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On Wal-Mart: Doing Good by Doing Nothing

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Article

On Wal-Mart:
Doing Good by Doing Nothing

RICHARD A. EPSTEIN

The major success of Wal-Mart has brought forth an unprecedented amount of criticism of the firm and its business practices. In this Article I subject Wal-Mart's critics to the same scrutiny that they bring to the firm itself, and conclude that virtually all of their charges are overblown and misdirected. In emphasizing the supposed dislocations that Wal-Mart's has had on the settled expectations of certain communities, the critics fail to take into account the positive benefits that the firm supplies its customers in the form of quality goods at low prices and the positive spillovers they provide by revitalizing poor or marginal neighborhoods. In stressing the dislocation that Wal-Mart creates for its competitors, the critics misapply the antitrust laws to competitive situations where they should play no role, or they propose various forms of intervention in matters of wage, health or land use regulation that serve the exclusionary interests of rival unionized firms contrary to overall social welfare. In relying on empirical studies, the critics overlook innocuous explanations of the supposedly negative effects of Wal-Mart's practices. Without some evidence that the firm has used deception or monopoly power, the proposed remedies for its alleged misdeeds result in expending public funds to reduce social welfare. Wal-Mart is not, and should not be immune to competitive pressures, to which it has yielded ground in recent years. But under no circumstances should it, or other big-box retailers, be singled out for special treatment. As is so often the case, the best government response to rapid changes in the business environment is to do nothing at all.
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On Wal-Mart: 
Doing Good by Doing Nothing

RICHARD A. EPSTEIN*

I. THE FALL FROM GRACE

Most Americans harbor a deep ambivalence about the success of the rich and famous. Often our pundits, authors, and political leaders love to praise our bold inventors and entrepreneurs whose imagination, talent and drive has helped make America great. As a youth, I recall reading the heroic biographies of such folk icons as Thomas Edison and the Wright brothers. I vividly remember in my own lifetime how Jonas Salk was elevated to sainthood for his discovery of the polio vaccine that halted a dreaded scourge that left many paralyzed. More recently, Bill Gates has attained legendary status with his youthful exploits in the founding of Microsoft. But often the worm turns, so that our inventive and entrepreneurial heroes become tarnished with age. Edison may well have been a folk hero, but he was also a jealous guardian of his patent rights, and the various companies named after him, including Commonwealth and Consolidated Edison, have taken their fair share of abuse over the years. A similar fate awaited the Wright brothers, with their disputes with Glenn Curtis, and Salk had his battle with Michael Sabin. Most recently, Bill Gates faced endless travails under the antitrust laws.

It is worth asking what accounts for this cycle whereby fame leads to resentment. Let me hazard a guess here. On the way up everyone loves the underdog who defies the odds and introduces new technologies that expand hope and possibilities for all citizens. But once the Wunderkinds reach the top, our social critics always fret with their former idols when they flirt with patent monopolies, rate regulation, and the antitrust laws. In large part, the belated hostile response stems from the simple and understandable fact that young heroes often take dubious actions in their later years in order to hold on to the fruits of their youth.

Our complex love/hate relationship with larger-than-life figures does much to shape the current controversies that swell over Wal-Mart and other big-box stores, which have received so much publicity, and abuse, in recent years. Sam Walton, even in death, has followed the descending arc from saint to devil. His large role in the rise of Wal-Mart is of course well

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known. Walton opened his first store in Rogers, Arkansas in July of 1962.\(^1\) From the outset, he hammered home his mantra of “Everyday Low Prices.” He knew that low prices required low costs, and so he was tough in negotiating with suppliers, and was steadfast in his opposition to a strong non-unionized workforce. His new firm was incorporated in 1969 and listed on the New York Stock Exchange in 1972.\(^2\) By Walton’s death in 1992, the company had become the largest retailer in the United States, and its torrid growth has continued since then, so that today the company is the second-largest corporation in the world, trailing only ExxonMobil (whose revenues fluctuate much more widely owing to the high variation in the price of oil).\(^3\) For its fiscal year that ended in 2006, Wal-Mart had gross sales of nearly $316 billion, or about 2.5% of U.S. GDP, on which it earned around $11.2 billion in profits, for a profit margin on sales of around 3.5%, and a market capitalization of around $200 billion (or less than twenty times earnings).\(^4\) It also employs around 1,800,000 people whom it calls, somewhat tendentiously, its “associates.”\(^5\)

It is not surprising that Wal-Mart’s take-no-prisoners attitude has generated a huge uproar from its many activists and union critics. Its tough position on wages illustrates, and perhaps exacerbates, the gaps between rich and poor. In a nation where economic success is fair game for political action, Wal-Mart presents a huge target of opportunity. Wake Up Wal-Mart, which is funded by the United Food and Commercial Workers International Union, is unstinting in its denunciation of the practices of the firm.\(^6\) Another organization with a similar agenda is Wal-Mart Watch, which is funded by the Service Employees International Union.\(^7\) These skilled and hardened political adversaries are in this battle for the long haul.

In one sense, however, the focus on Wal-Mart is odd because right now Wal-Mart is beset with stronger competition at home and abroad than at any time in its forty-four year history. Size in this regard is not an advantage. While it might be possible to grow a corporation with $30 billion in annual sales into one with $300 billion, Wal-Mart cannot duplicate that level of expansion over the next forty-four years, even if it

\(^2\) Id.
\(^3\) Id.
walks on water. The explanation involves the simple mathematics of mature firms. One big innovation can propel a $100 million firm into a billion dollar corporation. But that same billion-dollar innovation becomes a rounding error for a large corporation with $300 billion in sales. This larger corporation needs to hit a whole succession of homeruns to make any dramatic impact on its overall profile. And the leaders of the next generation with these billion dollar ideas will start their own firm (Google) and not work for last generation’s industry leader (Microsoft).

Wal-Mart is no exception to the inexorable law against exponential growth. Just look at some instructive particulars. As is well understood, the firm has saturated its initial rural base, and hence cannot expect to continue its out-sized rate of growth solely by moving aggressively or imaginatively in its traditional strongholds. So it has to strike out in different directions. Every day brings more reports of flat sales during the key holiday season—due perhaps in part to the political campaigns leveled against it. Nonetheless, its business strategy is far from being beyond reproach. Its overseas efforts in both Germany and Korea have floundered against stout competition by local competitors who have a better sense of their indigenous markets. In the United States, Wal-Mart has not been able to pursue a consistent strategy for upgrading its merchandise to compete with stores like Target (which, no surprise, has enjoyed greater growth albeit from a smaller base) that have nabbed the cohort of more upscale customers. As is often the case, the effort to expand the brand often alienates core customers by blurring a once clear set of expectations. And for a juggernaut Wal-Mart has not done well in the stock market either, for in the past several years the stock price has been at best unchanged. To this outsider, Wal-Mart looks less like a 900-pound gorilla and more like a fighter who, while still formidable, has lost its cutting edge as the great innovator. Ah, maturity!

II. CRITIQUING THE CRITICS

In light of this background, the horde of Wal-Mart critics have to perpetuate their false image of Wal-Mart's market invulnerability in order to rally their supporters. Oftentimes, they do so by making outsized claims that only their passionate protest activities stand between the nation and its economic oblivion. The harsh charges warrant serious response. In order to make this evaluation, it is instructive to look at three separate issues. The first task involves making an assessment of the global consequences of

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Wal-Mart's ascent in retail markets, which in turn requires estimating the impact its activities have on the usual cast of characters: customers, suppliers, employees, and competitors. Indeed, in principle, this analysis could extend to the second generation so that it embraces the customers, suppliers, employees, and competitors of Wal-Mart's customers, suppliers, employees, and competitors. The second task, which follows hard on the heels of the first, is to critique two central charges raised against Wal-Mart. The first asks about the soundness of the antitrust critique of Wal-Mart for the abuse of its dominant market position. The second looks at the efforts to alter the terms of the contracts that Wal-Mart has with its employees, chiefly with regard to the minimum wage. Once these tasks are completed, I offer in conclusion some more general observations on the strong differences in intellectual mindset that separate Wal-Mart's many critics from its far fewer defenders. It turns out that even egalitarians should be uneasy about joining forces with Wal-Mart's single-minded pursuers.

A. Is Wal-Mart Good for America?

The first critique of Wal-Mart is not directed at any of its specific practices. Instead it asserts that the rapid expansion of the firm is bad for America because of the way in which it upsets settled practices and expectations, and disrupts the lives of other groups and businesses with its aggressive market practices. In a strong sense, this challenge is misguided from the get-go. It is unwise to challenge Wal-Mart for its successes in the same way that it is unwise to challenge other businesses and social organizations for their successes. All that is needed to acquit any successful firm or organization of charges of social misbehavior is to know that it has operated within the rules of the game, without the benefit of subsidy from either its competitors or the public at large.\textsuperscript{10} The defense of successful businesses within competitive markets should look only to certain general stylized reasons, and no further. First, as noted above, their contracts produce gains to both parties. To be sure, not every contract succeeds in fact, but these are all positive sum games in expectation (that is, before performance) and most (but not all) of these are positive sum games afterwards. These huge gains constitute a large weight on the positive side of the social scale. Second, the increases in wealth brought about by voluntary exchanges have positive external effects on third parties, by giving them greater opportunities to realize gains from trade.

These two strong systematic effects make it most unwise to invoke empirical studies to upset these expectations, chiefly by attempting to

\textsuperscript{10} For a similar view, see Richard Vedder, \textit{Wal-Mart, Individuals and the State}, 39 CONN. L. REV. 1725 (2007). Indeed, although the point is not relevant here, if there is some illicit subsidy the first best course of action is to remove the subsidy, rather than to create a second distortion by adding some punitive measure to the subsidized firm.
estimate the size of the gains and losses of all possible players in any particular market niche, either up or down. There are too many collateral movements in both directions for these effects to offset the two systematic positives just noted. The proposition here works both ways, because I also put relatively little stock in empirical studies that try to document the efficiency of markets by using the same estimation techniques in support of the opposite conclusion. The reservations about this technique are not because those demonstrations of market superiority are wrong. Rather, the uneasiness arises, even though they are likely to be correct, because the mixed data is likely to be far less persuasive than the basic theoretical arguments that point in the same direction.

Caution quickly turns to skepticism about empirical demonstrations of how new entry reduces social welfare because of the total absence of any theoretical reasoning to support that conclusion. Thus any demonstration that competitors lose market share is perfectly consistent with the view that lower prices advance social welfare by releasing resources for deployment in other areas, where they can work to lower prices, improve products, or do both. Any empirical studies that show how suppliers of failed competitors are out of luck usually overlook the increased opportunities that are available to do business with the ascending firm. And these effects are powerful. A recent story in the *New York Times* documents the enormous shift in automobile employment from the midwest where strong unions have crippled the operations of Daimler-Chrysler, Ford, and General Motors to the booming southern states that have embraced foreign automakers that operate in nonunion environments. Socially, nothing whatsoever should be done to stop that shift.

Arguments about the global effects of employment practices take that same form. The theoretical model is clear: any restraints in the form of maximum or minimum wages prevent the formation of gainful contracts that would emerge in an unregulated market. That observation should be the end of the policy story. The efforts to measure some of the consequences of the innovation will only give a partial picture that misstates the overall effects. Fewer jobs for the incumbent firms are balanced out by more jobs with the new entry firms. And similar arguments can be made about firms that work in adjacent areas, either by geography or business line. Some direct competitors will lose market share. But other firms that supply complementary goods will do better by virtue of the emergence of new industries. Once we move beyond the immediate parties to the transactions, it is not proper to design an empirical study that considers only the negatives while ignoring the positives. Nor

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should we support any program that seeks to redress the harms that are caused by these inevitable shifts in economic fortune. It is suicidally complex to seek to require transfer payments from those who are helped to those who are harmed by these multiple and subtle interactions. The transactions costs overwhelm the entire system and operate as an effective barrier to entry or change.

Speaking more generally, we should continue to apply to each and every economic dislocation (positive and negative) the old maxim that they are *damnun absque injuria,* or harm without legal injury. Standard modern economics takes that approach when it treats competitive dislocations as "pecuniary externalities" that are pointedly ignored in the social welfare calculus. These pecuniary losses stand in opposition to "real externalities," such as the loss from pollution. The terms "pecuniary" and "real" do more to obscure than reveal. But behind the muddy terminology lies the critical point that pecuniary externalities are the necessary byproduct of global moves toward a superior situation whereas real externalities are not. In light of that distinction, it is wise to concentrate our legal firepower on checking pollution, ignoring any losses to individuals who come out second best in the competitive melee. For competitive externalities, we should rely on the Schumpertian process of "creative destruction" that is emblematic of any well-functioning marketplace. All innovation creates dislocation and losers, so that the best rule is not to particularize the inquiry to see which forms of economic dislocation give rise to redressable economic harms, and which ones do not. In the long run, we will do a far better job at lower cost in making our judgments about innovation if we follow the basic rule that the full range of economic affects on third parties at worst wash out, so that the gains from direct cost reductions and increased trade become decisive. Put another way, the gains to the parties that participate in new innovation are such a large thumb on the scale that it is always better to ignore all indirect external effects, up or down, on third parties. The huge empirical

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12 A pecuniary externality is an externality which operates through prices rather than through real resource effects. For example, an influx of city-dwellers buying second homes in a rural area can drive up house prices, making it difficult for young people in the area to get onto the property ladder. This is in contrast with real externalities which have a direct resource effect on a third party. For example, pollution from a factory directly harms the environment. Both pecuniary and real externalities can be either positive or negative. Wikipedia.com, Pecuniary Externality, http://en.wikipedia.org/wiki/Pecuniary_externality (last visited Jan. 17, 2007); see also Randall G. Holcombe & Russell S. Sobel, Public Policy Toward Pecuniary Externalities, 29 PUB. FIN. REV. 304, 304 (2001) ("Pecuniary externalities create third-party effects through changes in relative prices or asset prices. Unlike technological externalities, they do not misallocate resources and are necessary for the market to work efficiently.").

13 This is a theme that I have stressed elsewhere. See Richard A. Epstein, Forbidden Grounds: The Case Against Employment Discrimination Laws 497-99 (2005); Richard A.
literature on Wal-Mart offers an unintended confirmation of the basic thesis.

B. The Economic Studies Against Wal-Mart

1. Economic Displacement

The first case in point is one study that purports to find negative consequences from the possible entry of a new Wal-Mart store into the Chicago market on Chicago's West Side.\(^{14}\) Its authors, Chirag Mehta, Ron Bainman and Joe Persky, seek to analyze the economic impact that a new Wal-Mart will have on its existing retailers, which they estimate number about 763.\(^{15}\) Their initial assumption is that the majority of the job loss will take place within a three-mile radius of the proposed site. Their study takes at face value Wal-Mart's claim that its new facility will create 250 new jobs, of which 70% are full time, and will bring in about $600,000 in annual tax revenue to the city.\(^6\) Nonetheless, that study concludes that when the larger picture is reviewed, Wal-Mart's net impact will be a reduction in local jobs and income that will be offset by a 'slight' increase in tax revenues. The key assumption for this model is that Wal-Mart is the "market leader in terms of labor productivity," such that it is able to generate 51% more sales than its rivals.\(^{17}\) Therefore the study assumes that Wal-Mart will use 51% fewer employees to generate the same level of sales as its competitors. It also assumes that it will attract most of its customers from within the city, but reclaim only a few of the customers who go to suburban operations. The study then estimates that the net direct losses of benefits to Chicago residents will be $851,000, and indirect loss of benefits will be $332,000.\(^{18}\)

None of this evidence offers any reason to displace the assumption that more efficient production is to be turned aside so that less efficient firms should be immunized from competition. The first error of these calculations is to assume that the relevant welfare consequences are limited only to the City of Chicago. That kind of parochial assumption often leads to strong protectionist legislation that produces small local gains at the expense of larger social dislocations elsewhere. A more exhaustive study would ask whether this Wal-Mart at a minimum creates new opportunities


\(^{15}\) Id. at 1.

\(^{16}\) Id. at 3.

\(^{17}\) Id. at 4.

\(^{18}\) Id. at 5.
for others that might benefit from the operation, in Chicago or beyond. Suppliers, shippers and advertisement agents anywhere in the world could profit from the new store. The object of a sound social policy is to make sure that local restrictions do not cut down on these benefits. Indeed, the entire logic of the dormant Commerce Clause is to resist efforts of local interests to put up arbitrary barriers to interstate commerce.19

Yet even taken within its own terms, the study is ineffective because of two additional assumptions. The first is the naïve assumption that “Wal-Mart will use 51 percent fewer employees to generate the same amount of sales as its competitors.”20 The key point here is that the entire process should be viewed in dynamic, not static, terms. The lower wages and higher productivity should allow for an increase in sales above and beyond those which are made by the existing establishments. There is, accordingly, no reason to think that the Wal-Mart work force, within Chicago and beyond, will not respond to the increased demand that lower prices create. In addition, the higher efficiencies here should put added pressure on the existing competitors to work harder to reduce their costs and to expand their opportunities to keep the customers from taking the Wal-Mart option. Hence, the initial market response should be far more positive than this study presupposes, and the gains in question should increase over time—the study wholly ignores the temporal dimension—as new opportunities are created in the retail sector and elsewhere by the resources that are released to the economy by these efficient practices.

The second incorrect assumption is that the only impact that Wal-Mart will have on existing retailers is negative. Why should that be the case? The increased volume of traffic should open up opportunities for smaller retailers to enter the market to fill niches too small for Wal-Mart to colonize. Those positive externalities should also be taken into account. Other studies have pointed to just these real potential gains. Wal-Mart commissioned its own study of this question, which concluded that its store saved working families on average $2329, and created 210,000 jobs in the United States in 2004.21 More concretely, the study claims that from 1985 until 2004, Wal-Mart was “associated with a cumulative decline of 9.1% in food-at-home prices, a 4.2% decline in commodities (goods) prices, and a 3.1% decline in overall consumer prices . . . .”22 The study also indicates

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20 MEHTA ET AL., supra note 14, at 4.
that nominal wages are 2.2% lower, but given that consumer prices are 3.1% lower, real disposable income is 0.9% higher than it would have been in a world without Wal-Mart.\(^2\)

There is no reason to take this study at face value, of course, but other studies have pointed in the same direction. For instance, one study found that bringing Wal-Mart into an urban area spurs the arrival of 12.9 new stores, and leads to a $56.8 million increase in sales.\(^2\)\(^4\) Another study that focused on South Central Los Angeles concluded that the arrival of a new Wal-Mart revitalized a poor neighborhood by drawing new shoppers to the area.\(^2\)\(^5\) Once lured in by Wal-Mart, they often spent money at local shops as well, indicating a clear halo effect.

Finally, a replay of the Chicago incident has occurred in an economically depressed area of Cleveland. There, a proposed shopping center with Wal-Mart as its anchor store is estimated to generate $3 million in property taxes for the city each year, plus $700,000 in payroll taxes.\(^2\)\(^6\) The shopping center would bring nearly 2000 jobs to the area and would give the city a chance to reclaim some fraction of the $4 billion that Cleveland residents spend per year in retail shops—one-third of which goes to stores outside of Cleveland.\(^2\)\(^7\) To no one’s surprise, this proposed Wal-Mart store has met fierce opposition from Cleveland union leaders and some community groups. More tellingly, it enjoys the support of 78% of residents (according to one poll).\(^2\)\(^8\) Wal-Mart has continued with its plan to open the store. My sense is that the numbers in all these studies promise more precision than is attainable. But that is only all the more reason to stick with the basic presumption that more efficient competitors produce greater social gains for all—no questions asked.

2. The Antitrust Critique

It is also useful to look at Wal-Mart through the lens of the antitrust laws, in which the basic objective is to find ways to promote efficient forms of conduct that do not lead to market arrangements, such as cartels and monopolies, that work in restraint of trade.\(^2\)\(^9\) On this particular score, it is instructive to look at a recent antitrust attack on Wal-Mart’s activities

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\(^2\) Id.
\(^2\)\(^6\) Maich, *supra* note 24.
\(^2\) Id.
\(^2\)\(^8\) Id.
written by Barry C. Lynn of the New America Foundation, which shows again just how easy it is to go off the rails. The essence of Lynn's attack is that Wal-Mart plays too tough with its suppliers—pity Kraft and Coca-Cola—and customers, so that its break up is necessary in order to allow them the breathing room to remain viable enterprises that can escape bankruptcy's unhappy fate. Lynn's basic claim is that political control is needed to counteract the dominant influence that one firm exercises over the retail market. Markets must be subservient to democratic control, not independent of it. Lynn writes: "We must restore antitrust law to its central role in protecting the economic rights, properties, and liberties of the American citizen, and first of all use that power to break Wal-Mart into pieces."

Which pieces, or how many, is never said. And for good reason because the antitrust laws do not support this radical contention. The basic system of antitrust law is divided into two parts, and the Wal-Mart case fits into neither. The first situation involves cases where parties enter into some contract or other business arrangement whereby they restrict output, raise prices or divide territories. In each of these situations, the case for regulation does not rely on some vague conception of pecuniary externalities. It is now possible to give a precise demonstration that the proposed arrangement flunks the best test of economic efficiency that Lynn first decries and then misapplies. All these strategies result in losses to consumers that are systematically larger than the gains to the producers, by knocking out mutually beneficial transactions in which the buyer's reservation price is somewhere below the monopoly price and above the competitive one.

Given the high administrative and error costs that plague the entire operation, it is an open question whether the effort to identify and isolate these cases is a game that is worth the candle. I have expressed many doubts about the wisdom of having any antitrust law at all, and, more recently, about overreaching consent decrees that have resulted from the government efforts to break up various businesses. But whether those

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31 Lynn, supra note 30, at 36.

32 Wal-Mart is programmed to cut cost faster than price, to slow the introduction of new technologies and techniques, to dictate downward the wages and profits of the millions of people and smaller firms who make and grow what they sell, to break down entire lines of production in the name of efficiency.


criticisms are sound, at least it is possible to understand what objectives the government hopes to achieve in going after these institutional arrangements. It is of course beyond dispute that Wal-Mart has not run afoul of any of these provisions. It has always gone alone in opposition to its competition—not in cooperation with them—either by agreement, or acquisition or merger. We do not have to face the question, which often arises in merger contexts, of whether the efficiencies of the new operation provide a social benefit greater than the loss in social welfare attributable to higher market concentration.

The second half of the antitrust law is much more difficult to pin down, for it seeks, with evident difficulty, to identify those unilateral practices of a dominant firm that are likely to create long-run inefficiencies in the marketplace. The area of unilateral practices can include such tactics as tie-in sales, exclusive dealing arrangements, bundling and predation. Yet in all three of these situations, the analysis is beset with one overhanging complexity. Each of these various practices does not lie within the exclusive province of the dominant firm. Any firm can, and many firms do, practice these various techniques in order to expand their position in the marketplace. They do so because of the efficiency of the underlying arrangements, which leaves open the real question of whether it makes sense to stop dominant firms from engaging in these various practices, so that they have to yield ground to their rivals.

But once again, Wal-Mart does not come within a thousand miles of these particular antitrust strictures. Start with one key number in the Wal-Mart equation. Wal-Mart's profits as a percentage of gross sales equal 3.5%, which hardly suggests that it exploits anyone. Of course it works, as an agent for its customers, to pay rock bottom prices to its suppliers and employees. But those benefits are passed right on to customers. Its consistent low margins are what we expect from the firm. There is no hint that Wal-Mart sells below cost, or that it would have a ghost of a chance of surviving if it took that foolish a step in a crowded a market. It has no fancy tie-ins or exclusives, and it does not offer any odd sales packages that could (even if they shouldn't) draw the attention or ire of the antitrust sleuths.

There is good reason, then, why no government official and no private lawyer has tried a hand at the antitrust option. It simply does not work. And what is its underlying assumption? The same as above. The firm that succeeds through internal growth and price superiority does exactly as we

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should all hope. There is never in these cases any effort to focus on the position of individual competitors or customers, as Lynn seeks to do. There is rather the proper faith that the direct gains matter, and that the indirect consequences on net are likely to be positive as well. This sensible view then avoids the huge cost of a futile effort at breaking up Wal-Mart into arbitrary pieces that are less likely to function well. New entry here, as in other contexts, is the best remedy against various forms of abuse.

3. The Minimum Wage

The second line of attack on Wal-Mart is less global. Now Wal-Mart’s supposed exploitation is not perpetrated on Fortune 500 companies, but against the unskilled and often uneducated workers whom Wal-Mart hires. The animosity is surely driven up a notch by the company’s unyielding opposition to unions, which it (rightly) thinks will destroy the flexibility and cost structure that it needs to survive. Since there are reports that Wal-Mart shuts down any unit that unionizes in the United States or Canada, it is easy to see what stimulates the opposition. One way of course to limit Wal-Mart’s ability to control its own destiny is to increase the minimum wage laws, either selectively for big-box companies, or, if that fails, across the board. The key question is what justifies this interference.

As a matter of first principle, the argument against the minimum wage law is, I think, conclusive, and works on the same generalized principles that were noted above. The free movement of firms and workers in and out of the market generates the great social surplus. Set a minimum wage law that is below the market price, and it will have no effect, save as an annoyance. Set it above, and the supply of workers at the stipulated price is greater than the demand, so that some mutual beneficial exchanges are blocked. The exact empirical effects of the minimum wage laws are difficult to study, because of the constant efforts of both sides to evade them, as for example, by such expedients as working part time “off the clock.” But in the midst of these difficulties, the most obvious conclusion—an increase in unemployment rates—represents a serious oversimplification of the actual forms of market response.

Contracts do not have a single dimension of wages. Rather, the wage term is one of a diverse package of terms and conditions, some explicit, some implicit, which spans a range of issues that are hard to list in full. Some of the obvious candidates include the number, days, and duration of shifts; location of work; training on the job; prospects for future

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employment; the provision of rest areas, showers and other amenities; fringe benefits; vacation and sick leave policy; and the prospect of future promotion. The market wage thus represents the wage given for a contract whose other attributes have been set to maximize joint gains. There is no reason why any particular bundle of attributes has to have the same weight across firms, or the same weight for different individuals working at the same firm. For example, if two workers are offered identical packages, the one who lives nearer to the job is more likely to take it, and so on.

The key empirical question is what modification will be made on these collateral terms when the minimum wage is fixed by law above the market-clearing price. The answer is that these terms will shift in favor of the employer in order to offset the government-mandated wage increment. That shift, however, will on balance, still leave the pool of employers and employees worse off than before where it is difficult in the abstract to decide whether the employer or the employee has taken the greater hit from the imposition. But any estimated reduction in jobs is likely to be smaller than intuitively expected because of the ability of the parties to adapt their behavior along other margins. It follows therefore that the social loss from the regulation is not measured as a first approximation solely by the reduction in jobs. One must add to that figure the unambiguous reduction in employer and employee surplus that comes from the alteration in private contract terms in less satisfactory ways to reduce the impact of the minimum wage.

It is now necessary to determine the relative importance of the two different kinds of adjustments: firing (or not hiring new) workers versus alteration of contract terms. The answer in theory is this: the smaller the deviation between the market wage and the minimum wage, the more likely it is that the parties will make some (loss-mitigating) contract adjustments short of actual firing (or not hiring). Yet the higher the minimum wage, the less effective these devices are, so the greater the loss in jobs. If the increase in the minimum wage is too high, the particular labor market will shut down because all the opportunities for trade are blocked. That truth is in reality denied by no one. Yet the question is what that concession tells us about the desirability of smaller shifts in the minimum wage laws. Most simply, if minimum wage regulation imposes unambiguous welfare losses at high levels, at what level, and for what reason, should we expect it to generate social gains at lower levels? It is no mean feat to generate such an explanation because it requires a shift not only in the magnitude of certain effects, but also in their direction. The more obvious conclusion is that the lower the minimum wage, the fewer labor market distortions it creates.

What is so striking in the current debate over the minimum wage is that no one who defends today's highly fashionable increases has offered any theoretical explanation of why small increases in the minimum wage
are good while larger ones are bad. At this point, two questions remain to be answered. The first is how do the proponents of the minimum wage decide what increment they think to be appropriate. The second is whether they can adduce any empirical evidence that falsifies the standard assumption of pro-market economists that the minimum wage is routinely inimical to social welfare.

The first question is difficult to answer because there are so many different groups that are pushing hard for an increase in the minimum wage. Some of these supporters simply deny the force of the standard prediction of welfare losses from wage barriers in labor markets. They believe that firms are bluffing politically when they claim that they cannot pay more; or they assume that so long as all firms are subject to the same restriction, the minimum wage will change the wage level, but not the number or types of jobs. Their implicit view is that no one should worry so long as the wage increase hits all firms equally. These assumptions are in fact wrong. There is little to bluff about when labor is mobile, and employers face tough business constraints. In this context it is worth noting that the average income per employee at Wal-Mart is around $6000 per year, which means that if all 1,800,000 workers received only a dollar more per hour, about 25% of the net profit would be gone, and we have a different business to say the least.\(^3\)

More generally, minimum wage laws never hit all firms in the same way, even with their uniform facial impact. Some firms use higher skilled workers than others, and hence are less likely to be hurt by the increased wages. Indeed, they could well be benefited because the minimum wage hobbles their competitors more than themselves. Similarly, some firms will find it easier than others to shift to more capital investments, which will create distortions. It is therefore no argument in favor of the minimum wage to say that some firms benefit after its passage. That argument carries no more weight than the observation that protective tariffs increase the revenues of some firms. Finally, even if all firms were in the same position (which they are not), the minimum wage would still hurt the overall social position. The shortage of jobs and the shift to inferior contract terms would not disappear. The perfect parity only means that in this rarified world the social losses are evenly distributed, and not oddly skewed.

Once the theoretical conceptions of the minimum wage law are laid bare, it becomes necessary to look elsewhere to find out how the proponents of minimum wage laws propose to set the number. In this vein, it is no accident that the chief financial backers of the anti-Wal-Mart groups are key service sector unions that have tried without success to

\(^3\) Maich, \textit{supra} note 24.
organize Wal-Mart’s employees. Their private calculations have nothing to do with overall social welfare. Rather, the one question they ask is what minimum wage law will give them a comparative advantage against nonunion competitors such as Wal-Mart. Viewed from this partisan perspective, it now becomes possible to explain why small increases in the minimum wage law are good when large increases are bad. The small increases have a differential impact insofar as they are higher than the Wal-Mart wage but lower than the non-union wage. At this point the differential impact of the neutral law should be evident to us all. Yet the proponents of the modest increase in minimum wages will fight fiercely against a law that sets the minimum wage above the union wage—a scenario that is so destructive that no one on any side of the political spectrum supports it. Subsequently, in all political settings the battles over the minimum wage law come in small increments, which is why its dire effects on unemployment are not seen, but some adaptive responses on other contract terms remain possible. The point here is not that everyone thinks that minimum wage laws have no effect on employment levels. It is rather that everyone knows minimum wage laws have such an effect, especially when the leaps in the minimum wages are large.

So what then is the evidence on this? Here I will not look at the reams of evidence that point out the downside of the minimum wage law. Rather, space permits me to look only at one study that purports to find that the proposed levels of minimum wage increases in two cities—San Francisco and Santa Fe—have had no real effects on any of the variables that economists like to measure. Total level of employment, total number of firms, exits and bankruptcies show only statistically insignificant changes. The argument here has been touted as a refutation of the traditional view that the minimum wage causes job loss, because of the inability to find any real market effects on any of the standard measures from increases that are higher than those contemplated by federal law. There is, however, a simpler explanation. The minimum wage law only bites when it is set above the market wage. San Francisco and Santa Fe are expensive places to live, and both have educated workforces. The simplest explanation for this set of non-findings therefore is that the market wage is in fact above the minimum wage. The study did not check to see if this is true. But it does offer one clue that it is. For example, in its new store in San Francisco, Home Depot set wages at $10.77 per hour, which is above the local minimum. The easiest explanation is that this wage figure represents the market wage. And remember these regional variations are

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40 Id. at 3.
yet another reason why national minimum wage laws don’t make sense. They impact low wage and depressed areas far more than prosperous ones. In short, when it comes to the minimum wage, the unions and the activists are wrong. Wal-Mart is the source of opportunity. Its opponents block opportunities. They do not create them.

III. A CLASH OF WORLD VISIONS

The deep divisions that separate the two sides on the Wal-Mart struggle are indicative of deep philosophical differences that cover this particular issue, but also range far beyond. In this brief conclusion, let me outline one of the key differences: this difference relates to whether we care more about growing the pie or evening up the size of the slices. The former attitude is doubtless held by most of the defenders of laissez-faire, and the union members and activists congregate at the opposite pole. There is a brute inner logic to both positions. Those of us on the laissez-faire side think that free entry will not only produce the larger pie but will help with income distribution in the long run, by allowing free entry to control against undue market profits. On the other side, the egalitarians typically think that programs of wealth redistribution do not have much adverse effect on productivity, so they don’t see what they are giving up in output in order to achieve their own objective of flattening the income distribution.

It is worth probing the two strikingly different attitudes toward income inequality a bit more. Those like myself who come from the broad utilitarian tradition are often drawn to the standard that looks for Pareto improvements. Thus if one person is left better off, and no one else is left worse off, then the new distribution of wealth counts as an improvement over the old one. By that standard, any increase in wealth to the rich and famous counts as a social improvement even if the wealth of all other individuals remains static. Any increase in the differences in wealth between persons is welcome so long as it does not compromise the welfare of others. Indeed, even by the weaker Kaldor-Hicks criterion—when the gains to the wealthy are sufficient to buy off the losses to the poor—there is a social improvement with greater wealth, even if the transfer payments are not made. Yet the differences between the two standards should not be allowed to conceal one point they share in common. Neither test tolerates any overall decreases in wealth—which means that both tests in like fashion rule out an impressive number of influential social initiatives, including the various attacks on Wal-Mart. In addition, Kaldor-Hicks actually tolerates even larger differentials in wealth so long as this criterion is met, just as it permits narrowing of the gaps between rich and poor so long as overall wealth is not compromised.

Egalitarians take a very different view on this question. In their eyes, the skew in the distribution of wealth counts as much as the sum. Hence
they have deep suspicion of any change in relative wealth (including those changes that meet the standards for both Pareto and Kaldor-Hicks improvements) that accentuates the differences of wealth between rich and poor. In large measure their argument rests on the deep sense that redistribution (if it resulted in no loss of output) toward greater income equality is welcome because of the diminishing marginal utility of wealth—a point on which they have strong intuitive appeal. Once that principle is accepted, then the utility gains from some redistribution can justify some overall reduction in wealth. Thus, having the rich get richer is bad if the poor remain in the same position given the greater gaps in wealth that necessarily ensue.

In a highly schematic way, which does not affect the basic argument, assume that the world is divided into two perfectly homogenous groups, one rich (R) and one poor (P). If at the outset the income of the Rs was all 100 and that of the Ps was all 10, the believer in Pareto improvements would prefer a distribution of 1000 for each R and 10 to each P, if there were no other changes. It would be an open question whether he would prefer 1000 to R and 10 to P to a distribution that left R at 100 but increased P to 50. The egalitarian would have real doubts about the move from (100, 10) to (1000, 10), and at some point would prefer either the status quo or a third choice that results in a larger proportionate increase (such as 500, 50) instead of a still larger disproportionate one. Indeed, some egalitarians might prefer a new distribution of (80, 20), which has both a smaller skew but a lower total value.

The theoretical disputation has differential consequences for the two approaches. No matter how one slices the numbers, all voluntary market transactions meet the Pareto test between the participants even if we have no knowledge of the initial or final endowments of either parties to the transaction. It is enough to know that the standard rule of voluntary exchanges yields gains from trades. The question of distribution can take care of itself. But the egalitarian cannot adopt that agnostic position—he must always make some estimate about whether a possible increase in the skew justifies some restriction on market behavior. His judgments raise much greater difficulties on two levels: first, setting out the permissible moves from the full set of initial distributions; and second, trying to figure out how to evaluate these matters. On the first, there is no practical way to determine the relative gains to the parties, since these are routinely unobserved. On the second, there will be a real difficulty in deciding just how much wealth should be sacrificed for an improvement in overall equality. The approach of tinkering with literally billions of contracts is thus overwhelmed by both normative and practical concerns.

In light of these difficulties, a consistent egalitarian will look for a different way to deal with wealth differentials. Most notably, for all its difficulties, a system of progressive taxation looks to be a far less intrusive
way to balance off wealth against equality.\(^{41}\) But that tax, without more, does not reach individuals who are outside the wealth system. Hence, some form of government democrat that declines with income is the only way to reach all sectors of the population—at a major administrative cost. But neither of these initiatives involves the direct form of attacks on Wal-Mart. Rather they treat the case for redistribution the same for all persons, regardless of their status, by looking only at their relative wealth. They therefore do not support the strong market interferences that are characterized in the anti-Wal-Mart campaign, which, as noted earlier, are better explained as an effort of organized labor to preserve high wage jobs by legal interference that selectively blocks their low wage competitors. The surprising implication of all this analysis is that Wal-Mart comes out relatively unscathed even under an egalitarian critique, which at its best tries to preserve the efficiency of market transactions by using tax devices to moderate differences in wealth. In the end I think that this tax approach itself has serious drawbacks, as I have long been a supporter of the flat tax.\(^{42}\) But that debate gets us out of the world of Wal-Mart, to which this symposium is devoted. For our purposes, it is hard to find a coherent approach to social welfare or social justice that lends credence to the virulent attacks that are aimed at Wal-Mart. The proper social response to Wal-Mart seems clear—do nothing to either help or hurt it; and then wish it and its competitors the best of luck.

\(^{41}\) For discussion, see Louis Kaplow & Steven Shavell, Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income, 24 J. LEGAL STUD. 821, 821 (2000).