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Encapsulated competition

I. Introduction

While economists have made perfect competition the cornerstone of modern economic theory, dissatifaction with the concept has led to many quests for "second best" concepts, including such notions as "workable competition," "monopolistic competition," and "contestable markets." These endeavors have focused upon modifying the intraeconomic specifications of the concept. The present effort attempts to modify the concept by concentrating upon the interface between economic and social conditions. It assumes that competition is not self-sustaining; hence, its very existence, as well as the scope of transactions organized by it, depends upon contextual factors, the "capsule," within which competition takes place. Both the capsule and competition are treated as variables in the sense that, unlike perfect competition, which either exists or is absent, encapsulated competition exists—in varying degrees and forms. To explicate this socioeconomic concept the factors that constitute the capsule are examined, as well as the effects of power concentration among the competing units on the capsule and, hence, on the working of the entire system.

II. Why search for "second bests"?

Economists, from the early work of Walras to the later accomplishments of Debreu, have been concerned about specifying the prerequisites of perfect competition. Although lists vary about what is required,

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ing elements that result in a perfect system; they have their own inner logic and states of equilibrium. It follows that "second-best" systems must be found or formulated in some other way.

III. Encapsulated competition introduced

One approach followed here is to search for "second best" economic systems by making use of macro-sociology, which, in turn, draws on system theory. Here, too, behind formal terms and theorems lies a core idea, namely, that competition is nothing but contained conflict. In contrast with Adam Smith's assumption, macro-sociology assumes that people's divergent interests and pursuits do *not* mesh together automatically to form a harmonious whole. Hence, specific mechanisms are needed to keep conflicts within limits, and to protect competition from escalating to the point of self-destruction.

Furthermore, social systems are assumed to be neither fully competitive nor uncompetitive, but to vary in the *scope* of behavior organized by competitive rules. For example, the rules govern more relations among strangers than among kin; society considers competition more appropriate for commerce and sports than for relations among siblings. It is stronger in the American restaurant industry than among electrical utilities. Social systems also vary in the effectiveness of the mechanisms that limit competitive behavior.

One must move beyond the conceptual opposition between "free competition" and "government intervention," which implies that all interventions are by a government, that all interventions are injurious, and that unshackled competition is sustainable. A counter hypothesis advanced here is that competition can be preserved only within some socially set limits. This is true not only for the totality of social relations (avoiding societal strife) but also for economic relations *per se* (e.g., prohibiting the use of violent means; avoiding ruinous competition). The mechanisms limiting competition, thus preventing self-destruction, are explored shortly.

At the same time one must also establish the conditions under which the very same factors whose purpose is to sustain competition by keeping it within bounds themselves penetrate the realm defined by society as the proper arena for competition, violate its autonomy, and acceptance of competition has changed significantly from one generation to another.

Undoubtedly, some general ethical principles, exogenous to competition, directly sustain it. Primary is the belief in the moral virtues of competition in general; Americans, for instance, believe that it builds character. There is also the belief in the virtue of economic competition, of the "free market," not merely among philosophers and economists, but also among the overwhelming majority of the political leaders, voters, and public. Americans tend to endow "the market" with numerous virtues, from efficiency, to protection against tyranny, to a source of welfare for all ("when the tide rises, all the ships rise") (Novack, 1982; Lipset and Schneider, 1983, pp. 286ff).

As laissez-faire conservatism provides ethical justifications for competition, so a number of socialist ideologies, humanist psychology (e.g., the works of Abraham Maslow), and many counter-culture writers provided rationales in the 1960s and 1970s in the United States for either greatly narrowing the scope of behavior governed by competition (e.g., justifying various regulations that limit its scope, for example, by introducing automatic promotion into schools) or by justifying outcomes via mechanisms other than participation in competition (e.g., affirmative action) or by questioning the whole merit of the competitive spirit and system. (See, for example, Hirsch, 1976; Hirschman, 1982, pp. 1463–1484.)

The sociological point is not *whether* these familiar ethical precepts exist, but to what extent they are endorsed and followed. Thus, for instance, during the height of the counter-culture, small-is-beautiful, less-is-more social movement, competition lost legitimacy in the United States. This was also roughly the period in which regulation of the economy for social purposes (social justice; consumer, worker, and environmental protection; and scores of others) was greatly expanded. (The proportion of Americans agreeing that "government should limit profits" of corporations rose from 25 percent in 1962 to 55 percent by 1976 and to 60 percent by 1979—*Public Opinion*, 1980.) That is, loss in legitimacy of competition was accompanied by political penetration of the competitive arena to set outcomes by exogenous criteria.

Beyond these general positions, there are specific norms and attitudes that help to either sustain or undermine encapsulated competition. An obvious example is the endorsement of competing fairly, "by the rules"—"it does not matter whether you win or lose but *how* you rationale for the use of certain unorthodox business practices" (1982, p. 33).

If this were the case, the capsule, or at least its ethical element, would be explainable by transactions among the actors; ethics would be sustained by being good business, or shaved until it was. One would not need to go outside the realm of competition to explain the ethical forces that sustain it.

The alternative hypothesis is *not* that ethical principles and norms are immune to economic factors and considerations, but that they have a significant measure of autonomy and that they are partially formed by other factors, including developments within the ethical realm itself (e.g., the rise of new charismatic leaders and religious or moral-social movements, as in post-Shah Iran). Moreover, although it is expected that economic factors will affect ethical behavior (e.g., norms that exact high costs are less likely to be adhered to than those that do not), the effects also run the other way: economic activities condemned by ethical precepts are likely to be less common and more costly than those extolled by them. Without further discussion of the interaction effects between ethical and economic factors, as long as one accepts the idea that ethical factors have a significant measure of autonomy, one can understand why they could constitute part of the capsule that contains and, hence, sustains competition, but does not violate or unduly constrict it, as long as the ethical factors are properly formulated. More precisely, because these factors are viewed as continuous and not dichotomous variables, the content and power of the ethical factors are key factors in determining the extent to which competition is sustained, erupts into excessive (or all-out) conflicts, or is curtailed if not completely suppressed.

(ii) Social bonds: the hidden bases of competition

The perfect competition model entails impersonal relations among actors moving independently of one another in an anonymous market. "The fortunes of any one firm are independent of what happens to any other firm: one farmer is not benefited [sic] if his neighbor's crop is destroyed" (Stigler, 1968, p. 181). One might add: or, if his neighbor's crop thrives. Their orientation to one another is one of exchange characterized as follows: "The rational thing to do is to try to gain as much value as I can while giving up as little value as I can" (Dyke, 1981, p. 29). This orientation is not problematic in the perfect competition ers to that among members of the same community or those who deal extensively with one another). The existence and nature of social bonds are often reported to be significant factors in the relationships between supervisors and workers (and between other ranks), affecting productivity, quality of work, costs, and satisfaction from work. In the organizational literature this is often referred to as the addition of human relations (or Mayonian) considerations to those of "scientific management" (or Taylorism).

On the societal level, social bonds exist among regions (in the United States they were quite weak between the South and the North, but strengthened after the Civil War and the Reconstruction Era), races, classes, and generations. Historically, workers, minorities, and women resented not being included in major social networks, which unfavorably affected their economic opportunities. Growing social acceptance frequently is cited as one reason that American labor is much less radical, and more accepting of the political *and* the competitive economic system, than its European counterpart. Strikes and violence are reported to be less common.

Both micro and macro social bonds are to be considered as a continuous variable (or set of variables), not as a dichotomous one. It is too elementary to argue that such bonds exist; at issue is their relative strength and scope.

The relevance of these observations (often made, but also often overlooked) is as follows: the measurement of these attributes of the social bonds has to be tied (or correlated) to the scope (and other attributes) of competition. A *curvilinear* relationship can be hypothesized to exist between social bonds and competition. All things being equal, when the bonds are absent or very weak, the capsule that contains competition can be expected to be insufficient, with competition showing signs of threatening to break down the containing capsule, leading to all-out conflict. In labor relations, long and destructive strikes, shut-outs, wild-cat strikes, acts of sabotage and violence, and use of strike breakers would be indications of such a tendency. However, when various ranks of the employees consider themselves a community, if not an extended family (as they are said to do at Delta Airlines), labor relations are expected to be more harmonious (this is not to suggest that conflict will be caused only by weak social bonds, but that the latter is a contributing factor).

At the opposite extreme, where social bonds are very powerful, encompassing, and tight, economic competition is likely to be assumed to be endemic to the system, and gaining resolutions cannot rely only upon voluntary ethical commitments and social bonds because an actor can violate them at will. It follows that an institution that commands coercive power must be the ultimate arbiter of conflicts (e.g., by jailing violators of a court decree to force compliance). Moreover, the fact that the competitors themselves might resort to violence necessitates an institution able to disarm or at least deter the competitors from using their resources in violent clashes.

On the other hand, the government undermines encapsulated competition when it goes beyond sustaining the capsule to trying to affect the outcome of competition, by favoring some competitors. This might be justified by other values, such as social justice. In addition, to the extent that the government helps formerly excluded competitors to participate on an equal footing, such help legitimizes the system. Nevertheless, when these values are achieved by externally determining competition results, instead of improving the ability to participate in the competition, the balance between the capsule and the autonomous realm of competition is tilted against competition.

While analytically the competition-sustaining and the competition-undermining roles of government are clearly distinct, research on the effects of various government actions is often required before they can be appropriately classified. For instance, laws that prohibit shops' opening on Sundays, or after agreed hours, or laws prohibiting stores that sell the same items from being situated too close to one another may be used to sustain the capsule (by avoiding ruinous competition) or to favor white Christian shopkeepers over racial and ethnic minorities. A compelling argument has been made in favor of "income policies" which will use wage and price moderation; this would preempt the argument in favor of recessionary blood baths (Appelbaum, 1982; Davidson, 1982; Rapping, 1979; and Weintraub, 1978). Others argue that such programs would "distort" the economy and are effective only for short periods. Some government acts, such as laws that protect private property and the currency, or prohibit fraud and violence, are clearly supportive. Other acts obviously have other primary purposes: for instance, regulations on the quality of billboards to achieve "highway beautification."

1980, p. 266), however, (b) at a level closer to *full competition* (or cost) than one would expect from the small number of sellers and other such competition-limiting factors, and that, hence, (c) all said and done the "pricing performance in modern industrial markets has on the whole been fairly satisfactory despite significant departures from *the structural ideal of pure economic theory*" (ibid., italics provided). Several attempts to develop second-best models of less than perfect competition have not yielded widely accepted alternatives to the "first-best" model.

Encapsulated competition introduces a major new dimension to the issue at hand: actors are assumed to vary not merely in their economic power (ability to affect the state of the market), but also in their political power (ability to affect the government which is part of the capsule). Concentrated economic power may be converted into political power and exercised *either* to thwart the neutrality of the capsule-sustaining mechanisms or to use the government to favor one actor (or group of actors) over others (for instance, favoring big business over small business).

It follows that the power prerequisites of encapsulated competition include, first of all, dispersion of economic power. This requirement is not absolute, as it is in the perfect competition model. Everyday experience suggests that encapsulated competition can work despite some power concentration. (How much can be tolerated and what ill side effects are caused by various degrees of concentration is far from clear.) However, high concentration of economic power will undermine encapsulated competition not only because it will reduce the number of competitors (a point emphasized by economic theory of competition) but also because the higher the concentration of economic power the more likely it is to be a source of political power, which, in turn, undermines the capsule (a factor familiar to economists but not encompassed in economic theory).

Second, encapsulated competition requires segregation of political from economic power whatever its degrees of concentration (e.g., abolishing property-weighted franchises and poll taxes; prohibiting campaign contributions by corporations and labor unions) (Etzioni, 1984, pp. 131ff). The more effective the segregation of political and economic power, the more encapsulated competition can withstand

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