16.3 STABILIZING UNSTABLE MARKETS

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- Situate businesses and their business models within their market governance structures
- Define infrastructure, corporate governance, and market governance

The previous sections dealt mainly with the nature of the modern business enterprise as an individual organization. But, of course, no business is created in a vacuum, and no business can operate in complete isolation. This section will look at the economic, social, and political nature of markets to better understand how real businesses fit into a heterodox understanding of the economy.

Any business model–including those discussed above and beyond–is a plan for how to successfully operate a business within one or more markets. A good business plan will have to consider, among other things, the competition, the potential customer base, rules and regulations, and the necessary infrastructure to produce and distribute the product, whatever it may be. Established businesses will have worked out their business models over time, will have built (or had built for them) the necessary infrastructure (for instance, roads or communications protocols), and will typically have helped define the rules and regulations that dictate which individual and competitive activities are permissible and which are not. This is to say that markets themselves are defined by (and the way business enterprises behave in these markets is guided by) their infrastructure and their corporate and market governance structures.

DEFINITIONS

Infrastructure: the common structures, facilities, and systems necessary for organizations to operate. These may include physical infrastructure like highways, bridges, electrical grids, and sewage systems; as well as systems like the complex networks of computers tied together through communications lines and protocols we know as the internet.

Corporate governance: the rules and practices defining how and by whom a business is directed as well as how members of the business will interact with each other and those outside of the business. These are both formal rules like accounting practices or the corporate hierarchy of who reports to whom, as well as informal norms, traditions, and relationships.

Market governance: the rules and practices defining how business enterprises will behave in a market, including especially how they will interact with their competitors. These may include formal agreements–for instance, a consent decree by which a business agrees not to engage in an activity the government considers anticompetitive, or a joint venture operation between two energy companies to explore a potential source of crude oil. Probably more important, though, are the various informal arrangements by which certain types of competition and cooperation between businesses are allowed while others are not.

A side note: these shared rules and infrastructure are not fixed in time–they evolve, whether by unintended consequence or intentional change. Moreover, they are socially constructed, which means there is a political element to all of them. Although we're focusing for now on the private, business side of the matter, it should be remembered that there is almost always a government role in the development, regulation, and sometimes prohibition of these structures. Finally, a fourth component, **property rights**, is worth adding. Property rights are legal norms defining who can own what, what can be done with that property, and therefore how businesses can generate earnings and who has claims on those earnings. While property is often considered simply a natural right, the actual content of property rights is a complex, perpetually evolving, and highly contested subject.

These attributes of the organization of businesses and the markets in which they operate are all geared toward essentially the same thing: stability. As an earlier section explained, most parts of the modern economy involve sophisticated and usually large-scale technologies. For this and other reasons long term planning is necessary for production to go forward; and long term planning requires predictable outcomes. Hence, markets and businesses must be organized to promote stability. In particular, as a previous section explains, businesses require predictability in prices.

Now, consider the neoclassical models of previous chapters. In each of these some, perhaps natural, equilibration process is used–that is, a process by which firm's, consumers, and ultimately markets move toward an equilibrium, toward stability. The utility maximizing consumer seeks an optimal combination of consumers goods, the profit maximizing firm seeks an optimal level of production, and the market, through competition and price bidding, moves toward the equilibrium price and output.

Many heterodox economists reject each of these models, in part because of the unrealistic mechanisms by which equilibrium is reached. For instance, as chapter "Costs and Prices" demonstrates, few markets in the modern US economy are characterized by the sort of price adjustments that the standard market model relies on to reach a stable equilibrium. Moreover, considerable evidence suggests that competition–especially price competition–actually promotes instability. And it is for this reason that the concept of market governance is so important. Without a workable set of norms concerning acceptable and unacceptable forms of competition and cooperation, most markets would never reach equilibrium. Instead, price competition and chicanery would wreak havoc on businesses and consumers alike.

16.4 THE HIGH PRICE OF COLLEGE TEXTBOOKS

In this concluding section of the chapter we'll look at a question you've probably asked yourself: why do college textbooks cost so much? The question is particularly interesting for economic theory. Nationally, textbooks prices have risen more than three times the prices of other goods and services in the economy–an increase from the 1977 to 2015 of 1,041%, reports ABC News. As of September 2016, the average undergraduate student will be spending just shy of $1,300 a year on textbooks and supplies. That's no small sum.

Standard analysis would look for low elasticities of demand and lack of competition to explain high prices. Question: as a student, is your demand for college textbooks elastic or inelastic? Why? Likely, you answered 'very inelastic' since you have little choice in buying a textbook that is required for a course. (In fact a 2014 Student PIRG survey found that two thirds of students had foregone buying at least one textbook due to cost. Not surprisingly, almost all of those students indicated concern that the decision would impact their grades negatively.)

As for competition in the textbook publishing business, it may not surprise you to learn that, like in most other markets, there are only a handful of large corporations controlling the bulk of the college textbook supply. International corporations, which in many cases have existed for over a century, dominate the global market for these products, bringing in billions of dollars in revenue each year. While not a pure monopoly, it would seem that this industry is closer to our neoclassical monopoly model than to perfect competition. The outcome of this captive-market situation, as you've seen in a previous chapter, is clear: fewer students purchase textbooks than would like, and they pay higher prices than would exist under more competitive conditions.

But, then, is competition the solution? Certainly, the industry meets the definition of high concentration, suggesting that textbook publishing is far from the ideal model of perfect competition. Publishers appear to enjoy significant market power, especially in setting their own prices, rather than taking the competitive market price as given. But, if we accept that these large corporations are not price takers in the markets for their books, we still have to answer: how–that is, for what reasons–do they determine the prices they will charge? And this is where the business model becomes important.

The mainstream assumption that firms, always and everywhere, maximize profits suggests that output is being set according to marginal costs and marginal revenues, and that the high inelasticity of demand allows publishers to raise prices well above the actual costs of production. Firms produce to maximize profits, and a lack of competition allows them to take monopoly rents through higher prices.

But, consider the heterodox position–that business enterprises generally want to survive and grow, and that competition occurs chiefly through investments, not prices. This view suggests that it's not so much that publishers wish to get every last dollar of profit to be had (that is, to maximize profits), nor that they will raise prices to whatever the students (that is, demanders) are willing to pay. Rather, these producers are seeking to make the investments necessary to survive (to make a profit) in their markets. The prices they charge, then, may seem like price gouging, but may really just be the results of the markups necessary to cover the costs of those investments. (However, the more recent focus among publicly traded companies on keeping stock prices up may drive them toward price gouging over simply pricing to cover full costs.)

And this is where we come back to the original question: is competition the solution? From the perspective of heterodox economics, the high price of college textbooks reflects the high cost of investing in new textbook editions–in computer software tools to complement the text (and ensure the student pays for the online access), in test banks and slideshows to aid the instructor using the text, and so on. And what compels publishers to make these investments? Largely, competition. If a publisher neglected to develop new editions, it could not compete with the used textbook markets. If a publisher fell behind in developing software and supplements for instructors, the other publishers would have a competitive advantage in pitching their texts to instructors. Perhaps surprisingly, the conclusion is that prices are high, not so much from a lack of price competition, but because of a particular dynamic in investment competition. It is–or so one could argue–a lack of appropriate planning across the industry as a whole that keeps publishers grasping at market share by investing in anything and everything that might help sell their textbooks…and the student pays the price.

THE COURTS AND PROPERTY RIGHTS

In a previous breakout box it was mentioned that a proper understanding of market structure would require, among other things, an understanding of the specific property rights relevant to production, exchange, and consumption processes of the market. A recent US Supreme Court case offers a good illustration of that very point.

John Wiley & Sons, Inc. is a global publishing company with thousands of employees and a market cap (total value of outstanding shares) in the billions of dollars. In 2008 Wiley sued Supap Kirtsaeng for copyright infringement. Kirtsaeng, a Thailand native who had studied in the US, had discovered that foreign edition textbooks could be imported into the US to be sold at lower prices than the texts' American-edition prices. Wiley believed that this was a violation of their property rights which included the right to prevent importation of their copyrighted works.

While two lower courts sided with the publisher's position on the control that copyright afforded them, the US Supreme Court did not. They argued in their ruling that the 'first-sale doctrine', allowing those who obtained a textbook legally to re-sell it, limited Wiley's right to control the importation of their books. As an economist-in-training, how do you think things would be different if the Supreme Court had ruled in favor of Wiley? Would prices continue to rise, plateau, or come down? Would this change the direction of investment in the publishing industry? How would students, faculties, and higher education more generally be affected?

CHAPTER 17. MONOPOLY AND ANTITRUST POLICY