cost for each level of output. This lowest unit cost for each output is not the lowest unit cost on each short run curve, except for  $SRMC_2$ . Legend has it that this characteristic of the cost curves left Viner perplexed. The long run curve is badly named, because it does not refer to chronological time. It is more accurately called a "planning curve", which allegedly shows the alternatives open to the deciders as they reflect on future investments. In the rather strange future that they reflect upon there is no technical change to disrupt the shape of the long run average cost curve.

Figure 1: Perfect Competition and how to get there: "U-shaped" long run average cost



This is a story so analytically flawed that is astonishing that it was taken seriously when Viner proposed it, and amazing that it is being repeated eighty years



later. The first problem with Figure 1 is that it reflects an analytical process that in sailing is called taking "back-bearings", determining where one is by inspecting from where one must have come. The "U-shaped" average cost curve, short and long run, is the same. The story in Figure 1 would have some credibility if through theoretical analysis it were established that production functions would produce as a general case U-shaped short and long run average cost curves. The reverse was the case: faced with the pressing need for a cost structure consistent with many firms, Figure 1 was conjured up with no basis in a mathematical function.<sup>5</sup> This is one of many examples of neoclassicals hoping that nature will imitate art. Another example, "false trading" is considered in the discussion of competition under general equilibrium.

Second, no empirical evidence has been produced to support the argument that U-shaped average cost curves are the general case. This is not surprising, because the theory on which it is based is weak to the point of non-existent. It is a reasonable hypothesis that production facilities cannot grow larger and larger without limit before encountering problems that would limit efficiency. There is little reason to believe this is a binding constraint across all sectors. More basic, there is no reason to think that ownership of many production facilities would encounter systematic inefficiencies. Were this generally the case across sectors, it would be difficult to account for the prevalence of multinational enterprises.

Third, the analysis behind Figure 1 excludes technical change. This alone renders it non-credible. One is asked to believe that competition results from a process in which the owners of capital consider different scales of operation and choose among them, without assessing the impact of technical change on the possible choices. The exclusion of technical change from the analysis is not accidental. Were it included, outcomes would be indeterminate, carried to a far more complex level of asymmetric information and uncertainty.

However, were all other objections to Figure 1 ignored, one would remain that undermines the analysis. It represents the inappropriate application of partial equilibrium to a general equilibrium phenomenon. The choices by the owners of

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<sup>5</sup> The functions most commonly encountered in neoclassical production theory, the constant elasticity of substitution specification and the translog function, do not produce U-shaped cost curves. The absence of theory in neoclassical production theory is point out by Shaikh (1974).

firms manifested in Figure 1 are based on notional quantities and prices. Notional values are those that result when all markets clear. In other words, they are a general equilibrium concept, but the diagram is partial equilibrium with not explanation of how prices of outputs or input are determined. Without an explanation of this process, Figure 1 is irrelevant because the participants in the market receive no price signals. In the absence of price signals, owners of firms set prices themselves; this is the negation of perfect competition.

### Competition in General Equilibrium

The standard definition of competition from textbooks--many buyers and sellers, homogeneous product, *etc.*--is a low and vulgar theory. The neoclassical high theory of competition is found in Walrasian general equilibrium analysis. The superficially simple idea that many buyers and sellers interact to create competitive prices has no analytical content outside of the context of general equilibrium. Petroleum is a clear and major example of a commodity whose price determination contradicts general equilibrium theory

In a perfectly competitive market, buyers and sellers base their decisions on the prices they observe in the market (they are price constrained). Competition both produces these prices and dictates that the agents in the market treat them as "given", as beyond their individual control. This is the problem that neoclassical competition must solve: to construct a market in which the prices are determined by the participants, yet those participants individually cannot affect them.

This problem is not solved by falling back on the argument regarding the number of market participants, what might be called the "quantity theory of competition". While an increase in the number of sellers may increase some aspects of competition, it is not obvious that it would result in the specific outcome required for perfect competition, prices that the sellers believe they cannot affect ("parametric" prices). It is possible that some or all sellers would combine and manipulate prices, a market strategy pursued by many professional associations.<sup>6</sup>

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<sup>6</sup> In a famous passage in *The Wealth of Nations*, Adam Smith commented,

It may seem strange and unnecessary that to be truly competitive, sellers must treat prices as parametric. More realistic and easier to verify empirically would be a product environment in which sellers may manipulate prices, but the ability of each to do so is constrained by the number and size distribution of market participants. It would not be difficult to argue that this form of competition would bring many of the same benefits to society that neoclassical perfect competition allegedly generates. However, this sensible approach to competition would be unacceptable to the neoclassicals because the benefits it would bring are consistent with public intervention in markets. For example, public intervention through anti-monopoly regulation could increase the social benefits of competition.

It is obvious and rational that public authorities should scrutinize markets to ensure that they operate for society's benefit. For neoclassicals, this rational and sensible rule is analytically constrained by the condition that public intervention to make markets operate in a more socially beneficial manner is only justified by the existence of a "market failure". This term has a very specific meaning: some aspect of a specific market environment prevents the simultaneous clearing of all markets that would otherwise create an equilibrium that is Pareto Optimal.

The political implications of this formulation of markets are considerably more important than its economics. Neoclassical market analysis reduces to the assertion that there exists an ideal market outcome which can be approached in reality. In this ideal outcome the distribution of resources and consumption of the products produced by those resources is optimal, in the sense that no better distribution is possible. In the absence of market failures, the barriers to achieving this best outcome are created by public action. Unless it can be shown beyond reasonable doubt that private actions create market failures, it follows that public action to regulate markets is a barrier to individual welfare.

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People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.... But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies, much less to render them necessary. (Smith 1776, 145)

Neoclassical competition theory carries a powerful political message: people acting collectively is detrimental to social welfare. As shown in the discussion of partial equilibrium, this conclusion is entirely dependent upon a totally arbitrary specification of production costs. Were this specification magically to be imposed on all industries, a more fundamental difficulty would remain. A necessary condition for Pareto Optimality is full utilization of all resources. A necessary condition for full utilization is a mechanism for markets to adjust to that outcome and no other. This extremely restrictive, analytically ad hoc and empirically absurd outcome reveals the fundamental purpose of neoclassical competition theory. The explanation of how firms operate in markets is secondary to demonstrating that any measure to limit the behavior of capital is unjustified.

Essential to this defense of the rights of capital is general equilibrium market clearing. Consider an economy with ten per cent unemployment of labor and idle industrial capacity. In such circumstances idle capacity exists because firms discover that they cannot profitably sell more output; the unemployed have looked for work and found none available. In these conditions prices reflect that the economy is *demand or income constrained*. Were demand to increase, outputs would rise and prices would change. Some prices would rise and others would fall, generating a different allocation of resources. Only when all resources are active will prices assume the autonomous, allocative role that they play in the neoclassical parable of competition that makes competition socially beneficial.

The benefits of neoclassical competition cannot be justified on a market-by-market basis. It delivers benefits only on the grander scale of aggregate full employment of resources, "full employment general equilibrium". In the absence of full employment of resources, it cannot be demonstrated theoretically that any specific competition-fostering measure will lead to improved allocation of resources and welfare gains to the population. An aggregate competitive full employment is the necessary condition for the efficient operation of each specific market. Achievement of general equilibrium is logically prior to establishing competitive outcomes in partial equilibrium.

At the end of the nineteenth century Leon Walras created the theory of general equilibrium, which is the *sine qua non* of neoclassical competition (Walras 1926). In a Walrasian world, people come to the market place with a fixed amount of commodities to sell, with the purpose of making exchanges to acquire a different set of commodities. There is no production, which makes a Walrasian market the equivalent of what Marx names "simple commodity circulation", buying in order to sell (and *vice-versa*). Market traders compare the prices of what each has to sell with the prices of what is to be bought. They then choose the most advantageous combination of buying and selling.

At first glance, this approach appears not very promising for the purpose of establishing competitive full employment in a capitalist economy. No production is involved, which implies there is no role for employment. Commodities come to the market already produced. The only important action is to determine a set of prices that will ensure that there are no surpluses or shortages (excess demands and excess supplies).

Even in this simple system of fixed supplies, the process of price formation is not very satisfactory. If traders are left unregulated, the probable result will be a set of prices that leaves some commodities unsold. This would occur, for example, if on the basis of an initial set of prices the seller of beer received a price so low that that he or she was unable to make the required contribution to the total expenditure that would allow all apples to be sold. One way out of this problem would be to allow commodities to be sold at different prices during the market period. This happens in real markets: left-over apples would be dumped at a below-cost price as the market closes. This cannot be allowed if the trading process is to produce an efficient outcome. If any commodity sells at more than one price during the market period, this is *prima facie* evidence that trading was demand constrained; i.e., sales were not determined by relative prices, but relative prices were established by the need to sell.

We discover, as Walras did, that even this simplistic imaginary market requires conscious regulation. If left an unregulated "free" market, it would not produce socially beneficial outcomes. The need for public intervention could not be excluded. The process Walras designed to avoid this outcome was regulation by an

"auctioneer". The role of the auctioneer is to stand at the centre of all traders and listen to the alternative offers by buyers and sellers. Walras assigned this auctioneer the draconian powers almost beyond any imposed by a government on a market: to prohibit any trades at prices that leave excess demands and excess supplies, in other words, disequilibrium prices. No trading at disequilibrium prices is permitted. The auctioneer is granted perfect foresight so he or she knows in advance the general equilibrium trading outcome for each market.

Actual markets do not have auctioneers except in very special cases. Real auctioneers do not care about the general equilibrium purity of the prices they gavel down. Markets, with or without auctioneers, do not clear simultaneously. They clear sequentially, and there is no going back if a general disequilibrium price is established for a commodity. Nothing remotely resembling a Walrasian market exists in any exchange economy, yet Walrasian markets are taken as the basis of neoclassical competitive theory. It is an interesting sociological phenomenon that such a patently absurd view of market operation should be incorporated into a social science. More interesting still, this theatre of the absurd is treated as the norm, and what actually occurs as a deviation from that norm, "false trading", that must be justified.<sup>7</sup>

Investigation of general equilibrium reveals the meaning of "perfect competition". Many buyers and sellers will be unable to affect prices when they trade in a market with an omniscient auctioneer and no "false trading" is allowed. In other words, they will be unable to affect prices when a higher authority forbids it, when the market is *regulated*. Far from being a defense of "free markets", neoclassical competition theory is revealed as the rationale for regulation of markets.

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<sup>7</sup> Inversion of fact and fantasy is enshrined in official neoclassical terminology. Following the proposal of Sir John Hicks in the 1930s, exchanges that result in excess demands and excess supplies are called "false trading", with the implication that what happens in the imaginary market is "true". One has entered a quasi-religious realm, in which the observed world is false, and the world of the imagination is true. Faced with this intractable problem of clearing markets, Hamlet's famous lament comes to mind, "O cursed spite, That I was ever born to set it right" (*Hamlet*, Act I, Scene 2).

In the profoundest sense, it is not a question of whether markets are regulated, but who will do so and with what accountability.<sup>8</sup>

The problematical nature of neoclassical competition becomes all the greater in attempts to include within the Walrasian framework the most important traded commodity, labor power, the potential to work (labor services is the term neoclassicals prefer). It is the clearing of the labor market, above all others, that determines full utilization of resources in a capitalist economy. To include it as one of the many traded items in the Walrasian market requires the introduction of production into the system. Production creates many theoretical difficulties for neoclassical economics, the analysis of which lies beyond the scope of this chapter.<sup>9</sup>

The market for labor power cannot be treated like the markets for produced commodities and services without flights of fantasy that make the mythical auctioneer seem a credible construction. In a Walrasian world workers arrive on the market day with their labor power to sell. A price is struck that satisfies every seller of labor power in terms of the amount of time contracted for work, and every employer must also be content with the contracted labor time. On this basis, workers determine their incomes by choosing the optimal amount of work in light of wage rate offers and their preferences between income and leisure. Workers, too, are price constrained, treating employment opportunities as unlimited at the prevailing wage.

Even in the abstract problems arise with this approach to the labor market. It would be somewhat credible to argue that at the outset of the potato market period no potatoes have been sold, so that the market for potatoes takes the form of a great collection of unsold potatoes.<sup>10</sup> This is not the case for the labor market. An excess supply of labor occurs when the vast majority of workers is employed. It is

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<sup>8</sup> This is one of several messages in Kenneth Arrow's famous book on social choice theory (Arrow 1951).

<sup>9</sup> See Weeks (1989, Chapter 10) where the limitations created by the process of aggregation are treated.

<sup>10</sup> This example involves invalid simplifications: first, in a Walrasian market, farmers are price-takers, so it is against the rules for them to offer any prices; and, second, the argument is partial equilibrium, not general equilibrium. It is possible that notional excess supply of potatoes at a 'false trading' price set might transubstantiate into a cleared market for potatoes at a higher price in the general equilibrium price set.

reasonable to assume that the excess supply of any commodity other than labor would imply disappointment on the part of the vast majority of sellers.

In contrast, an excess supply of labor power is consistent with contentment for the vast majority of sellers. The neoclassical equilibrating adjustment that would eliminate the excess supply, a lower real wage, would leave the vast majority of sellers (the employed) worse off (paid less per unit of effort). This contrasts with the situation of the seller of a non-labor commodity, who loses from the fall in price, but gains from the rise in quantity sold (with no change in effort expended). At any moment the vast majority of workers is not on the market. Thus, if wages fall or rise for the newly-employed, this is false trading, not evidence of allocative efficiency.

In conclusion, neoclassical theory has no adequate explanation for market clearing that has even a remote resemblance to the operation of labor markets. The theory provides no analytical basis for concluding that exchange economies tend automatically to full employment. The theory provides no justification for treating economies as price constrained. Therefore, it cannot be established even in the abstract that prices generate an allocation of resources that is socially efficient. In consequence of the foregoing, the conclusion follows that there is no theoretical basis for the judgment that competition brings welfare and efficiency benefits, except in the Walrasian fairy-tale.

The assertions that competition is desirable and its absence lamentable, that restriction of competition has a negative impact on people's welfare, are ideological defenses of capitalism and should be rejected. While neoclassical theory has no theoretical or empirical insight into competition, buyers and sellers do compete. Understanding competition and its consequences requires a methodological break that abandons the *ex machina* invoking of competition as a magic wand that turns the anarchy of the market into harmonious optimality. Karl Marx was a writer who clearly and decisively made that break and developed a coherent alternative, based on the basic principle that competition is part of the movement of capital.



## Competition and Capital

Pointing out the absurdity of the neoclassical Walrasian-based theory of competition is not a difficult task. Most people, even many mainstream economists, would view the high theory of competition to be logically flawed and analytically opportunist in its assumptions. Nonetheless, private enterprises interact in markets as rivals, sometimes in conflict, sometimes in conspiracies. Especially during the post war period up to about 1980, when economics was less dogmatic, a more *ad hoc* approach to competition characterized the profession.

This pragmatic approach, developed in the economics sub-field of "industrial organization", paid little attention to the fantasy world of Pareto Optimality. It focused on the actual structure of product and input markets. Theoretical criticism of perfect competition and analytical alternatives were offered by Chamberlin (1933), Robinson (1933) and Sweezy (1939), who sought a general formulation of firm behavior between the ideal extremes of perfect competition and monopoly. The intractability of specifying a general theory of "imperfect competition" (Robinson's term) led to an empirical focus, epitomized in the path breaking work of J. S. Bain (1941). These sensible approaches to the analysis of competition, even the empirical work of Bain, would never become completely respectable in a profession that resolutely maintained Walrasian competition in its microeconomic "foundations".

Ideology has been the fundamental barrier to the adoption of a sensible analysis of competition. A search for a rigorous theory of imperfect competition implies an admission unacceptable to the neoclassicals: that competition is systematically flawed and the Pareto benchmark is theoretically and empirically irrelevant. Despite their insights the proposed alternatives of Chamberlin, Robinson, Sweezy and others suffered from one of the basic limitations of the neoclassical approach. Though these critics rejected the Walrasian clearing of markets, they maintained the treatment of competition as a phenomenon of the size and power of firms.

To my knowledge only two major economic thinkers abandoned the quantity based approach to competition, Karl Marx and Joseph Schumpeter.<sup>11</sup> The role of competition in the analysis of Schumpeter of capitalism is explicitly non-neoclassical. The two major elements of this difference are, first, that the rivalry among firms does not result in a competitive equilibrium. Competition is a process of "creative destruction", in which the rivalry eliminates the weaker firms rather than facilitating their adjustment to a sectoral norm of efficiency. Second, competition brings social benefits through this destructive process, but not by generating a harmonious equilibrium (Schumpeter 1961).

Similar conclusions were reached earlier by Marx on the basis of an analysis considerably more sophisticated than that of Schumpeter. Marx's analysis has greater sophistication because he begins by asking the fundamental question: why is there competition? The answer to this question reveals the historically specific character of capitalism. Competition is the historically specific result of the loss of the ability of people to produce. This loss results from the separation of labor from the means by which work is realized, from their means of production.

The central characteristics of a developed economy, commodity production, the major role of finance and dynamic technical change, are the result of the separation of the vast majority of the population from the means of production. That separation implies that in order to obtain their basic needs, people must offer themselves for work, become employees. This, the wage labor relationship, creates in a commodity producing society, in which the products of labor are produced with the prior purpose of exchange.

From the point of view of the working population, the wage labor relationship is the mechanism by which its needs are met, through the intermediary of money. From the point of view of capitalists, the wage labor relationship is the means by which it organizes production. Prior to the capitalist epoch, competition was possible only to a limited extent, so limited that calling it "competition" is misleading. Labor mobility was restricted by feudal restrictions in agriculture and

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<sup>11</sup> Baskoy (2003) argues that in the work of Thorstein Veblen one finds a theory of competition that is distinctly non-neoclassical. While he makes a strong case for this, it remains that Veblen himself did not bring his various insights together in a single, coherent presentation.

guilds in cities. Most land could not be bought and sold. As a result, money could not be used to mobilize resources for production.<sup>12</sup>

Once money became capital, a general and liquid claim on resources, competition was the consequence. The origin of competition is money functioning as capital, not the presence of many firms. The principle form this competition takes is the movement of capital among sectors, as the liquid money capital is converted into productive capital. This movement of capital manifests itself as a rivalry for market shares. This rivalry cannot achieve neoclassical type market equilibrium because the movement of capital conveys technical change. Technical change transforms the production process, which creates a hierarchy of firms. Recent entrants use lower cost techniques, and previous entrants have older techniques with higher unit costs. This hierarchy of firms is not the result of an assumption. It is the necessary result of technical change and the passage of time.

At any moment the movement of capital into some sectors results in increased rivalry over market shares, while in other sectors it eliminates actual and potential rivals to establish dominant market power. Marx succinctly summarized this process as follows:

In practical life we find not only competition, monopoly, and the antagonism between them, but also the synthesis of the two, which is not a formula, but a movement. Monopoly produces competition, competition produces monopoly. Monopolists compete among themselves; competitors become monopolists...*The synthesis is such that monopoly can only maintain itself by continually entering into the struggle of competition.* (Marx and Engels 1976: 197)

## Conclusion

If competition is specified as the rivalry among established firms, all of which have similar or, in the extreme case, identical unit costs, and none can profitably expand, the result is harmonious market equilibrium. It is a formulation that assumes what it seeks to prove: that all contestants are the same, so none is

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<sup>12</sup> Conditions differed by country. See Polanyi (1944) and Hilton (1976).

eliminated in the rivalry. This is rather like a tennis tournament in which I assume that all the contestants have exactly the same skill, stamina and commitment, then I conclude that play will go on forever because no one can win or lose.

This is an absurd conclusion for a tennis match and even more so for capitalist rivalries. In the neoclassically competitive world there is no technical change endogenous to the competitive process. Technical change enters the analysis as chronologically long run force to be separately treated, divorced from short run market rivalries. This is a profound misunderstanding of capitalism, whose dynamism arises precisely from technical change being embodied in the competitive process. This fundamental and obvious insight implies that the neoclassical theory of competition is not an analysis of capitalist rivalry.

Rather, it is a technically obfuscating rendering of the "petty commodity production" model of the political economy romantics of the nineteenth century, Jean Charles Léonard de Sismondi and Pierre-Joseph Proudhon.<sup>13</sup> The assumption of a minimum unit cost at a relatively low level of production simulates family enterprise, and the complementary assumption of a homogenous product harks back to pre-industrial agrarian society. We should not be surprised that the movement of capital and technical change play no role in neoclassical competition. It is a convoluted specification of a society that exists only in the minds of romantics. It would be a harmless curiosity rather like fairy tales were it not used as the ideological defense for capitalism and its excesses.

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<sup>13</sup> Sismondi best known work is *Nouveaux principes d'économie politique, ou de la Richesse dans ses rapports avec la population* (New Principles of Political Economy, 1819), and Proudhon stated his economic and political analysis in *The Philosophy of Poverty* (1847). Marx criticized both in considerable detail in *Theories of Surplus Value*, sometimes called the fourth volume of *Capital*.

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