

Chapter 8 consists of two main parts. Section I considers various alternative views of competition ranging from classical to post-Keynesian and section II examines the empirical evidence on pricing and profitability. Section I opens with the classics. Smith and Ricardo (section I.1) and Marx (section I.2) all agree that competition tends to equalize wages rates and profit rates, so that market prices tend to gravitate around, but remain different from natural prices (prices of production). Marx in particular emphasizes the “anarchic” character of these gravitational fluctuations. He generalizes Ricardo’s argument that only certain conditions of production regulate the market price by extending the notion from agriculture to all industry. He also argues that competitive firms are active price-setters and aggressive cost-cutters (unlike the passive price-taking firms assumed in perfect competition), and that the creation of techniques with lower production costs generally requires greater investment in fixed capital per unit. This turns out to be important to his analysis of the choice of technique and the time path of the average rate of profit. Section I.3 examines the post-classical move away from the analysis of capitalism into the analysis of its idealized form. The price-setting and cost-cutting firm is replaced by a passive price-taker and the anarchical movement of market prices around prices of production is replaced by exact equality obtaining within equilibrium-as-a-state. Competition is taken to prevail only if there is a multitude of small price-taking firms each of which pursues its own myopic interest. Jevons and Walras use this to build a story of a socially optimal and economically efficient market society, and this continues to dominate the profession. Section I.4 argues that the theory of perfect competition is internally inconsistent because it requires irrational expectations. If all firms are exactly alike any action undertaken by one of them must be undertaken by all. Any signal that causes one to increase output will cause all the others to do the same, so market supply will expand significantly and the price will drop. Given that perfectly competitive firms are also perfectly informed, it would be quite irrational for any individual firm to “expect” that it could sell as much as it wanted at any going price. Yet this is precisely what is required in the theory of perfect competition and in macroeconomics founded upon it. It follows that the theory of rational expectations cannot be grounded in the theory of perfect competition. Conversely, the theory of perfect competition collapses if firms are assumed to be sensible in their expectations, for even mildly informed firms would recognize that they face downward sloping demand curves under competitive conditions. This sheds an intriguing light on Sraffa’s (1926) critique of standard economics, on Keynes’s treatment of the firm (chapter 12), and even on Patinkin’s passing attempt to get around this difficulty.

Sections I.5 and I.6 examine the Schumpeterian and Austrian arguments. Schumpeter lauds Walras’s model of price-taking firms and maximizing agents but then also says that its static nature is incompatible with the constant creation of new methods and new commodities. He proposes to extend the perfectly competitive model by allowing for perturbations caused by innovations but has very little to say about the resultant patterns of prices and profits. Austrian economics rejects the notion of perfect competition because of its reliance on perfect knowledge, on competition as a state rather than a process, and on firms as passive price-takers rather than active innovators. The Austrian emphasis on competition as a process that bids away excess profits has many similarities to the classical theory of real competition, except for its explicit assumption of rapid profit rate equalization and the lack of a distinction between regulating and non-regulating capitals. Austrian economics also shares

the neoclassical vision that firms are efficient servants of consumers and that union activity and government intervention are unwarranted intrusions into market processes.

Sections I.7–I.9 examine the price theories of monopoly capital, imperfect competition, and Kaleckian and post-Keynesian schools. They all implicitly or explicitly associate competition with perfect competition and point to the historically rising scale and centralization of capitalist production as *prima facie* evidence of a rising degree of monopoly. Hilferding is the first to advance the claim, and Lenin’s seal of approval subsequently makes this the official Marxist view. Monopolists are said to be driven to export capital abroad because the alternative of reinvesting their profits in their own sectors would expand supply and drive down prices and profit rates. Sweezy, Baran, Mandel, Bellamy Foster, and others argue that monopoly theory is more “reality based” than competition theory (which they typically conflate with perfect competition). Kalecki’s monopoly markup price theory becomes the foundation for the Marxist monopoly school through Baran and Sweezy and for most of post-Keynesian economics. The orthodox theory of imperfect competition is also driven by the attempt to make standard theory more realistic, in this case by relaxing one or more of the assumptions of perfect competition: imperfect knowledge in order to focus on the uncertainty and indeterminacy of the future, non-negligible scale of production to ground the notion of barriers to entry, not very large numbers of consumers and firms to justify price-taking, diminishing returns to justify flat cost curves, and some consumption and production “externalities” arising from interactions of outcomes. Profit maximization is generally retained, but the condition $p = mc$ is replaced by $mr = mc$. Sraffa (1926), Chamberlin, and Robinson are the key figures. Kalecki’s central theme is that firms set prices, selling prices differ even for relatively homogeneous products, and lower cost firms charge lower prices. However, these same phenomena are also implied by the classical notion of real competition (chapter 7, section V). Then the distinguishing feature of Kalecki’s formulation and of the subsequent post-Keynesian literature becomes the claim that prices are set through stable monopoly markups, in which case long-run profit rates differ even across price-leaders according to their respective degrees of monopoly power. As always, “competition” is generally taken to be the same as perfect competition, safely interred in some distant past.

Modern classical economics (section I.10) emphasizes the central role of competition and argues that market prices gravitate around prices of production, so that the two are not the same. One approach treats the two as close enough to take them as equal. A second position insists that market prices fluctuate considerably during their gravitation processes, so actual decisions are always in the context of fluctuating and uncertain market prices. A third position dispenses with price and profit rate equalization on the mistaken impression that competition requires their exact equalities. Prices and profit rates are then considered random variables and approached through statistical mechanics. I argue that the latter approach is more properly applied to the deviations of prices and profit rates from their regulating centers. The final issue concerns the behavior of the firm. Almost all modern classical economists treat the competitive firm in the same manner as neoclassical theory, as a price-taker. At one end, there are those who assume that market prices are close to prices of production and that firms are price-takers, so that competition is close to perfect competition, the choice of technique is based on the highest rate of profit available at some given price, and that re-switching is a central issue. At the other end, there are those (including myself) who argue that competitive firms set prices and engage in price-cutting, that competition is an antagonistic and destructive process, that

the choice of technique is based on the lowest cost, and that re-switching is not a particularly important phenomenon (chapter 9, section X).

Section II opens with a summary of the patterns expected by theories of perfect, imperfect, and real competition, respectively (table 8.1). Perfect competition assumes a very large number of very small firms, identical in scale and cost structure, and all facing the same horizontal demand curve. Firms are assumed to passively take prices and technology as “given,” and this uniform price is assumed to be supremely responsive to market demand and supply. Since firms are identical, they must all have the same profit margins and profit rates. Hence, there can be no correlation between the firm profitability and scale. Imperfect competition theory uses these patterns as benchmarks. Hence, industries in which the number of firms is not very large, the entry scale is not very small, prices are not very flexible, prices and costs are not uniform, and firms face downward sloping demand curves are all deemed uncompetitive. Similarly, price-setting and price-leadership by firms is viewed to be an indication of their monopoly power related to their scale, capital intensity, and relative market share (concentration ratio). By contrast, in real competition the intensity of the competitive struggle does not depend on the number of firms, their scale, or the industry concentration ratio. Price-setting, cost-cutting, and technology variations are viewed as intrinsic to competition. Market prices for a given product are expected to differ within limits, and firms are expected to respond to changes in demand and supply through periodic price adjustments. Newer firms will tend to have larger scale and lower costs, and tend to make room by cutting prices. Older firms will react as best as they can, but do not always fully match newer prices. Hence, in real competition one would expect to find a positive correlation between selling prices and unit costs, and a negative one between these and firm scale and/or capital intensity. Once we allow for price-cutting behavior, profit margins and profit rates can be the same or even lower for larger firms—precisely what most studies find (chapter 7, section VI). Given that more efficient firms tend to be larger and more capital-intensive, one would also expect concentration ratios to be correlated with so-called barriers to entry.

Perfect competition assumes that all firms are alike, so that each firm within a given industry is a regulating capital with a profit rate equal to its industry average. Since competition between industries equalizes profit rates, all firms everywhere must have the same rate of profit. Hence, a persistent difference in firm-level profit rates becomes evidence of imperfect competition, as does any correlation between profit margins and scale or capital intensity. In the theory of real competition, profit rate equalization implies that regulating firms with higher capital output ratios must have higher profit margins. Since capital intensity is linked to scale, one would expect that industries with higher entry scales will have higher profit margins. The distinguishing claim in real competition is that profit rates are equalized across regulating capitals in different industries. So the question becomes: Do industries with high concentration ratios and higher entry requirements have higher-than-normal profits?

Section II.3 examines the supposed nexus between price rigidity and monopoly power. Means attributes the relatively infrequent changes in prices of some firms to their monopoly power. Yet Tucker finds that profit rates are lower for larger businesses of the Analysis (a common finding, see chapter 7, section VI.3). Eichner presents data in which the average price of concentrated industries is smoother than that of competitive industries. But he fails to note that the smoother prices do not increase any faster over time, and fails to provide evidence that concentrated industries have higher

profit rates. Semmler shows that in various studies the degree of price flexibility does not correlate with concentration ratios. Section II.4 notes that if profit rates are equalized, they must be uncorrelated with industry capital intensity. Since the profit rate is the ratio of the profit margin to capital intensity, the former will then be positively correlated with the latter (and hence with scale). Hence, only a correlation of excess profit margins with capital intensity or firm size could be considered as support for the monopoly power hypothesis. Section II.5 addresses the “structure-performance” hypothesis that industries with higher concentration ratios have higher profit rates and/or profit margins, beginning with Bain’s original study and responses by Mann, Stigler, Brozen, Demsetz, and many others. In the end, neither hypothesis stands up in the face of the cumulating contrary evidence.