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Ideas & Trends: Discount Nation; Is Wal-Mart Good for America?

By STEVE LOHR

THE annual celebration of the American consumer economy -- the holiday shopping season -- is just underway, and Wal-Mart, the juggernaut of retailing, already seems to have claimed its first victim. The corporate owner of F.A.O. Schwarz stores said last week that it would file for bankruptcy. Bemoaning the news, analysts explained that the F.A.O. Schwarz formula of selling premium-priced toys in sumptuous surroundings could not withstand the steady advance of Wal-Mart into the toy business.

"Will Wal-Mart Steal Christmas?" asked a Time magazine headline.

The toy war is merely the most recent manifestation of what is known as the Wal-Mart effect. To the company's critics, Wal-Mart points the way to a grim Darwinian world of bankrupt competitors, low wages, meager health benefits, jobs lost to imports, and devastated downtowns and rural areas across America.

Yet there is a wider, less partisan view of the company, which perhaps more visibly than any other corporation marches to the mandate of the global capitalist economy.

"Wal-Mart is the logical end point and the future of the economy in a society whose pre-eminent value is getting the best deal," said Robert B. Reich, the former labor secretary and a professor of social and economic policy at Brandeis University.

To the company's supporters, Wal-Mart is an agent of economic virtue, using its market power to force suppliers to become more efficient and passing the gains on to consumers as lower prices. The enthusiasts say Wal-Mart is a big reason for the country's almost nonexistent inflation and impressive productivity gains.

There is a lot to be said for getting the best deal, economists say. Prices, they note, are essentially a yardstick of efficiency, translated into consumer terms. Prices are concrete and measurable, while other values of consumer and social welfare -- say, product quality or job preservation -- are often hard to quantify or require costly intervention like protectionism or subsidies.

Moreover, some economists note, lower prices for the kinds of basic goods on sale at Wal-Mart superstores, like food and clothes, are of the greatest benefit to the less affluent. Grocery prices, for example, drop an average of 10 to 15 percent in markets Wal-Mart has entered, analysts say.

"Wal-Mart is the greatest thing that ever happened to low-income Americans," said W. Michael Cox, chief economist of the Federal Reserve Bank of Dallas. "They can stretch their dollars and afford things they otherwise couldn't."

Wal-Mart is the largest American corporation in terms of sales, \$245 billion last year. It is now the nation's largest grocer, toy seller and furniture retailer. More than 30 percent of the disposable diapers purchased in the country are sold in Wal-Mart stores, as are 30 percent of hair-care products, 26 percent of toothpaste and 20 percent of pet food. Wal-Mart has nearly 3,000 stores in the United States, and plans to add an additional 1,000 over the next five years. Increasingly, the company is taking its formula abroad; Wal-Mart is now the largest private employer in Mexico.

The prospect of Wal-Mart amassing even more market power does not worry free-market economists like Mr. Cox. Despite the company's gains, the retail industry is still not highly concentrated, he said, with Wal-Mart accounting for 20 percent of the sales of the 100 largest retailers. Its success has been built, Mr. Cox said, on mastering the use of information technology to streamline its operations -- much like Dell Computer in the personal computer business. Inevitably, less efficient rivals will be winnowed, he added, and those that remain will compete aggressively for consumer dollars.

"With the new technology of the information age," Mr. Cox said, "we're moving to a new market structure in a lot of

industries. And the optimal number of firms has gone way down."

Antitrust has traditionally been the tool for insuring competition and keeping a watchful eye on powerful companies. But the evolution of antitrust policy over the last 30 years -- to emphasize price, not the number of competitors -- has actually worked to the advantage of businesses like Wal-Mart.

In the past, antitrust policy assumed that more companies meant more competition, which was good for consumers. The Robinson-Patman Act of 1936 -- sometimes called the anti-chain store act -- was passed partly to protect small local retailers from the Great Atlantic & Pacific Tea Company, the Wal-Mart of its time. It prohibited price discrimination, or discounts, to different purchasers when the effect was to lessen competition. At the time, the drift of antitrust policy was to restrain big business and protect mom-and-pop stores.

The populist tinge to antitrust continued for decades. In ordering the break-up of the Aluminum Company of America in 1945, Judge Learned Hand of the United States Court of Appeals for the Second Circuit wrote that the purpose of antitrust was to "perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete against each other."

In 1966, the Supreme Court sided with the Federal Trade Commission in challenging a merger in the Los Angeles grocery market, Von's Grocery and Shopping Bag Food Stores, which together had only 7.5 percent of the local market.

But the intellectual tide shifted by the 1980's, especially under the growing influence of the so-called Chicago school of economics, which emphasized prices as the fundamental gauge of consumer welfare. Market concentration and company size meant little. If big companies raised prices, they were bad. But if, like Wal-Mart, they achieved greater efficiency from economies of scale and passed the benefits onto consumers as lower prices, they were praised.

"Has our thinking on antitrust driven us toward an economic world that Wal-Mart represents?" asked Andrew I. Gavil, a professor at the Howard University law school. "I would say that it has. The harder question is whether that is a good or a bad thing."

To keep cutting costs, Wal-Mart is tough on its suppliers. Selling to Wal-Mart, by all accounts, is a brutal meritocracy. Manufacturers have been forced to lay off workers after Wal-Mart canceled orders when another vendor cut its price a few cents more. Other suppliers have shifted to low-cost operations in China and elsewhere when squeezed by Wal-Mart to cut costs further.

Yet here again, many analysts regard Wal-Mart's practices as simply leading the way in the inevitable drive to making the economy more efficient. "Wal-Mart is tough, but totally honest and straightforward in its dealings with vendors," said Michael J. Silverstein, a senior vice president at the Boston Consulting Group. "Wal-Mart has forced manufacturers to get their act together and forced them to compete internationally."

There is some evidence that the company's zeal for efficiency has gone too far. Wal-Mart's detractors point to a trail of litigation over pinch-penny issues like unpaid overtime, and to a federal investigation into its use of poorly paid illegal immigrants as janitors. Wal-Mart insists that any problems do not reflect the culture of the company as a whole. "If there is valid criticism that comes from these cases, we will own up to it and made improvements," said Ray Bracy, vice president of international corporate affairs for Wal-Mart.

Wal-Mart's growing power has brought increased scrutiny from federal and state regulators. But as long as the company keeps delivering lower prices, they will most likely be reluctant to act, beyond prosecuting employment infractions. The classic behavior of a predatory corporation is to cut prices to drive out competition in order to raise them later. There is no evidence yet that that is the Wal-Mart strategy.

"Consumers get huge benefits from Wal-Mart as long as it has real competition," Mr. Reich said. "The worry is that it becomes so powerful that it can unfairly stifle competition."

Drawing (Drawing by Ross MacDonald)