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Summary of articles by Robert H. Frank and Philip J. Cook: ‘Winner-Take-All Markets’ and ‘The Growth of Winner-Take-All Markets’”

(This is a summary of the first and third chapters of the book.)

Winner-take-all markets, in which the rewards for being the top performer(s) are vastly greater than for even close competitors, have long been common in sports and entertainment. In these markets, the rewards are based on relative, rather than absolute performance. This article shows how technological innovations, expanding global trade, and changes in social norms are making these markets increasingly common in fields as diverse as law, journalism, consulting, medicine, investment banking, corporate management, publishing, design, fashion, and higher education, among others. It argues that winner-take-all markets increase income inequality, waste talents and resources, and affect the culture in disturbing ways, all of which profoundly affect individual wellbeing. However, solutions are suggested to diminish both the allure of the top rewards and the pernicious effects of cutthroat competition.

CAUSES OF THE INCREASE IN WINNER-TAKE-ALL MARKETS

In today's economy, decreasing transport and tariff costs, combined with advances in information processing and telecommunications, mean that what were formerly local or regional markets for many products and services are now global, with far greater amounts of money at stake. At the same time, technological and marketing capabilities enable the mass customization of products, spawning greater specialization of markets, each one of which may have a winner-take-all structure. These changes have dramatically increased the rewards for top performers, while competition for top performers has become more open and intense.

Further, changes in production methods mean that the benefits of increased productivity flow not to laborers, but to those who design, direct, and finance the production process. These are the group whom Robert Reich has referred to as "symbolic analysts", who engage in "problem-solving, identifying, and brokering."[1] The salaries of these professionals rise more quickly than do those of other workers. As their salaries rise, they demand more positional goods -- goods that have additional value based on their reputation as the best or most prestigious in their category. Because only a small number of products can make this claim, this increased demand promotes winner-take-all markets.

In winner-take-all markets for products, only barely detectable differences in quality may mean the difference between success and failure. While the public may care little about which product wins, the stakes are enormous for the manufacturers and producers. This produces a new class of experts capable of making the difference between corporate success and failure. Given their pivotal positions, competing firms attempt to outbid each other for their services. The result is a winner-take-all reward structure for those in this field.

In addition, social norms that once restricted competition have eroded. Old norms of loyalty that caused people to stay with the same company, team, or university have been replaced by bidding wars for the top talent. Norms which prevented CEOs from making much more than others in their company are far less powerful. Norms against sensationalizing the news and exploiting people's private lives are also deteriorating as journalists and entertainers compete for winning ratings.

NEGATIVE CONSEQUENCES OF WINNER-TAKE-ALL MARKETS

Consumers benefit when technology enables the most talented writers, musicians, entertainers, and scientists to disseminate their works widely, but there are also many socially harmful results when the rewards for success are so high, the competition for these rewards is so intense, and the rewards depend on relative performance. These include the following:

Growing income inequality. Wage theory holds that pay rate is related to productive contribution. However, this relationship is broken in winner-take-all markets. An Olympic runner may win first prize by mere fractions of a second, earning thousands of times more than the runner-up, yet the difference in talent is barely perceptible. Wealth and power are increasingly concentrated in the winners; those who are merely very good earn far less. Increasing income inequality caused by the prevalence of winner-take-all markets is undermining social cohesion.

Misallocation of talent. The allure of spectacular rewards in winner-take-all markets has attracted some of the most talented people to enter these markets, but has also caused too many contestants to compete for a limited number of top positions. The rising stakes in litigation, for example, have led people to pay more and hire the best lawyers, thereby attracting many of society’s most talented people to careers in litigation. Yet this influx of talent has created no new social value or wealth. By siphoning talented people from productive careers in traditional markets, it has actually reduced our national income.

Unproductive consumption and investment. In military arms races, countries fear losing position if they do not buy more arms, yet everyone is worse off if each country buys more arms. Similarly, positional arms races in winner-take-all markets increase the losses caused by overcrowding the field. Competitors invest in products and practices which may help them win but which have little or no social value. In the end, everyone pays more just to maintain the same relative ranking.

Stifling of social mobility and elitism in higher education. Without elite undergraduate or graduate degrees, it is increasingly difficult to gain entrance to competitive graduate schools or firms. With a winner-take-all mentality, elite colleges and universities have assumed the role of gatekeeper for the top job prospects. To attract top students, universities engage in bidding wars for professors who are academic superstars, thus participating in positional arms races which do little or nothing to increase social value.

Mediocrity in popular culture. Success in popular culture is often based not on quality but on hype, with success measured as rapid market triumph. People want to read the book or see the movie they have heard about. The more people do this, the more popular the book or movie will be, vastly increasing the payoffs. The search for rapid market triumph makes the success-breeds-success feature so pernicious. Products must achieve success early or they are considered failures. Thus, the emphasis is on hype and on relying on tried-and-true formulas and sequels, stifling creativity.

Increased competition and changing norms in private life. Ordinary citizens also compete for rewards based on relative, rather than absolute performance. People spend more and more for a limited number of houses in the best locations, pay more to dress better than others, and undergo plastic surgery to look better, yet their relative ranking in housing, dress and appearance may remain the same. They simply spend more to remain in the same position. Plastic surgery may serve to enhance individual appearance, but it also changes the norm of appearance. What used to be acceptable appearance no longer is, causing people to want to make more money simply to keep up with community standards.

POSITIONAL ARMS CONTROL AGREEMENTS TO LIMIT WASTEFUL COMPETITION

Just as pollution causes externalities, most of the inefficiencies of winner-take-all markets are due to the costs participants impose on others. To mitigate the harms of winner-take-all markets, the best remedies will be those which redirect individual and social incentives, while preserving freedom of choice as much as possible.

A number of strategies used to control wasteful competition have been used and are referred to as positional arms control agreements. These strategies seek to reduce the benefits winners receive and control the competition. They include:

Legal mechanisms. Higher income taxes and luxury goods will decrease the rewards of upper incomes and thereby reduce the attraction of entering these competitions. This would encourage the marginal contestants to enter other fields where they could add greater social value. Conservative economists argue against a more progressive tax system by saying that it would inhibit growth. But if, as appears, most of the highest earners work in winner-take-all markets, the effect of more progressive taxes may actually be to stimulate economic growth. The time-honored trade-off between equity and efficiency is far less agonizing than it appears. Consumption taxes on houses, clothes, cars, and plastic surgery increase the cost to individuals for participating in positional arms races, thus reinforcing whatever residual social norms against conspicuous consumption may remain. In addition to tax reforms, other legal mechanisms for controlling these markets may include campaign finance rules and health and safety regulations.

Private agreements, such as dress codes or uniform requirements, may also be used. Sports leagues may enact pay caps and revenue sharing agreements, or industry groups may work out strategies for sharing basic research costs.

Social norms may play an important role. In some communities, for example, social norms to discourage dueling, conspicuous consumption, and cosmetic surgery.

In general, detailed, prescriptive government regulation is not the preferred approach to moderating the effects of winner-take-all markets. Policies which internalize the social costs of individual actions, altering the reward structures to discourage socially damaging activity, are better policy tools.

Notes

1. Robert B. Reich, *The Work of Nations: Preparing Ourselves for 21st-Century Capitalism* (New York: Knopf, 1991).