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THE WAL-MART DEBATE
A False Choice Between Prices and Wages

BY JARED BERNSTEIN AND L. JOSH BIVENS

The benefits and costs of Wal-Mart's expansion across the United States have been hotly debated. Critics of the retailer have documented the extent to which Wal-Mart uses its market power to undermine its workers' compensation, squeezing suppliers and hurting local economies along the way. Supporters of Wal-Mart counter that the lower prices offered by the company more than compensate U.S. consumers for any depressing effect the company's expansion has on wages.

In a more technical Working Paper, we assess many of the competing claims about Wal-Mart's impact on prices and wages.[1] We note, however, that this is a very narrow question and argue that the debate over Wal-Mart's economic impact is plagued by false dichotomies. The more important question for the future isn't whether Wal-Mart is a force for good or evil in the American economy, but whether the economic benefits provided by Wal-Mart (and other big-box retailers) can be preserved even if their labor compensation is dramatically improved. To this end, our research finds that:

- A study by the consulting firm Global Insight, which concludes that Wal-Mart's expansion has saved U.S. consumers $263 billion, is deeply flawed. The statistical analysis generating this widely quoted figure fails the most rudimentary sensitivity checks used in good economic analysis, rendering its conclusions unreliable.
- A robust set of research findings shows that Wal-Mart's entry into local labor markets reduces the pay of workers in competing stores. This effect is largest in the South, where Wal-Mart expansion has been greatest.
- Wal-Mart could raise wages and benefits significantly without raising prices, yet still earn a healthy profit. For example, while still maintaining a profit margin almost 50% greater than Costco, a key competitor, Wal-Mart could have raised the wages and benefits of each of its non-supervisory employees in 2005 by more than $2,000 without raising prices a penny.

"Everyday low prices?" Not that low

Wal-Mart recently convened a seminar to discuss academic studies that examined its impact on local (and the national) economies. Wal-Mart also commissioned a study from the consulting firm Global Insight (GI). Of all the studies done on this topic, the GI report found by far the largest positive impacts of Wal-Mart on the economy, and defenders of the company cite GI's results most often. We find, however, that GI's estimate of Wal-Mart's dampening effect on inflation is indefensibly large and is contradicted by more careful research reviewed in the EPI Working Paper, *Wrestling With Wal-Mart: Tradeoffs Between Profits, Prices, and Wages.* While the statistical fragility of the GI results requires long explication, there is a more fundamental problem with GI's results—they are internally inconsistent.

GI reports that Wal-Mart lowered overall prices (as measured by the overall consumer price index (CPI)) by

a total of 3.1% from 1985 to 2004. They also report that Wal-Mart has lowered commodity (goods) prices by 4.2% over this period. However, in an unrelated portion of the text, GI correctly notes that "consumer prices for services are dominated by rents, imputed rents, utilities, medical services, and transportation—all areas outside of Wal-Mart's product offerings."

The GI report bases its findings on the overall CPI. Yet fully 60% of the items in the CPI are services, not commodities.[2] Thus, if the impact of Wal-Mart on service inflation is zero, then the GI numbers on Wal-Mart's impact on prices are inconsistent. GI's finding that Wal-Mart's expansion led to a 4.2% decline in *goods* prices translates to only a 1.7% decline (not the reported 3.1%) in *overall* prices (4.2 * 0.4 = 1.7). In short, the two top-line findings of the GI report (Wal-Mart's effect on overall prices and goods prices) are internally inconsistent with each other.

Overall, we find that the Global Insight research methodology is fraught with problems. Some of the results it yields—such as that Wal-Mart lowers housing rents and that its greatest effect on food prices occurred *before* its expansion—make no sense. Our analysis argues against using any estimate of consumer savings from Wal-Mart's expansion that is derived from the Global Insight study.

Can low prices make up for low wages?

A key concern in the debate over the economic consequences of Wal-Mart's expansion is the effect this has on workers' wages. Most would grant that prices are lower at Wal-Mart than in many competing stores (although the magnitude of this price difference is often less than implied by company defenders). A critical question, however, is whether the benefits of lower prices are implicitly clawed back when Wal-Mart drives down wages not just of its own workers, but throughout the retail sector as a whole.

Dube (2005) and Neumark (2005), in papers reviewed in *Wrestling With Wal-Mart*, present strong evidence that Wal-Mart's expansion has driven down earnings for workers not just in competing retailers, but across stores throughout the region of Wal-Mart expansion.

There is another point to be raised here about the implicit horse-race between prices and wages that underlines the Wal-Mart debate. Essentially, the defenders of Wal-Mart argue that the price-depressing effects of Wal-Mart outrun the wage-depressing effect, leading to rising purchasing power for American workers. However, the prices that are reduced through Wal-Mart's expansion constitute an ever-shrinking share of American families' expenditures.

Wal-Mart essentially gives people the ability to buy food, apparel, household goods, and furniture at reduced prices. As seen in **Figure A**, the share of expenditure in each of these categories has shrunk over time. By contrast, the expenditure shares on health care, housing, and transportation for families have gone up over time. These cannot be bought at Wal-Mart, yet they constitute an ever-growing share of American household expenditures. In short, the benefits from the same price effect in Wal-Mart's product areas are shrinking over time. The real pressures on family income are coming from items that can't be bought at Wal-Mart. These products and services can, however, be bought with higher wages.

The idea that encouraging Wal-Mart's expansion constitutes a progressive endeavor that will provide big benefits to poor Americans in the future is misguided; truly progressive policy should focus on the big-ticket items in most families' budget—health care, housing, and education.

Do higher wages have to mean higher prices?

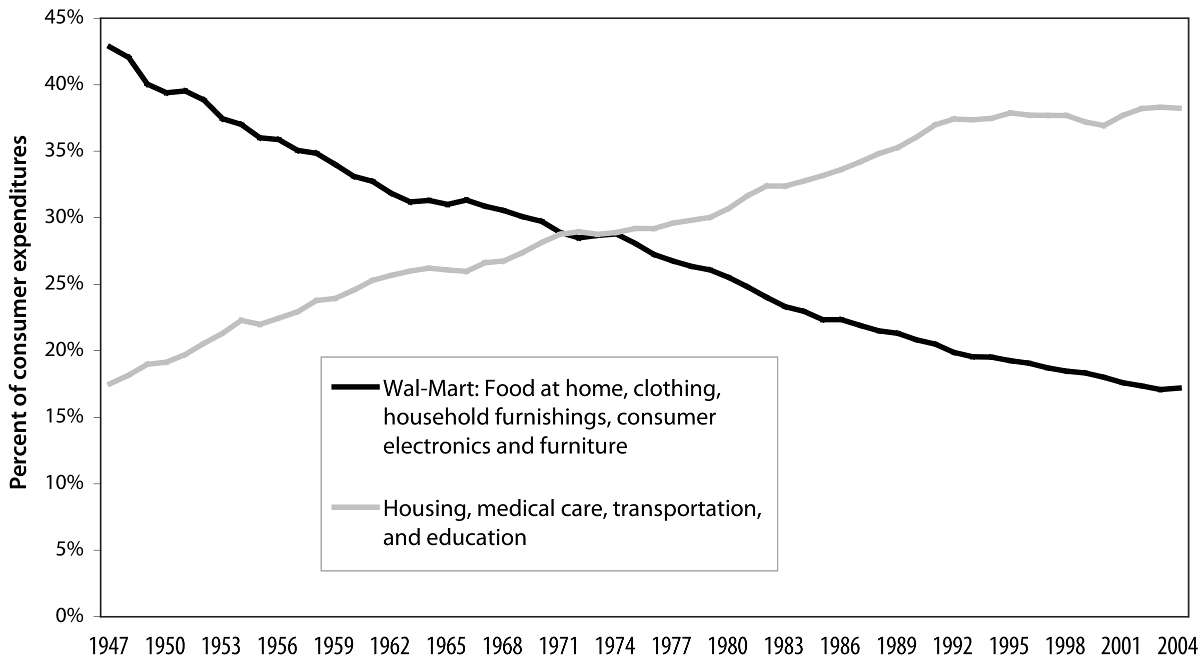
Other issues make the narrow "wages vs. prices" debate described before particularly uninformative. One side of the debate assumes that the cost of higher compensation to employees at Wal-Mart is higher prices to consumers. This isn't necessarily the case—some (or all) of the costs of increased compensation could come from reduced profit margins, raising the living standards of Wal-Mart employees while preserving the benefits from low prices.

To get a feel for how much of a wage increase could be financed out of reduced profit shares, one can imagine Wal-Mart's profit margins falling back down to their 1997 levels, which would also cut half of the difference between their margins and a key Wal-Mart competitor, Costco (which posted a profit margin of 2.0% in 2005). Reducing the profit margin by this much would give Wal-Mart $2.3 billion to plough into improved worker compensation without the need to raise prices. In *Wrestling With Wal-Mart,* we calculate that this would translate into just under $2,100 per non-managerial employee. Simply returning to its 1997 net profit margins, Wal-Mart could give its non-supervisory workers 13% pay increases without raising prices, while maintaining higher profit margins than a main competitor.

Wal-Mart could definitely raise compensation for its workers and still have lower prices than its competitors. Note that labor costs for its non-supervisory staff account for less than 7% of its total sales. If Wal-Mart's price advantage relative to its competitors is even in the neighbor-

FIGURE A

Shares of consumer expenditures on goods that can be bought at Wal-Mart



Source: Authors' analysis of Bureau of Labor Statistics data, except for Wal-Mart store openings, which is obtained from www.walmartfacts.com.

hood of what its defenders claim, consumers would still find Wal-Mart's prices lower. To believe otherwise is to believe that Wal-Mart's price advantage comes completely from substandard worker pay and not through any cost efficiencies.

Is this any way to run an economy?

A particularly contentious issue regarding Wal-Mart's effect on the American economy involves its employees' use of publicly financed programs like Medicaid and food stamps. A recent internal Wal-Mart memo revealed, for example, that 46% of Wal-Mart workers' children are uninsured or on Medicaid. This compares to 29% for large retailers and 32% for all retailers. Critics of the company argue that this (disproportional) use of Medicaid is an implicit subsidy from taxpayers to a rich corporation. Supporters of the company counter that the lion's share of these subsidies benefit the low-wage workers at Wal-Mart, and this is exactly the point of them.

On this point, both sides are right: subsidies to low-wage workers accrue to both the company they work for and the workers themselves, with the lion's share of the subsidies going to the workers.

This, however, does not imply that it is inappropriate or economically harmful to either Wal-Mart consumers or employees to pressure the firm into increasing its compensation package, particularly with regards to health care. Part of this debate comes down to whether policy makers should be more concerned about primary or secondary income distributions. In other words, is it better to intervene directly and require employers to pay a living wage or to allow whatever compensation employers choose to pay but supplement it with government supports? The primary income distribution is that which holds before the effects of taxes and government transfer payments (i.e., Social Security payments, unemployment compensation, disability income, etc.) are factored in. The secondary distribution includes the effect of all taxes and transfers.

When it comes to offsetting the damage to the wage structure we document above, many policy analysts seem to believe that the sole intervention point is the secondary distribution. That is, they are quick to accept the primary distribution as an outcome that cannot and/or should not be altered. In their view, if the market is generating "too

much" inequality, the government can offset this through redistributive fiscal policy. Many defenders of Wal-Mart's current business model advocate expanding the Earned Income Tax Credit (EITC) as the "correct" way to help Wal-Mart's workers.

While there is some merit in this view, this strategy makes U.S. workers and their households too reliant on the single instrument of fiscal redistribution—the expansion of transfer programs. EITC expansion, for example, is clearly a viable policy remedy for lost earnings, but there are reasons not to rely solely on this strategy.

First, it relies on tax increases. We cannot ask American workers to depend exclusively on taxpayers and politicians continually ratcheting up their willingness to offset the degradation of the wage structure induced by Wal-Mart, not to mention globalization, the loss of manufacturing employment, union power, and so on.

Second, the federal budget is already constrained by the current and, more importantly, the projected gap between future federal outlays and revenues under current policies. According to the Congressional Budget Office, under plausible assumptions, that gap is expected to grow much wider in coming decades, largely due to the pressure of health care price increases and current tax policies.[3] This does not mean that potentially useful policies like expanding the EITC should be off the table, but it does mean that any spending program outside of defense and homeland security faces a very steep challenge for at least the medium term. Wal-Mart defenders who argue that workers harmed by its practices should rely on government transfers to make ends meet are essentially telling those workers to get taxes raised if they want any help, and to struggle in the meantime.

Recent budget developments indicate that no help is on its way. While Wal-Mart supporters argue that it's fine for Medicaid to pick up the health coverage of uninsured workers, the president has proposed $5 billion in cuts to Medicaid over the next five years and has proposed an additional $5 billion in cuts to other programs for low-income people in his most recent budget. Further, in February of this year, Congress passed a budget reconciliation that included a $27 billion cut in Medicaid over 10 years. In other words, the tide is pushing hard against expanding these redistributive measures, and may be for some time to come.

Conclusion

Wal-Mart does a lot right. It has expanded productivity by being more efficient and leaner than many other companies. Many of the benefits shoppers accrue from Wal-Mart's expansion could be preserved even if the retailer had to meet the expectations of its critics regarding fair worker compensation. Defenders of the company too often set up false dichotomies such as low prices vs. high wages when in reality, better compensation for workers won't negate Wal-Mart's competitive edge.

Endnotes

1. See EPI Working Paper #276, *Wrestling With Wal-Mart: Tradeoffs Between Profits, Prices, and Wages*.
2. See http://www.bls.gov/cpi/cpiri2004.pdf.
3. U.S. Congressional Budget Office. 2005. *The Long-Term Budget Outlook*. Washington, D.C.: Government Printing Office. http://www.cbo.gov/ftpdocs/69xx/doc6982/12-15-LongTermOutlook.pdf.