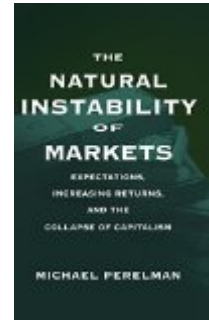




Michael Perelman. *The Natural Instability of Markets: Expectations, Increasing Returns, and the Collapse of Capitalism.* New York: St. Martin's Press, 1999. xiv + 188 pp. \$39.95, cloth, ISBN 978-0-312-22121-8.



Reviewed by Thomas E. Hall

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Economists have long known that competition has some ugly side effects. In competitive industries, firms go out of business. The competitive process exhibits Schumpeter's creative destruction as new technologies come along which displace existing industries. Workers lose their jobs, and firm owners lose wealth. This is all very unpleasant for the people who are adversely affected by these changes, but in the net society is better off by reaping the benefits of economic efficiency. At least, that is what economists generally believe about the competitive outcome. This is why most economists argue that (with the exceptions of a few cases such as public goods and natural monopolies) a policy of enhancing competition is desirable.

Michael Perelman challenges this conventional economic orthodoxy by arguing that the economic instability caused by competition may be so large that it outweighs the beneficial effects of economic efficiency. In fact, competition is so awful that "the tendency of the competitive process is to lead to depressions" (p. 62). Perelman does not argue that monopolies are the solution, in-

stead he contends that society's welfare is enhanced by having an industrial structure that is neither too competitive, nor too concentrated. The optimal structure lies somewhere in between, where the gain in economic stability resulting from a less than perfectly competitive structure exceeds the loss to society of lower economic efficiency.

It's an interesting argument, but one that isn't well enough documented for most people to accept. Too much of Perelman's discussion focuses on what's wrong with competitive markets, and too little on the benefits they create. Yes, the competitive process can cause wrenching changes in society, but what about the lower prices we pay, the wider variety of goods and services we choose among, the improved quality of products...? These considerations are given short shrift compared to the evils of "instability."

A serious weakness of the book is its lack of a discussion on the role of demand. For example, Perelman considers economic depressions to be the intensification of the competitive process. While most of us would agree that competition

among firms is more intense during economic recessions, would we extend the argument by saying that competition caused the downturn? I don't think so. Economic recessions are typically caused by slowdowns in aggregate demand growth. As spending growth slows, firms have to compete more intensely for scarcer sales. Thus, we observe more competition during downturns, but competitive pressures hardly caused the recession.

Perelman also argues that high wages during recessions are good since "high wages represent a healthy stimulant to the economy . . . because high wages will encourage productivity" (p. 121). This efficiency wage argument has merit, but taken to extremes it could cause major problems. After all, if promoting high wages is such a great idea, during the next recession let's be sure to raise the minimum wage to \$1 million per hour and see how well that stimulates recovery!

We often tell students not to get caught looking at the trees when they should be concentrating on the forest. I think the opposite applies to this book. Several of Perelman's trees, i.e., the specific cases he discusses to buttress his argument, are quite interesting. For example, there is an informative history of entry and exit in the automobile industry, an excellent discussion of x-efficiency, and a summary of estimates of the costs of unemployment in terms of numbers of suicides, homicides, and such that would be useful to instructors of macroeconomics principles classes. However, I am considerably less enamored with the forest, the idea that competition creates more problems than it solves.

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