

## The Benefits of Asymmetric Markets

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**E**conomists have long been fascinated by the paradox that, given favorable conditions, people's selfish greed for power and profits can annihilate the very power and profits they lust after, and in the process turn the chaos and anarchy of unbridled greed into order and harmony. Ever since the paradox was first noted, generations of economists have admired, taught and argued it, and the Arrow-Debreu theory of general competitive equilibrium is the culmination of the profession's long struggle to understand fully all its conditions and implications.

The resulting theory of general equilibrium, with its careful setting out of the many conditions on which the conclusions depend and its clarification of the way in which conclusions and underlying conditions are interconnected, has rightly been hailed as a remarkable intellectual achievement. Of course, the conditions set out have been chosen with a view to obtaining the conclusions, not for their realism; and some of them are admittedly and blatantly unrealistic. Accordingly, the important and remarkable results of the theory pertain to an imaginary economy. However, the theory's portrayal of the market forces that govern resource utilization and allocation resembles our actual economy closely enough to be of great practical importance. Hence the great attention that the theory has received and the consensus that it represents an important milestone in our understanding of the market economy.

One must be careful, however, not to read more into general equilibrium theory than what it says. Everybody knows that the U.S. economy is far removed from the theory's imaginary model of perfect competition—the empirical evidence on unemployment and capacity underutilization makes that clear—but the intellectual pleasure one gets from following the theory's elegant logic and beautiful results easily makes one forget its limitations. Economists are often so mesmerized by the magic of perfect competition that they neglect or fail to notice other, equally important

achievements of the real market economy around us, most of which seem to result from monopoly tempered by competition and competition tempered by monopoly.

For, as Schumpeter pointed out more than 60 years ago, monopoly power over others and monopoly profits earned at their expense, though considered ethically reprehensible by some, often yield important benefits, especially when suitably curbed by competition or legal constraints. The powerful often help the powerless as they try to preserve and increase their power; and they are prompted to introduce new products, cheaper methods of production and to create new productive capacity by their desire to secure and enhance their continued access to monopoly profits.

The preoccupation of general equilibrium theory with the perfectly competitive model hides those valuable services from view, because it precludes the monopoly power that creates them. Moreover, since perfect market information by all economic agents is a necessary condition of perfect competition, general equilibrium theory assumes away by implication the very basis of modern economic life—specialization and division of labor—for they are incompatible with the assumption of everybody's having perfect information, as will presently be shown. Yet it would be absurd to refer to specialization and division of labor as instances of "market failure." They are "failures" only in the sense that they imply a departure from the model of the perfectly competitive market; but they surely are the roots of the actual success of market economies in the real world.

Let me now consider some of those benefits of real-world markets which the perfectly competitive model of general equilibrium theory leaves out and cannot deal with. The simplest way to introduce them and show how market forces lead to their creation is to drop the one assumption underlying general equilibrium theory that does perhaps the most violence to reality. I have in mind the assumption that all economic agents possess all the market information relevant to the transactions they enter or contemplate entering into. That is the crucial condition necessary to render markets perfect for buyers and sellers alike; and we must now look at the nature and operation of markets that come about when that condition is *not* fulfilled.

## **Asymmetric Information and Asymmetric Competition**

Theoretical models of the economy are always based on simplifying assumptions to abstract from the irrelevant and bewildering complexity of reality. The condition of perfect information postulated in the theory of perfect competition may seem to be such an innocent assumption to a casual observer of commodity exchanges, the closest approximations to the ideal of perfect competition. After all, grains, fibers, metals and other staples are so perfectly graded and standardized that they can be (and are) traded sight unseen. All the market-relevant information concerning such commodities is condensed into just three bits of easily ascertained information: the identity of the product, its grade and its price. What the casual observer may fail to notice is that

such perfect standardization and grading become profitable only when the majority of the buyers are expert specialists.<sup>1</sup>

Perfect markets don't emerge spontaneously. Most markets are imperfect to begin with, in the sense that they deal in many different brands and models of a given product, each with its own strengths, weaknesses, special features, and its own different price. To render such a market perfect by grading and standardizing and equalizing the prices of identical products, most of its members on the buying and selling side would have to compete knowledgeably and, to do that, would have to assemble piecemeal all the bewildering volume and variety of information concerning the nature, quality, convenience, cost and availability of all the competing brands and models. That takes much time and effort and is not something every market participant can do or finds worth doing, which is why the assumption of perfect knowledge, crucial for rendering markets perfect, is unrealistic.

Moreover, the assumption not only simplifies reality but also distorts it, because market relevant knowledge is not randomly distributed among market participants but, in most markets, biased in favor of one or the other side of the market. Such a bias has a great impact on market behavior and market outcomes, because knowledge is power, and those on the better informed side of the market can exploit the people on its other side. Such power is the main source of monopoly power, its exploitation yields monopoly profit, and rivalry among market participants who wield such power is the main form of monopolistic competition.

That explains why buyers' and sellers' perfect (and hence *equal*) knowledge of relevant information is a necessary condition of perfect competition, whose very essence is the symmetrical status of transactors on the two sides of the market. At the same time, it also explains why perfect competition is so rare in real life.

The root cause of the unequal distribution of knowledge between buyers and sellers is the division of labor, which causes everybody to know more than others about their own specialty and less about other people's specialties than others know about them. The farther the division of labor proceeds, the wider becomes the gulf between the specialist's knowledge and the nonspecialist's ignorance of each specialty. While specialization reserves most production activities for its own specialists, it cannot do the same for exchange activities considering that the division of labor forces each one of us to obtain through market exchange everything we need but don't produce ourselves. Market exchange therefore is one of the few activities that specialists and nonspecialists alike participate in. Moreover, exchange in markets for final products (and in a few other markets as well) takes place between unequal partners, with a specialist facing a nonspecialist on the other side of his market.

Such disparity in the knowledge and preparedness of buyers and sellers to deal with each other and to stand up to each other is an important and unavoidable feature of today's market economy, which has received surprisingly little attention.

<sup>1</sup>For the argument that the standardization of products is always the result of the buyers' expertise, see Scitovsky (1951 or 1971, p. 17).

That is why it will be the pivot around which most of the argument of this paper will revolve.

First, however, it is well worth asking how something so obvious and ubiquitous could have been so much neglected by the profession. The main reason, I think, is that differences between buyers' and sellers' marketing knowledge have not been too great and widespread until fairly recently; but another reason could also be the profession's desire to exorcise power from its idealized picture of the economy. Since knowledge is power, one way of doing that was to assume away one of its sources by assuming equality of the different economic agents' market-relevant knowledge—an assumption that was not as absurd in the 18th century as it has become today. Power was admitted into economic theory only as an exception, in the form of natural, state and conspiratorial monopolies. All other monopoly power was expected to be eliminated by competition.

The main thrust of this paper is that today, superior knowledge and earlier knowledge are the main sources of monopoly power; that only by eliminating differences in knowledge could one eliminate such power; and that competition, while mitigating monopoly power and diminishing monopoly profits, works its main beneficial effects by harnessing the monopoly power created by superior knowledge to promote the social welfare.

### **Buyers' Markets**

The most important examples of the asymmetry of information between buyers and sellers are the markets for consumer goods: both those where producers sell them and those where consumers buy them. Producers in the advanced economy are obviously more knowledgeable about the goods they sell than those they sell them to, but retailers also know more than their customers about the goods they sell. Since consumers must know something about all the various markets they frequent, they must spread their time and expertise thin, whereas sellers naturally concentrate their attention on a single market and cannot help but learn much more about the cost, nature, quality, variety, availability and marketing of the products they sell than the buyers facing them. That is why the typical seller is a specialist, the typical buyer a generalist in virtually all markets for consumer goods.

That difference between the market-relevant knowledge of the two sides gives the sellers an advantage to exploit. Competition among the suppliers diminishes this advantage but cannot eliminate it completely, as long as the buyers remain inexpert and unable clearly to distinguish qualitative differences between competing offers. The asymmetry between the information of the two sides distinguishes monopolistic competition from perfect competition and bilateral monopoly. While monopolistic competition may reduce net profits to zero (by equating price to average cost), it retains its monopolistic character and works its beneficial effects as long as price-makers can set prices above marginal cost.

The simplification of reality by the perfectly competitive model would be relatively innocuous if monopolistic competition merely added monopoly profits to adjustment profits, and diminished the efficiency with which perfect competition

would utilize and allocate resources and products. As already mentioned, however, there is also a positive side to monopolistic competition. It creates a number of important services and amenities, not only for consumers, but for producers and society at large as well. That is why providing a complete survey of the functions and benefits of the real-world market economy calls for setting the model of the perfect market aside and analyzing monopolistic competition in depth.

In primitive economies, where the division of labor is limited, sellers exploit their superior knowledge by striking bargains favorable to themselves. In advanced economies, however, the much greater specialization and division of labor leads to so great a disparity in both numbers and knowledge between the specialists on the one and the generalists on the other side of the market that the former find it profitable to save the cost of the time and skill that bargaining requires by setting prices on a take-it-or-leave-it basis. The resulting price-maker price-taker relationship is the well-known institutional form that asymmetrical market situations usually take in advanced economies; and since it gives all the market initiative to price-makers, it provides the further advantage of enabling them the better to exploit their superior knowledge.<sup>2</sup>

Not only do sellers set their prices unilaterally, they usually also take the initiative in deciding what kinds and qualities of products to sell and what services to offer. That tempts some of them to cheat by cutting corners, offering inadequate service, shoddy merchandise, and so on. In turn, this causes price takers to try to compensate for their lack of expertise by taking price-makers' reputations, rankings, distinctions into account when they make market decisions and by insisting that professionals and servicemen be licensed and obtain diplomas before marketing their expertise. The importance buyers attach to such tokens of reliability renders their demand less elastic and competition more monopolistic in character. Sellers facing less than perfectly elastic demand find it profitable to add a markup or profit margin to marginal cost in setting their prices. Such markups are an incentive for them to promote sales by nonprice competition, because they can always benefit by selling more at a price above marginal cost, provided that the cost of promoting sales in this way remains below the additional profit it generates.

Nonprice competition can take many forms and consists in offering customers any one and any number of a great variety of amenities and services. These include the free information that advertisements and window displays provide about the availability, advantages, nature, appearance and price of products; the convenient location of stores, the pleasant surroundings, polite service; charge accounts, credit and delivery facilities most stores provide; explicit or implied guaranties of the quality of what is sold; refunds for returned merchandise offered with a smile; and the seller's ample inventory, allowing instant delivery of whatever buyers want, in whatever model, size, color and quantity they want it, and catering to random surges, unexpected shifts and the secular rise in demand.

<sup>2</sup>For the first discussion of the subject matter of this section, see part III of Scitovsky (1951), or part IV of the revised 1971 edition.

All those and similar conveniences together constitute what is called a buyer's market. That term, sometimes used merely to denote the buyers' advantage in not being rationed but free to buy as much as they want at a set price, gains in meaning when it also denotes, as it usually does, the many convenient services and amenities sellers provide to attract and please customers thereby to effect more sales, either because they have an excess supply to get rid of or, as in the present case, because additional sales at prices above marginal cost add to their profits.

To the unwary, for whom monopoly and profit are dirty words, the use of the term buyers' market may seem paradoxical in this last case, considering that it is the sellers, not the buyers, who earn monopoly profits, even if part of the profits are spent on pleasing the customer. But that is the wrong way of looking at the subject. Buyers clearly prefer having the information, the guaranties, the comfort and the many other conveniences created by nonprice competition, and most people willingly and freely pay for the surcharge that the seller's monopoly profits represent.

These conveniences may be looked upon as ancillary services which the sellers provide as joint products with the goods they sell. Although the cost to the seller of providing such services must be less than the profits the seller hopes to generate with their aid (since otherwise the seller would not offer them), their value to most customers exceeds what they pay for them. Nowadays, discount houses sell many of the same goods for less but without the ancillary services, thereby providing buyers with an opportunity to buy the merchandise without the services attached. The fact that discount houses have captured only a small fraction of the market shows that most consumers prefer to buy *and are willing to pay for* both the goods and the conveniences that come with them.

If sellers did not provide those services, buyers would be inconvenienced, having to go without some of them and either performing the rest for themselves or buying them separately at increased cost. In general, economies of scale render credit cheaper to merchants than to consumers; transportation in bulk by sellers more economical than transportation piecemeal by buyers; the larger inventories of a few sellers probably add up to less than the combined small inventories of many customers which would otherwise be necessary. But the scope for economies of scale is the greatest in the provision of information. Advertisements provide buyers with some of the information they lack; and it is much cheaper for a few sellers to advertise and make generally known information they already have than it would be for each buyer to ferret it out individually. Each seller, of course, wants to provide only the part of information favorable to herself; but that bias is largely offset by competitive advertising and legislation enforcing truth-in-lending, truth-in-selling and the disclosure of ingredients in the food, side-effects in the pharmaceutical industries. Guaranties and warranties combine the advantages of added information and lower insurance costs. In short, nonprice competition not only compensates buyers for the monopoly profits they pay, it also improves the Pareto efficiency of markets.

Very similar to the amenities created by nonprice competition among retailers are those that result from nonprice competition among producers of consumer goods.

They too are prompted to hold inventories and also to invest in standby capacity; produce their goods in many sizes, models and variants; offer warranties and repair services to the final buyer; cater to the public's desire for variety by constantly improving products, changing designs and new fashion. Further, they are prompted to engage in the research, development and investment required for the introduction of new products and cheaper methods of production. All that benefits the economy as a whole. Finally and perhaps most importantly, they too engage in advertising, not so much to inform their already established customers as for reaching a wider public that previously hardly even knew the existence, let alone the affordability of their products, thereby to secure a mass market. Advertising is almost as essential for creating a mass market as is a mass market for realizing the economics of scale in manufacturing. In short, nonprice competition among producers is a most important driving force of both product and process innovation even if it is not by itself a sufficient condition of technical progress.

The great benefits of innovation and technical progress as the engine of growth need no stressing, but it is worth noting one of their important side effects: the rise in equity. Market-oriented innovation consists largely of the progressive exploitation of mass-production methods for cheapening and making generally available an ever-increasing number of goods and services that previously were the privilege of the rich. Accordingly, although the market economy tolerates substantial inequalities in income distribution, it nevertheless increases equity, because market-oriented growth is mostly oriented toward equity as well.

Let me note that all the above benefits, all the ingredients of the buyers' market, stem not from the sellers' monopoly positions but from competition among them as they try to encroach upon each other's markets or defend their own. The distinction is important, because a positive markup will not always give rise to nonprice competition. For one thing, the seller's market may expand so rapidly that he has no need to seek deliberately to increase his sales. In the heyday of British imperialism, for example, the world market for British products opened up so fast that British manufacturers could barely keep up with the demand and wasted neither money nor effort on innovation and improving their products. That explains why many years later, when their Continental and U.S. competitors entered the export market, their design and technology had fallen so far behind that they were unable to hold their markets against the new competition (Tylecote, 1981, p. 26).

For another thing, nonprice competition is only one of many ways to secure and preserve monopoly positions. Some of the other ways include monopolistic agreement among competitors, tacit collusion, the buying out of competitors, seeking political influence to impose protective tariffs, and restricting domestic competition or the entry of newcomers through licensing or regulation. Since nonprice competition alone secures the many social benefits just discussed, it is desirable that price-makers adopt it in preference to all the other restraints on competition. That is a strong argument for antitrust and anti-monopoly legislation, additional to and probably more important than the traditional one.

While the social benefits of nonprice competition are of paramount importance, monopoly power itself also provides benefits as a source of both funds and superior market information for investment.

That nonprice competition stimulates innovation and technical progress has been mentioned earlier, but firms will respond to that stimulus only if they can expect to reap a steady and enduring flow of monopoly profits sufficient to repay research, development and investment costs and make it worth their while to take the gamble that innovation involves. The ephemeral profits created by change (and adjustment to change) in a highly competitive market are not enough. That fact is generally recognized today, which is why most countries enact patent laws to assure monopoly profits to inventors in case secrecy or the difficulty of replicating their innovative technology fails to do so.<sup>3</sup>

Another important benefit a producer gets from market power is more information on which to base investment decisions than would be available under perfect competition. A perfectly competitive economy would transmit only price signals or rather, in view of the rarity of futures and contingent futures markets, only current price signals. Asymmetric monopolistic markets are superior in that respect, because in addition to price information, they also provide some additional information relevant to investment decisions. At a minimum, each price-maker has available quantity signals, which (unlike price signals) show not only that investment would be profitable but also *how much* investment is likely to be profitable. The increase in a producer's sales and unfilled orders or the reduction in inventories represents that producer's share in the overall rise in market demand. Since that share is the part it can most easily capture and hold onto without encroaching upon its competitors' actual and prospective markets, this amount indicates a minimal and fairly safe scope for capacity expansion and investment. In addition, most price-makers have an idea of the elasticity of the market facing them and so also know something about the ease or difficulty and danger of expanding their market at competitors' expense.<sup>4</sup>

### **Sellers' Markets**

The asymmetric relationship between buyers and sellers can, of course, also go the other way around, putting the buyers in the favored position of price-makers when they happen to have superior market knowledge and a large enough number of people or firms on the other side of the market—two advantages that usually go together.<sup>5</sup> Before unions were established and in sectors where they were not established, employers assumed the role of wage-makers thanks to their knowing more about labor market conditions than workers. Similarly, before the advent of mass production, large wholesalers and trading companies became knowledgeable price-

<sup>3</sup>For the argument of this and the previous paragraph, see Schumpeter (1942). For arguments that investment, innovation and technical progress require the inducements that monopolistic competition and the funds and information that monopoly provide, see Schumpeter (1926).

<sup>4</sup>For a detailed discussion of the subject of this paragraph, see Richardson (1960).

<sup>5</sup>For a detailed discussion of sellers' (as well as buyers') markets, see Scitovsky (1985).



makers in their market relations with the small craftsmen and manufacturers who were their suppliers.

The implications of such a relationship are the mirror image of those discussed in the previous section. The sellers' lesser knowledge of the market gives the supply curve facing the price-maker buyers an upward slope, which enables them to maximize profits by setting their buying price *below* the marginal value product of the goods they buy or the labor they hire, by a profit margin that is the larger, the less elastic the supply facing them.

Capacity limitations permitting, the price- or wage-making buyer finds it profitable to absorb (and to stand ready to absorb) more input when more is offered at his set price, as long as that is below the marginal value product of the labor he hires or supplies he buys. That is the counterpart of the price-making seller's readiness to cater to surges in demand out of inventory or standby capacity. More input results, of course, in more output, which must be sold to render the added inputs profitable, and whose selling requires additional sales effort. That may slow the rate at which buyers can absorb unsolicited offers of supply, but does not prevent it if their calculations of the marginal value product of their inputs allows (as it should) for the selling costs of the extra output.

Firms that enjoy the advantage of being price-makers in both the markets where they buy and the markets where they sell are especially able to absorb unsolicited offers of supply and cater to autonomous surges in demand. Witness the very fast growth of trading companies in Japan and 19th century England, which absorbed the output of the fast-increasing number of small manufacturers, and the fast-increasing output of Britain's manufacturing industry during the industrial revolution, which enabled it to absorb fast-increasing supplies of labor.

Nonprice competition by price-making *buyers* consists of the inducements they offer to increase the supply of their inputs beyond its natural increase. The scope for providing such inducements is greater the slower the natural rise in the supply of inputs and the larger the profit margin (or monopsonistic markdown) between the buyer's marginal valuation of his inputs and the price at which he offers to buy or hire them. Examples of such inducements are good working conditions and fringe benefits employers offer their workers, and amenities like credit, transportation, quality control, help in acquiring raw materials. Also included is advice about design, quality improvement and the introduction of new products, which large trading companies offer to the small manufacturers whose products they market. The provision of such services justifies calling such a situation a sellers' market, since here, the extra services the buyers (or employers) provide in the hope of reaping additional monopsony profits are in the sellers' favor.

The close parallelism between the nonprice competition among sellers and buyers and between the buyers' and sellers' markets they respectively create makes one wonder why most of Britain's price-maker employers failed, during the industrial revolution, to engage in such nonprice competition and provide their workers with amenities and conveniences corresponding to those shopkeepers provided for their customers. The probable explanation is the tremendous unemployment and poverty

created by the enclosure movement, which increased the reserve army of industrial labor faster than the ability of industry to employ them. That is why the adversary relations in the labor market of that time failed to soften. The workers, who felt exploited and resentful, used collective action to turn most of the labor market into a bilateral monopoly. By contrast, in the labor market composed of Japan's largest firms, nonprice competition is as strong as in consumer markets, leading to much better relations between employers and employees.

Another difference between labor and consumer markets is that nonprice competition for labor not only attracts workers and keeps them loyal, it also raises their morale and in many kinds of jobs increases the quality and quantity of their work.

## **Reconciling the Advantages of Price and Nonprice Competition**

My account of buyers' and sellers' markets may have seemed paradoxical, since it presented monopolistic competition, not as a market imperfection that abridges welfare, but as a creator of benefits that add to welfare. Nonprice competition played a key role in the argument; and that raises three interrelated questions: 1) How do price-makers choose between price and nonprice competition? 2) Can the respective benefits of the two kinds of competition be reconciled? 3) Are the benefits of nonprice competition peculiar to asymmetric markets or are they available in symmetric markets as well? In addressing these questions, I shall simplify the exposition by dealing only with the behavior of price-maker sellers, omitting the parallel argument for the price-maker buyers.

### **How Do Price-Makers Choose Between Price and Nonprice Competition?**

Asymmetric markets provide the price-making seller with many more policy variables than are (or would be) available to members of the symmetric perfectly competitive market. Such a seller will naturally choose the most profitable competitive weapon or combination of weapons, which depends on the nature of the market; and in an uncertain world, the seller's choice is bound to be difficult and uncertain. How the price elasticity of demand determines the seller's profit-maximizing price and profit margin is too well-known to be repeated here. Once a seller has set a price and markup at what it considers their best level, the scope for further price competition is exhausted. However, nonprice competition may still add to the seller's profits, and its scope and effectiveness are greater, the larger the profit margin set. Since inexpert buyers lead to the price elasticity of demand being lower and the profit-maximizing price being higher, nonprice competition prevails in inexpert markets. On the other hand, price is the dominant competitive weapon in markets where buyers are well informed and choosy—the limiting case being the perfect market, where every member has perfect information and sellers are restricted to price as their only competitive weapon.

Recall in this connection my initial statement above that monopolistic competition not only diminishes monopoly power and profits but creates positive benefits as

well. It should now be apparent that price competition does the first, nonprice competition accomplishes the second but may at the same time also affect the level of monopoly power in either direction. When the amenities of nonprice competition increase marginal cost, they tend to diminish monopoly power as measured by the size of the profit-maximizing markup. On the other hand, nonprice competition often also has the subsidiary effect of fragmenting the market by differentiating products and offers, and of creating goodwill, reputations and buyers' loyalty, all of which tend to secure and prolong monopoly power and raise the profit-maximizing price. Since those are important advantages for the price-making seller in the long term, they may bias the choice of competitive weapons in favor of nonprice competition. In other words, when the price-maker believes her set price to be above its profit maximizing level, she may, rather than lowering the set price, keep it unchanged and use nonprice competition to raise the level of the profit-maximizing price.

Oligopolistic markets are known to tilt the price-maker's choice in favor of nonprice competition even further, because they restrain price competition for fear of provoking retaliation and precipitating an all-round reduction of prices and profits. Of course, nonprice competition can also be countered, but that is a much slower and more difficult process. One reason is that price reductions are more conspicuous, sooner noticed, easier to match or outdo and much harder to retract than most forms of nonprice competition; another reason is that nonprice competition requires skill and inventiveness, whose limited supply limits the length to which rivalry in offering its various amenities can go.

### **What is the Tradeoff between Price and Nonprice Competition?**

Having dealt with the price-maker's preferences between price and nonprice competition, we can next look at their respective benefits from society's point of view. We know that price competition promotes price flexibility and narrows the markup between prices and marginal costs, thereby helping market forces to harmonize individual agents' economic behavior and so to approximate the ideal of market clearing and efficient resource allocation more closely. On the other hand, those narrower markups lessen the scope and inducement for merchants to create a buyers' market and for producers to innovate, provide variety and otherwise anticipate and cater to the public's tastes. Nonprice competition creates these social benefits, and while it can raise or lower markups, it is more likely to widen than to narrow them. Thus, the respective advantages of price and nonprice competition are likely to be mutually incompatible.

In short, there is a tradeoff between the social benefits of the two kinds of competition and I know of no way to compare or rank them. Common sense suggests that nonprice competition should have priority, because it seems more important to have progress and continually to adapt and devise goods and services according to the public's needs and desires, rather than to cheapen existing goods and services to induce people to make fuller use of them. At the same time, it is also clear that society needs both. To get both, we have to compromise and accept less than perfect resource utilization and allocation for the sake of gaining some of the benefits of nonprice

competition. Since market forces cannot provide unaided a full (or even an adequate) measure of both kinds of benefits, they need to be supplemented by deliberate policies, like patent and copyright laws to buttress monopoly, antitrust action to encourage nonprice competition, legislation for truth in lending and selling to block misleading advertising, and employment policies to increase resource utilization.

Note in this connection that the simple-minded argument for noninterference with market forces loses much of its force once one recognizes that efficient resource utilization and allocation are not the only benefits of the market economy, that its other benefits are no less important, and that there is a degree of incompatibility between the two sets of benefits.

### **Can the Benefits of Nonprice Competition Exist in Symmetric Markets?**

The number, variety and importance of the social benefits that nonprice competition creates in asymmetric markets makes one wonder whether they are absent in symmetric markets, which provide little or no scope for nonprice competition. Or if they are present, who creates them and in response to what inducements?

A general equilibrium theorist might answer that in perfect markets, demand for amenities whose benefits exceed their cost would be bound to elicit supplies. But this answer overlooks two facts. First, markets cannot signal consumers' hopes and desires for things not yet in existence and only transmit information about the urgency of demand for already available products, services, amenities. Secondly, such an answer also overlooks the risk of catering to a demand not yet formulated, which requires monopoly profits to pay for an investment that may easily misfire.

The problem here is not the static problem of whether demand for an amenity already known and found valuable would call forth a supply, but whether a product not yet even thought of would be dreamed up and developed by someone. The creation of buyers' and sellers' markets is a matter not of responding to consumers' wishes, but of anticipating them. In that it resembles, on its smaller and cheaper scale, the innovative process in the realm of production.

Only someone with imagination, initiative, willingness to gamble, and the capital to gamble with can provide the amenities of a buyers' market. In asymmetric markets, price makers who have already seized the initiative and enjoy some monopoly profits are certainly the best-placed, if not the only ones to create these amenities. Credit cards, however, are an important example of a consumers' convenience often provided by third parties—banks.

In symmetric markets in which both sides lack marketing expertise, marketing experts can and usually do insert themselves as middlemen, providing information and other services and conveniences to both sides and reimbursing themselves for services rendered, sometimes by charging commissions but more often by assuming the price-maker's role in both their buying and selling, thus reaping both monopsony and monopoly profits. The large wholesale houses of merchant capitalism and the trading companies (*shoshas*) of Japan already mentioned are the important historical examples; other examples are auction houses, real-estate brokers, used-car and antique dealers, and junk shops.

Symmetric markets in which buyers and sellers alike are expert professionals are bilateral monopolies and commodity exchanges. A good example of a bilateral monopoly is the market for armaments. There, one important amenity of the buyers' market is ruled out by its great expense: the seller's willingness to hold inventory to satisfy additional demand quickly. However, another very expensive amenity—product improvement and the development of new products—is important enough for the buyer to initiate it and pay for it directly, on a cost-plus basis.

Another important example of bilateral monopoly is the unionized labor market. There, the most important missing amenity is a counterpart to the readiness (under favorable circumstances!) of price-making employers to absorb additional labor. At the same time, many of the services and amenities that nonprice competition among employers for scarce labor would provide, such as good working conditions, health insurance and pensions, are usually obtained by bargaining between union and management. Note the close parallelism between this and the previous example.

## **Concluding Thoughts**

I have purposely left commodity exchanges to the end. In these exchanges, expert professionals compete among themselves on both sides of the market, which brings us back to the subject of general equilibrium theory.

In designing their mathematical models, general equilibrium theorists made a deliberate decision to make prices and the quantities demanded and supplied the only dependent variables. They chose to regard all else, including the quality and variety of products and services, as exogenously given constraints. Their decision to have no other variables in their models must have been dictated by a mental picture of the main practical examples of perfect competition: the commodity exchanges that trade in cotton, wheat and other agricultural staples, and in raw materials, as well as in futures of those staples and raw materials.

In those exchanges, there is little need for the ancillary services and amenities discussed in this paper. Technical progress in the production of staples and extraction of raw materials is mainly initiated and financed by agricultural research institutes, along with the monopolistic manufacturers of farm equipment and extractive machinery. As to the services and amenities that constitute buyers' markets, some of them, like advertising and window displays, are redundant where buyers and sellers alike are knowledgeable professionals and the merchandise is so highly standardized and graded that it can be bought sight unseen. Other amenities, like credit or transportation, are provided or bought by each side for itself, since both sides can purchase these amenities with equal ease and at equal cost.

That still leaves unaccounted for the cost of the premises in which dealers transact their business, the communication and other equipment they need, and the services of the brokers and other personnel who run the exchange. The cost of their pay and maintenance is negligible and usually paid for out of the very small

commission (typically one-tenth of 1 percent) that the exchange charges to both buyers and sellers.

In short, general equilibrium theory, which deals with an imaginary economy modelled on commodity exchanges, had good reason to ignore the social benefits of nonprice competition. But for those who seek to understand the real economy in all its depth and complexity, the benefits of monopolistic, asymmetric, nonprice competition cannot be ignored.

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