

**Why Do Global Markets Suffer From Chronic Excess Capacity?: Insights
From Keynes, Schumpeter and Marx**

**James Crotty
University of Massachusetts, Amherst
June 18, 2002**

**I am grateful for research support provided by the Political Economy Research
Institute of the Economics Department at the University of Massachusetts, Amherst.**

Introduction¹

In the aftermath of the Great Depression and World War II, national economies, even those in which markets played a very powerful role, were placed under the ultimate control of governments, while international economic relations were consciously managed by the IMF and World Bank. Western governments, with varying degrees of enthusiasm, lent support to unions, regulated business, tightly controlled financial markets, and built social welfare systems. They also began to regulate aggregate demand in pursuit of high employment and fast growth, a phenomenon known as the ‘Keynesian revolution.’ Business and financial interests accepted these changes in part because strong capital controls and low levels of trade and investment flows after the war left them without a credible “run-away” threat to undercut government economic policies they disliked. The global prosperity that characterized the quarter century following the war -- the so-called “Golden Age” of modern capitalism -- reinforced the belief that market economies need strong social regulation to function effectively.

Contradictions inherent in Golden Age capitalism led in time to the end of prosperity.² Economic instability began in the late 1960s and erupted full force in the 1970s with two OPEC oil price shocks, the collapse of the Bretton Woods fixed exchange rate system, and the buildup of excessive debt in the Third World. These problems created a powerful movement, led by business and, especially, financial interests, to roll back the economic regulatory power of national governments, replacing conscious societal control with the “invisible hand” of unregulated markets, and eliminate restrictions on the flow of goods and money across borders, creating an integrated global economy.

Supporters of neoliberal globalization used neoclassical economic theory to sell their program. The standard neoclassical view holds that, absent excessive government interference, both national economies and the integrated global economy will operate efficiently, more or less like the models of a perfectly competitive market system found in college textbooks. Competitive market pressures lead to the full utilization of labor and productive capital, and cause aggregate demand (or spending) to balance full-capacity income, a proposition known as Say’s Law. There is thus no need for governments to engage in activist Keynesian aggregate demand management. Globally integrated

financial markets will raise efficiency and productivity, it was argued, because they will allocate world savings to the most productive investment projects no matter where in the world they are located. The elimination of cross border barriers to imports and direct investment will raise efficiency by subjecting stodgy domestic oligopolies to more intense competitive pressure and allowing even firms in small countries to take advantage of global economies of scale. In sum, neoliberals believed that the replacement of state economic guidance with a liberalized global market system would raise global income growth and improve economic performance everywhere.

Heterodox critics of neoliberalism, on the other hand, argued that the abandonment of growth targeting by activist demand management would slow real GDP growth and generate higher unemployment. High unemployment and the drive for labor market ‘flexibility’ in turn would slow real wage growth and raise inequality. Financial liberalization would lead to high real interest rates and increased instability in global financial markets. Poorer countries that substituted neoliberalism for interventionist economic development policies, it was argued, were less likely to experience rapid long-term growth. These problems were not seen as the inevitable result of increased global integration per se, but were caused by the specific institutions and practices that constitute neoliberalism.

Though each side defends its position with selected data, the weight of the evidence from the last two decades supports the position of the critics. Global income growth has slowed substantially from its Golden Age pace, as has the rate of growth of capital accumulation. Productivity growth has deteriorated, real wage growth has declined and inequality has risen in most countries, real interest rates are higher, financial crises erupt with increasing regularity, especially in developing economies, average unemployment has risen, the less developed nations outside East Asia have fallen even further behind the advanced, and post-1997 growth in East Asia has slowed.

What Caused Chronic Global Excess Capacity in the Neoliberal Era?

This essay focuses on one of the most important economic problems created by the spread of neoliberal globalization -- *the generation and continued reproduction of substantial excess capacity in most important globally contested industries.*

There is no official data on global excess capacity. There is not even a consensus on how it should be defined and measured. Nevertheless, reports from consulting firms, industry trade associations, and occasional studies by international organizations agree that large excess capacity has plagued almost all globally contested industries for at least two decades. Business Week noted that: A supply outpaces demand everywhere, sending prices lower, eroding corporate profits and increasing layoffs.³ Former GE Chairman Jack Welch claimed that A there is excess capacity in almost every industry.⁴ The Wall Street Journal observed that A from cashmere to blue jeans, silver jewelry to aluminum cans, the world is in oversupply.⁵ The Economist worries about A a malign deflation caused by excess capacity and weak demand,⁶ speculating that the gap between sales and capacity is A at its widest since the 1930s.⁶ Excess capacity in steel hovers near 20%, in autos it has been as high as 30%, and these figures are dwarfed by recent unused capacity numbers in semiconductors and telecommunications.

An adequate understanding of chronic excess capacity must begin with the recognition that the spread of neoliberalism has been accompanied by a substantial slowdown in global economic growth. Though economists debate its causes, the slowdown is empirically indisputable. The most widely accepted work on long-term economic growth has been done by Angus Maddison for the OECD. It shows that the annual rate of growth of real global GDP fell from 4.9% in the Golden Age of 1950-73 to 3% in 1973-1998 – a drop of 39%. Calculated on a per capita basis, the decline in the growth rate was 55%. In Latin America, GDP growth dropped by 43% between the periods, while Africa showed a 38% decline. The only major area where GDP growth increased was Asia (excluding Japan), an area in decline since the 1997 Asian crisis.⁷ Using a different measurement procedure from Maddison's, the United Nations estimates that world GDP grew at an annual rate of 5.4% in the 1960s, 4.1% in the 1970s, 3% in the 1980s, and 2.3% in the 1990s.⁸

Neoliberal enthusiasts failed to foresee the decline in the global growth rate because they relied on Say's Law: in their models it is not possible for demand to fall below full-capacity supply for a prolonged period. As Joseph Stiglitz, a Noble Prize winner and former Chief Economist for the World Bank, puts it, neoliberal economic theories embody "market fundamentalism -- in which, *by assumption*, markets work

perfectly and demand must equal supply for labor and for every other good or factor” – including capital.⁹ But as Keynes taught us, in an unregulated market economy aggregate demand can be chronically deficient, as in the Great Depression.

Providing a persuasive explanation for the slowdown in global demand growth since the early 1970s is not difficult: many economists have done it. The initial rise in excess capacity is thus not a mystery. However, the answer to the question of why global supply did not eventually adjust to the slower rate of growth in demand, leading to a slow paced but balanced expansion, is not obvious. Neoliberals did not foresee the possibility of long-run excess capacity because in standard neoclassical micro theory it simply cannot occur. Even Keynesian macro theory has a blind spot in this regard because it assumes that sluggish aggregate demand growth will eventually lead to a proportionate slowdown in the growth of aggregate supply through its impact on investment and productivity.

The explanation for the long-term character of excess capacity presented here integrates insights from both Joseph Schumpeter and Karl Marx and can be summarized as follows. The shift to neoliberal policies in most of the world beginning in the late 1970s created additional impediments to demand growth in a world economy already reeling from two oil price shocks and restrictive macro policy imposed in response to the inflation they caused. Sluggish demand growth in turn led to a sharp rise in excess capacity in globally contested industries. Meanwhile, liberalization raised competitive intensity across the globe by eliminating existing barriers to the movement of goods and money across borders that protected the market power of national oligopolies. High initial excess capacity combined with the collapse of barriers to the free movement of capital triggered competitive wars for survival. As is explained below, this led firms to adopt policies that both further constrained global demand growth and expanded industry capacity at a pace faster than would be understandable within either a neoclassical or Keynesian framework, reproducing excess capacity. Global neoliberalism has thus unleashed a destructive dynamic interaction between its macro and micro levels of activity, a kind of vicious economic circle.

What Caused the Slowdown in the Rate of Growth of Global Demand?

Since the global demand slowdown has been analyzed by many progressive and even mainstream economists, here I merely list six impediments to global aggregate demand growth, each of which is embedded in the structures and policies of global neoliberalism.

First, the slow growth of wages and employment brought on by global neoliberalism has stifled consumer demand. Wages have been restrained by high average unemployment, the decline of unions, weaker government support for collective bargaining, and a worldwide slowdown in productivity growth. One study of 19 developed countries (not including the US) found that after rising rapidly through the early 1970s, real compensation growth fell to 1.2% a year in 1979-89 and again to 0.7% in 1989-96.¹⁰ Fear of job loss has risen dramatically due to greater import competition, the increased mobility of physical capital, the 1990s merger and acquisition explosion, and chronic job “churning” associated with labor-saving technical change and new corporate strategies of downsizing and re-engineering. By weakening labor’s bargaining power, job insecurity has lowered both real wage and household income growth. Growth in workers’ disposable income has also been retarded by a shift in the tax burden from mobile capital to immobile labor and by rising household debt burdens in many countries.

Second, the evolution of the global financial system has depressed global growth. High real interest rates were imposed after 1980 by independent, conservative, and inflation-obsessed central banks. The natural predilection of independent Central Banks for high real interest rates was reinforced by the spread of financial deregulation in the 1980s and 1990s. Global investors were increasingly able to use capital flight to punish countries that used low interest rates to pursue growth and employment. Moreover, the heightened instability of global financial markets has significantly increased the incidence of banking and currency crises, which induce serious recessions in the areas in which they occur, and lead financial investors to demand larger risk premiums on loans.

Third, the growth of private and public investment spending has slowed because of lower profits, higher real interest rates, increased uncertainty, sluggish aggregate demand growth, and conservative attacks against government spending.

Fourth, fiscal policy has become increasingly restrictive. Government spending in

Europe and North America is still large. But there is no question that after rising significantly in response to slow growth and high unemployment rates in the 1980s and early 1990s, government spending as a share of income peaked, and in many countries begun to decline, as conservative political forces become ever more powerful. The structural budget deficit is designed to measure the net stimulus to aggregate demand from government spending and taxes. For the advanced countries, the structural budget deficit fell by 3.4% of GDP in the 1990s, creating a huge drag on aggregate demand growth.¹¹

Fifth, liberalization programs imposed by a coalition of internal and external neoliberal forces, including G7 governments, the World Bank and the IMF, have severely weakened state-guided development models across the Third World, including in East Asia. This has lowered aggregate demand growth in the developing world.¹²

Finally, the spread of IMF and World Bank mandated austerity and restructuring programs across the developing world have badly hurt global growth.

Why the Neoclassical Theory of “Perfect Competition” Cannot Help Us Understand Chronic Excess Capacity

An adequate explanation of chronic excess capacity requires a realistic theory of competition. In neoclassical theory, intense or ‘perfect’ competition always leads to maximum efficiency and the quick elimination of excess capacity. The mainstream theory of perfect competition is primarily concerned with the blissful *state* of perfectly competitive equilibrium, not the messy and often destructive out-of-equilibrium *process* that is supposed to create it. It is important to understand precisely where the neoclassical theory of competition falls short.

Non-academic business analysts and most business historians understand that competition can become excessive or “cut-throat,” leading to price wars, low profits, dangerous debt burdens, and policies -- such as scorched earth labor relations -- that may be necessary for short-term survival but erode long-term industry efficiency. Neoclassical micro theory exorcizes these destructive dimensions of intense competition through the use of two key assumptions that are empirically indefensible. The first, which seems innocuous on its face, is that production cost per unit rises rapidly as output increases.

The second is that there is “free” or costless exit from low profit industries.

A main tenet of the theory is that intense competition will force price down until it just covers what economists call “marginal cost.” Marginal cost is the extra production cost (of labor, materials and so on) incurred in making the last unit of output sold. If production cost per unit remained constant no matter what the output level, then marginal production cost and average production cost per unit would be the same. When perfect competition forced price to equal marginal cost, total firm revenue would equal total production cost, leaving no revenue left over to pay the firm’s “fixed” cost -- the cost of maintaining the capital stock in the face of depreciation and obsolescence (or, alternatively, of paying interest and dividends to the investors who provided the firm with the financial capital it requires). In this case, intense competition would cause the representative or typical firm to suffer a loss equal to fixed cost every period, a process the industry could not long survive. Keep in mind that leading firms in most important global industries have enormous fixed costs.

Neoclassical theory hides this destructive side of intense competition by making the empirically false assumption that production cost per unit always rises rapidly as output increases. This means that marginal cost and price exceed average unit production cost. In equilibrium, the gap between price and average production cost is large enough to cover all fixed costs. Even though competition is fierce, the typical firm does not lose money.

Consider a simple numerical example. Suppose it cost a typical firm \$1 to produce the first unit, \$2 to produce the second unit, and \$3 to produce the third and last unit: average production cost is \$2 per unit. Even if competition forced price down to the marginal cost of \$3, the firm would still receive \$1 more per unit than the average cost of production. This gap between price and average production cost will generate enough revenue to cover fixed cost, so firms in the industry can live happily ever after. But consider what would happen if production cost remained constant at \$2 per unit. Marginal cost and price would be \$2, so price would equal average unit production cost, and firms would suffer losses equal to fixed cost.

Now consider our industry in equilibrium with price at \$3. Suppose that a fall in demand creates temporary excess capacity. Since production falls, marginal cost and

price fall as well. The gap between price and average unit production cost will shrink and the number of units sold will fall, so revenues in excess of production cost will no longer be large enough to cover total fixed cost. Excess capacity will thus create at least temporary losses for the typical firm.

Can excess capacity become chronic in the neoclassical world? Here is where the second assumption comes into play. *If* we assume that exit is “free” or costless, losses caused by excess capacity will induce firms to exit from the industry by moving their productive capital to more profitable industries until excess capacity is eliminated. When full capacity is restored, revenue received by the remaining firms will again be large enough to cover both production and fixed costs and equilibrium will be restored.

The moral of this neoclassical story is that in a well functioning market system, excess capacity is a self-correcting, transitory phenomenon; it simply cannot become chronic. Unfortunately, the story is a fable. To understand why excess capacity has become chronic, we must rely on realistic assumptions about marginal cost and the reversibility of invested capital.

Global trade and investment are dominated by industries – such as autos, electronics, semiconductors, aircraft, consumer durables, shipbuilding, steel, petrochemicals, and banking – that I call *core industries*. Empirical studies of core industries studies suggest that marginal cost normally does *not* rise with output unless production levels approach full capacity: it typically remains constant or even declines as capacity utilization rises. Therefore, if unrestricted competition forced price to equal to marginal cost in core industries, it would eventually lead to a raft of bankruptcies.

This problem is easiest to see in the important new information-technology and telecommunications (ITC) industries, where marginal cost is often near zero. Creating an additional copy of computer software or adding another customer to a web network is relatively costless. For this reason, many mainstream economists recognize that the neoclassical theory of perfect competition cannot apply to ITC industries. For example, Harvard President and former U.S. Treasury Secretary Lawrence Summers has argued that ITC firms have large fixed costs and much smaller marginal costs. This new economy is Schumpeterian because:

the only incentive to produce anything is the possession of temporary monopoly

power B because without that power the price will be bid down to marginal cost and the high initial fixed cost cannot be recouped. So the constant pursuit of monopoly power becomes the driving force of the new economy.¹³

What these economists fail to recognize is that the difference between ITC and other core industries in this regard is merely one of degree.

It is also crucial to recognize that most productive assets are not liquid; they are significantly immobile or irreversible. Thus, exit from an unprofitable industry is not “free,” but involves a substantial loss in the value of the firm’s capital. Once in place, assets lose substantial value if re-allocated to a different industry or sold on a second hand market. A study of the aerospace industry estimated that “capital that flowed out of the sector sold for only one-third of its estimated replacement cost.”¹⁴ Bankrupt telecom firms have recently been selling their assets for 20 cents on the dollar. With illiquid assets, exit can destroy the bulk of the firm’s invested capital. Keep in mind that firms have the strongest incentive to leave an industry when profit prospects are dimmest and excess capacity is greatest. But this is precisely the time when the price of industry-specific assets on the second hand market will be at its nadir as the supply of such assets grows just when demand for them has collapsed.

Finally, note that core industries have significant economies of scale: over a wide range of output, the bigger you get, the lower your costs, the more effective your marketing efforts, and the cheaper your financing. For example, General Electric, Ford Motor Company, and IBM have total assets of \$405 billion, \$273 billion, and \$88 billion respectively.¹⁵ This has several important implications for the theory of competition in core industries. First, as scale economies grow, fixed costs rise and marginal costs fall. The greater the economies of scale, the more destructive the marginal cost pricing associated with intense competition becomes. Second, for key firms in core industries, rising excess capacity means ever higher fixed costs per unit: the industry cannot function effectively unless production is near full capacity. Third, the investment required to compete effectively in core industries is very large, so exit from the industry is very costly. Fourth, since minimum efficient scale is large, a modest number of giant firms can often produce enough to meet the bulk of global demand; this makes the creation and reproduction of oligopolistic arrangements in the industry manageable.

Schumpeter's Theory of Natural Oligopolies

It should now be clear that the all-out competition inherent in the neoliberal pursuit of unrestricted global economic integration would lead to the eventual destruction of core industries. Once the unrealistic assumptions that underpin the neoclassical theory of competition are rejected, one can see that *the ability of firms to cooperate sufficiently to maintain price substantially above marginal cost is a necessary condition for the existence and reproduction of core global industries*. This is why John Maurice Clark referred to such industries as “*natural oligopolies*” and why Joseph Schumpeter argued that the most important industries in American economic history, those chronicled by historian Alfred Chandler in such classics as Scale and Scope, could never have evolved or achieved longevity unless their dominant firms had engaged in what Schumpeter called “*corespective competition*.”¹⁶ Johns Hopkins University business historian Louis Galambos recently observed that “global oligopolies are as inevitable as the sunrise.”¹⁷

Firms in natural oligopolies must cooperate to hold price above marginal cost by a margin wide enough not only to avoid losses, but also to help finance large investments in capital goods and technological improvement. As noted, the fact that economies of scale are such that a small number of firms usually dominate the industry makes cooperative arrangements administratively feasible. Market power and corespective competition also provide the stable, profitable environment necessary to induce firms to accept the risk involved in investing in the huge, illiquid capital projects that success in core markets requires. Finally, it is essential that firms cooperate to avoid the creation of substantial excess capacity. Sooner or later, high excess capacity will cause some beleaguered firm to cut price and increase sales to lower the excessively high fixed cost per unit that excess capacity creates. But initial price cuts eventually trigger price wars, as other firms try to protect their own market share. As the Financial Times noted, “since the huge capital investment in a steel mill or a chip plant is a sunk [or fixed] cost, the temptation is always to run the business flat out [when demand slows], charging only a rock-bottom marginal cost.”¹⁸ Plagued by chronic excess capacity, steel was selling recently for \$200 a ton, which is well *below* its current production cost of \$260. Business Week reported on “a no-holds-barred price war fueled by oversupply and sluggish

demand” in the computer hardware industry.¹⁹ Firms try to avoid excess capacity by informally regulating the pace of capital accumulation to keep supply growth from exceeding demand growth. *Note that the significant slowdown in the rate of growth of global demand in the neoliberal era has made it extremely difficult for core industries to maintain the collective discipline required to avoid excess supply.* It is far easier to agree to share new customers than it is to find consensus on who should suffer losses and close plants.

Schumpeter stressed that key firms in natural oligopolies do compete intensely, though in normal times they do so in ways that do not erode industry profitability. They pursue high market share and industry dominance through cost cutting investment, technological and organizational innovation, marketing and distribution policy, new product development, and so forth. Any firm that fails to lower costs and improve quality over long periods invites attack by stronger industry rivals. And failure to achieve adequate cost reduction over time by industry insiders will eventually lead to entry by more efficient outside firms, or the loss of customers to substitute products.

The kind of competition that is crucial for dynamic efficiency, Schumpeter insists, is not the price competition focused on in static neoclassical theory.

In capitalist reality as distinguished from its textbook picture, it is not [price] competition which counts but the competition from the new commodity, the new technology, the new source of supply, the new type of organization (the largest scale unit of control, for instance) – competition which commands a decisive cost or quality advantage and which strikes not at the margin of the profits and outputs of the existing firms but at their foundations and their very lives. This kind of competition is...the powerful lever that in the long run expands output and brings prices down...²⁰

Though large barriers to entry give them a good deal of pricing leeway, dominant firms in natural oligopolies cannot let price or profit rates get so high that they tempt outsiders to invade the industry.

The relation between competitive intensity and efficiency in core industries is thus much more complex than acknowledged in mainstream theory. Core industry performance can suffer from either excessive competitive intensity leading to destructive price wars or from competitive pressure that is too weak to spur enough investment, technical change, and long-term cost reduction to assure the survival of the industry.

The argument that intense competition will destroy core industries obviously does not imply that laissez-faire economic policies and corespective competition assure socially efficient performance. History tells us that that unless modern capitalist markets are subject to effective social control, they cannot achieve widespread prosperity for an extended time period.

Adding Marx: Destructive Competition and Chronic Excess Capacity

We are now prepared to address the central question posed above. Why hasn't global supply growth adapted to the reduced pace of global demand growth in the past two decades, eliminating excess capacity? Combining Marx's ideas about the destructive side of competition and Schumpeter's theory of natural oligopoly and corespective competition leads to an interesting answer.

The rise of global neoliberalism destroyed the conditions required to sustain corespective relations in most core global industries, and in so doing created chronic excess capacity. Corespective relations cannot be sustained without adequate long-term demand growth as well as limits on the number of large firms in the industry. Global neoliberalism increased the intensity of competition by slowing demand growth, which created widespread excess capacity, and by eliminating cross-border barriers to competition. As a result, we have witnessed an outbreak of what I call "coercive competition", leading to cut-throat pricing, the destruction of secure oligopoly profit margins, and rising financial fragility in core markets.

The concept of coercive competition is central to the explanation of chronic excess capacity. Under corespective competition and adequate demand growth, core global industries are highly profitable. That is why large multinational corporations from mature industrialized economies have always tried to dominate them. However, as the post-war period evolved, barriers to the penetration of national markets in advanced economies by firms from other developed countries fell, and firms from developing countries tried to enter core industries so they could advance up the global technology/productivity/value-added ladder. For example, an index of merchandise import penetration for the U.S. constructed by economist Robert Feenstra rose from 14% in 1970 to 31% in 1980.²¹ Each new wave of entrants adds to the potential for market

overcrowding, making interfirm cooperative relations increasingly difficult to maintain. Had global aggregate demand growth remained strong, the newcomers would have been easier to accommodate. In the Golden Age, fast growth and constraints on international competition allowed Northern oligopolies to maintain some degree of corespective relations even as Japan and, later, Korea and Taiwan began their slow ascent up the export pecking order. But, as we have seen, neoliberalism severely constrained global demand growth. With sluggish demand, established players must quickly exit from the industry as new firms enter to avoid chronic excess supply.

Why did new firms continue to enter unprofitable and unstable core industries? A key reason is that emerging countries have to pass through most of the rungs on the technology ladder if they are to achieve economic development. They cannot go directly from labor-intensive textile exports to auto, electronic and semiconductor exports. Governments thus *must* either induce indigenous firms to invest in core industries or do it themselves through public companies. The alternative is to give up any hope of becoming a developed nation – a politically unacceptable option.

Why didn't established firms withdraw from these markets as sluggish demand growth and new entrants caused profits to deteriorate? Neoclassical micro theory fails to recognize that *established firms have good reason not to exit quickly from unprofitable core industries!* They have huge illiquid physical, human and organizational assets that will suffer considerable loss of value if they are forced to pull out of the industry. But consider the firm's prospects if it decides not to exit. The outcome of the intra-industry wars for survival unleashed by neoliberalism is unpredictable. If it were known in advance which firms would lose the struggle for survival, the losers would exit early to cut their losses. And those who are demonstrably weaker than their opponents often do leave. But given the major loss entailed in exit, most competitors try to 'stay in the game' even as competition intensifies. Firms that survive the current struggle will reap the secure, above-average profits that are expected to emerge when the eventual winners are in a position to eliminate excess capacity and get the industry under oligopolistic control once again. Given a guarantee of massive asset value loss under exit, and some positive though imprecisely estimated probability of maintaining the value of its assets and gaining membership in a profitable future oligopoly if the firm remains in the game,

refusal to exit is often a rational choice. Excess capacity is thus not the short-term phenomenon pictured in neoclassical theory.

One more insight is needed to understand why excess capacity has been so durable. *Firms that decide to stay in the game must continue to invest in the face of deteriorating industry conditions in order to have any chance of winning the war for survival.* In an article that focused on the complex role of competition in Marxian investment theory, I labeled this phenomenon “coerced investment.”²²

To stay in the game, firms must invest to take advantage of the ever-larger returns to scale made possible by rapid technical change and global market integration. Investment is also needed to shed labor through downsizing and re-engineering and, with attacks on labor the order of the day, to increase direct monitoring and control of workers. Firms must invest to acquire best practice technology for both cost reduction and quality reasons: in core markets such as autos and semiconductors the acquisition of best-practice technology often requires huge capital investments of ever increasing size. They must invest in style and model change in order to maintain market share in industries where fashions and fads quickly come and go. Finally, they must invest to get inside the borders and on the ground floor of expected high growth developing markets, a designation that now rapidly shifts back and forth across geographical boundaries. *Many of these investment projects increase capacity -- and thus reproduce excess capacity -- even though this is not the reason firms undertake them.* The Economist sees the cost cutting pressures associated with globalization as a key culprit behind the burst of new capacity: the “rush to build plants all over the place has merely added to the capacity mountain.”²³ Of course, plant closings take place along side coerced investment, but with sluggish demand growth, their impact is too weak to significantly reduce excess capacity.

Schumpeter observed that co-competitive competition leads to the “creative destruction” he believed inherent in capitalism. No doubt coercive competition has its creative aspects as well: for example, it accelerates the elimination of obsolete capital and the implementation of new technologies. But operating within the institutions and policies of global neoliberalism, the destructive dimension of coercive competition dominates its more benign aspects.

Note that the existence of substantial coerced investment in core industries is not

inconsistent with the empirical observation made above that the growth of total investment -- including residential investment, public investment, investment for the sole purpose of increasing capacity, and investment in industries not subject to destructive competition – has slowed substantially in the past two decades, constraining demand growth.

What we see here is a destructive macro-micro dialectic at work. *In the era of global neoliberal capitalism, sluggish aggregate demand growth and chronic excess aggregate supply constantly reinforce one another.* The global aggregate demand slowdown of the 1970s and early 1980s created widespread excess capacity that exacerbated the ongoing rise in competitive intensity caused by the reduction of barriers to cross-border flows of goods and money. The more intensive competitive pressures become, the more they force firms to reduce investment spending designed to expand capacity, cut employment, slash wages, attack their unions, and substitute low for high wage labor and temporary for permanent labor. Businesses and high-income households pressure governments to cut social welfare and infrastructural spending so that taxes on corporations and the rich can be lowered without creating budget deficits. Governments feel pressure to lower taxes on capital and mobile skilled workers so they can attract and maintain multinational businesses. But all these actions further constrain global aggregate demand growth, which creates yet stronger competitive intensity in a seemingly endless downward spiral.

Coercive Competition in the Global Auto Industry

The global auto industry provides a good example of these competitive processes at work. It has massive scale economies and huge fixed costs. Slow trend global growth, new entry, and modest exit have created a vast global capacity overhang in autos. In 1999 Business Week reported that at least three quarters of the globe's forty auto makers were "drowning in debt and glutted with factory capacity: the industry can make 20 million more cars and trucks a year than it can sell."²⁴ PricewaterhouseCoopers concluded that global capacity utilization in autos fell from 80% in 1990 to less than 70% in 1999.²⁵ With such large fixed costs, high excess capacity has killed profits in all auto markets other than the U.S. in the second half of the 1990s. According to the Wall Street Journal,

AThe huge fixed costs involved in developing new vehicles and running big auto factories means auto makers feel compelled to maintain B or expand market share.²⁶ Business Week noted that this has led to Acutthroat pricing on top of the overcapacity problems.²⁷ To make matters worse, in 2001 the US auto market itself turned unprofitable as the financially fragile US economic boom petered out and the temporary monopoly on SUV and light truck sales held by US firms came to an end.

Yet even though firms faced excess capacity, losses or minuscule profit margins, and excessive debt, they continued to pour investment capital into the industry. Investment to take of advantage of rapidly rising economies of scale is mandatory: estimates of current minimum efficient production scale range from 2 million to an astounding 4 million cars per year. Ford, GM and Daimler Chrysler are again investing heavily in Asia, even though sales are not expected to return to 1996 levels until 2004. According to the Wall Street Journal, Asia “has turned into a war of attrition, with the Big Three aiming to be among the winners.”²⁸ Meanwhile Honda and Toyota have increased capacity in the US by 50% since 1996.²⁹ GM recently invested \$1.5 billion in Saturn to try to maintain its competitiveness, and thereby avoid losing the \$5 billion it had previously invested.³⁰ Daimler-Chrysler, Volkswagen, and Renault plan to collectively invest \$5 billion in production facilities in Mexico over the intermediate future.³¹ The Wall Street Journal observed that “many experts warn of vast overcapacity in Asia and South America if auto makers complete even a fraction of already announced plans for new plants.³² All the large automakers are investing heavily in the development of new models, an expensive undertaking thought to be required just to maintain market share.

This is mostly coerced investment. Its main effect is to continuously recreate industry excess capacity and debt burdens, maintain downward pressure on wages and employment, and in the process help restrain the growth rate of aggregate demand.

In Prospect: Re-Oligopolization On a Global Scale?

Marx offered an important insight into the relation between competition and cooperation among firms. He argued that the balance between competition and cooperation in industries shifted qualitatively from time to time. All-out competition is so

destructive that it ultimately forces the combatants to seek the peace and safety of corespective relations. But opulent profits and too much insulation from competitive pressure for too long often leads to insider inefficiency and subsequent invasion by domestic or foreign outsiders, triggering intense competition once again. In the following quotation, the term monopoly should be broadly interpreted as cooperative interfirm relations.

In practical life we find not only competition, monopoly and the antagonism between them, but also the synthesis of the two, which is not a formula, but a movement. Monopoly produces competition, competition produces monopoly. Monopolists are made from competition; competitors become monopolists. ... The synthesis is of such a character that monopoly can only maintain itself by continually entering into the struggle of competition. (Marx, 1963, p. 152, emphasis added)

The rapid pace of necessitous or coerced investment, the paucity of profit, and rising debt burdens in recent decades are dividing the competitors in core global industries into those who are in decline and those who remain relatively strong even if objectively they are in weak condition. Coercive competition eventually begins to identify winners, who, when they are few enough in number, will seek to restore the cooperative relations necessary to raise the industry profit rate. Though technological superiority influences this sorting process, it is mainly those with deep pockets, not efficiency in design and production, who are winning this life and death struggle. *Since the mid 1990s, core global industries have experienced an ongoing merger and alliance wave of historic proportions.* In 2000 global M&A deals were worth \$3.5 trillion, about six times their 1994 value. There was \$1.1 trillion of cross border mergers in 2000, thirteen times the 1991 amount.³³

Conclusion

At present, we are in a disorderly, uncertain stage in the consolidation process in core global industries, one that raises a question of great importance. Will the current movement toward the reconstruction of cooperative competition and secure oligopoly profits overcome the pressures of destructive competition in an era of sluggish global demand growth? It seems likely that success will continue to evade firms trying to restore effective oligopolies unless the pace of global demand growth picks up significantly, but

aggregate demand continues to be constrained by the same forces that created destructive competition in the first place. And even if we were to assume that mergers, acquisitions and alliances among core industry firms eventually lead to the restoration of viable oligopolies, a serious problem would remain. Who will regulate these global super groups, forcing them to act in the interest of the majority of the world=s people? There are at present no democratically constituted and controlled national or transnational government agencies with both the ability and the will to do so, and there are no serious prospects of their creation in the intermediate future.

NOTES

-
- ¹ The ideas discussed in this essay are presented in much greater detail in James Crotty, "Slow Growth, Destructive Competition, and Low Road Labor Relations: A Keynes-Marx-Schumpeter Analysis of Neoliberal Globalization," Working Paper Number 6, Political Economy Research Institute (UMASS) web site, <http://www.umass.edu/peri/research.html>.
- ² See for example Samuel Bowles, David Gordon and Tom Weisskopf, *After the Wasteland* (Armonk, NY: M.E. Sharpe, 1990).
- ³ *Business Week*, January 25, 1999.
- ⁴ *New York Times* November 16, 1997, p. 3.
- ⁵ *Wall Street Journal*, November 30, 1998, p. A17.
- ⁶ *The Economist*, February 20, 1999, p. 15.
- ⁷ Angus Maddison. *The World Economy: A Millennial Perspective* (Paris: OECD Development Center, 2001), p. 126.
- ⁸ United Nations, *World Economic Survey* (New York: United Nations), various issues.
- ⁹ Joseph Stiglitz, *Globalization and Its Discontents* (New York: W.W. Norton, 2002), p. 35 (emphasis in original.)
- ¹⁰ Lawrence Mishell, Jared Bernstein and John Schmitt, *The State of Working America: 1998-99* (Ithaca, NY: Cornell University Press), p. 362.
- ¹¹ International Monetary Fund, *World Economic Outlook* (Washington: International Monetary Fund, April 2000), p. 132.
- ¹² For an analysis of how this process played out in Korea, see James Crotty and Kang-Kook Lee, "Economic Performance in Post-Crisis Korea: A Critical Perspective on Neo-Liberal Restructuring," Working Paper Number 23, Political Economy Research Institute (UMASS) web site, <http://www.umass.edu/peri/research.html>, 2001.
- ¹³ Lawrence Summers, "The New Wealth of Nations," speech given May 10, 2000, US Treasury Department website, www.ustreas.gov/press/releases/ps617.htm.
- ¹⁴ Valerie Ramey and Matthew Shapiro, "Displaced Capital," *National Bureau of Economic Research*, Working Paper 6755, October 1998, abstract.
- ¹⁵ *World Investment Report* (New York: United Nations, 2001), p. 91.
- ¹⁶ Alfred Chandler, *Scale and Scope: The Dynamics of American Capitalism* (Cambridge, MA.: Harvard University Press, 1990).
- ¹⁷ *Wall Street Journal*, March 8, 1999, p. B1.
- ¹⁸ *Financial Times*, December 6, 2001.
- ¹⁹ *Business Week*, June 30, 2001, p. 32.
- ²⁰ Joseph Schumpeter, *Capitalism, Socialism and Democracy* (London: George Allan and Unwin Ltd, 1976 [1943]), pp. 84-85.
- ²¹ Robert Feenstra, "Integration of Trade and Disintegration of Production in the Global Economy," *Journal of Economic Perspectives*, Fall 1998, p. 35.
- ²² See James Crotty, "Rethinking Marxian Investment Theory: Keynes-Minsky Instability, Competitive Regime Shifts and Coerced Investment," *Review of Radical Political Economics*, 25(1), March 1993, pp. 1-26.
- ²³ *The Economist*, May 10, 1997, p. 21.
- ²⁴ *Business Week*, January 25, 1999, p. 69.
- ²⁵ *The Economist*, January 8, 2000, p. 58.
- ²⁶ *Wall Street Journal*, January 16, 2000, p. B1.
- ²⁷ *Business Week*, January 25, 1999, p. 69.
- ²⁸ *Wall Street Journal*, December 8, 1999, p. B1.
- ²⁹ *Newsweek*, February 4, 2002, p. 38.
- ³⁰ *Wall Street Journal*, April 20, 2000, p. A4.
- ³¹ *The Financial Times*, May 24, 2000, p. 10.
- ³² *Wall Street Journal*, August 4, 1999, p. A1.
- ³³ Not all these mergers were undertaken to restore lost market power. Many resulted from the pressure, rooted in equity markets, to sustain reported earnings via serial acquisition when growth through reinvestment in existing industries could no longer do the job.
