

The ABC of Economic Literacy: 'C' is for competition

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To understand competition, you should visit a tropical rainforest. To most visitors, rainforests, with their impressive fauna and flora, may look like places of abundance. The truth is quite different: the quality of the soil is often poor, and hardly any sunlight reaches the floor – scarcely the best conditions for opulent vegetation.

The reason why rainforests are nevertheless impressive ecosystems is the competition that they promote. The trees only grow so tall because they are competing for precious sunshine. Thousands of highly specialised plants, birds and insects compete for nutrients. The result is a thriving place of biodiversity.

In many ways, markets are just like rainforests. They bring together scarce resources and virtually unlimited wants. It is through competition between these different wants, and competition between different ways of satisfying them, that markets create prosperity out of scarcity.

In economic thinking, competition has two main functions.

First, it spurs companies to try harder and be better than their rivals. They do so, of course, in order to make a bigger profit for themselves. As a most welcome by-product for society, products get better, new ones are invented and prices fall thanks to competition for customers' business.

The second function of competition is its disciplining effect. In a competitive world, you can never be too sure of your position. If a rival has a better idea or a better product, your days as a market leader are numbered. Competition is the best antidote to complacency, arrogance and laziness.

Competition is always both a discovery procedure and a tool of disempowerment. Both these functions are crucial for a market economy – but not only there.

Competition is equally desirable in many other places. Where cities compete for residents and their taxes, people will get better public services. Where teachers compete for promotion based on performance, their students will get a better education.

Unfortunately, many economists have trouble distinguishing between the results of competition and competition itself. However, the distinction should be quite easy: competition is always the rivalrous behaviour of competitors, not the number of competitors nor the prices they charge.

To promote competition, the most important things regulators can do is to just let it evolve.

Competition does not need encouragement, nor does it need to be mandated. It is just what happens naturally when scarce resources meet unlimited demands. Rainforests do not need gardeners, either.

The New Zealand Initiative is a Wellington-based think tank formed by the merger of The New Zealand Business Roundtable and The New Zealand Institute. www.nzinitiative.org.nz. CEO Dr Hartwich is a regular speaker at PortfolioConstruction Forum programs.
