

How Wal-Mart Is (Mis)Shaping the Global Economy

By Richard Wilson

If you live in a big city outside the South, Wal-Mart probably crept up on you slowly and stealthily. Until recently, you probably thought of it as one of a growing number of “big box” retailers like Target and Costco—huge stores with large parking lots and low prices for products of all kinds. And—if you thought about it at all—you assumed that Wal-Mart was concentrating on smaller communities, especially in the rural South and Southwest—and it would be years before it showed up at a shopping mall near you.

Now, Wal-Mart seems to be everywhere. It’s the nation’s largest retailer, largest grocer, and largest employer. It is trying to open stores in New York City, Chicago, Los Angeles, and other cities where it hasn’t had a presence. And whether that presence is good or bad for our communities, our consumers, and our workers is being debated in city councils and county boards, in the newspapers and on television, with conservative economists praising it for its “Every Day Low Prices” and the labor movement and others attacking it for its “Every Day Low Wages.”

Chances are you’ve heard that Wal-Mart pays much lower wages than unionized retail chains, that it skimps on health insurance for its workers and their families (forcing many to rely on Medicaid), that it fiercely resists union organizing efforts by its employees, and that it is being blamed for holding down workers’ earnings and living standards throughout the retail and service sectors of the economy.

But what’s less well-known about Wal-Mart may be even more important: Wal-Mart exemplifies a major shift in the balance of economic power, with manufacturers getting weaker and retailers getting stronger. Since the dawn of the industrial age, American manufacturers have been the driving force behind our economic growth. By the 1950s and 1960s, our big manufacturers could honestly take credit for helping the U.S. become a global power and for contributing to the rapid growth in the country’s middle class. But today, the manufacturers that are left in the U.S. are a shadow of their former selves. Of course, Wal-Mart should not shoulder all of the blame for the demise of American manufacturing. But, as this article will explain, it has been a major player, particularly in clothing, housewares, and electronics.

Today, Wal-Mart is able to dictate what many manufacturers throughout the world will produce, how they will make their products, how much they will charge for them, and how much they will pay their workers. Thus, Wal-Mart’s fierce determination to cut prices at all costs drives down wages and

benefits not only in the retail sector but also in the manufacturing sector—and not only in the U.S. but also throughout the world. To a large degree, Wal-Mart (the world's largest employer), together with China (the world's most populous country), is shaping the global marketplace.

It All Started Simply

The idea behind Sam Walton's success was one shared by a number of "discounters." The more you reduce the price, the greater the sales—and profit. Even if the profit on the sale of an individual item is substantially cut, the increase in sales volume results in a larger profit. In turn, this larger volume arms the retailer to demand a lower price from the manufacturer.

Walton applied this approach with a vengeance; he never tired in his search for new ways to cut costs. His maniacal drive to chop away at every expense no matter how small is legendary, and he applied it to both his personal and business lifestyle. He continued to wear cheap shoes, regularly borrow pocket change, and urge employees to use cheap hotels and avoid taxis by walking. The current CEO, Lee Scott, has bragged that those who stay in hotels are expected to bring the free pen from their room back to the national office for reuse. Those who pilgrimage to Bentonville, Ark., where Wal-Mart still has its headquarters, are surprised by the mix of furniture garnered from old floor samples in the offices of top executives.

In addition to experience as a discounter and his extreme frugality, Walton had a good sense of his customers: people who had little money to spend and had to stretch every dollar to get the basics for their families. With each reduction in price, more and more people started to buy.

Walton took the company public in 1970. The stock was successful, giving him the means to build even more stores. From these grew more volume, and greater volume grew more stores. But it wasn't until the 1980s that costs could be cut along a new dimension, gouged deeper than ever before imagined, thanks to the incredibly cheap products that were to come from Asia and Latin America. By the late 1980s, Wal-Mart was no longer only a discount chain that built enormous stores with big parking lots; it was a force embarking on a complete overhaul of the retail industry.

Wal-Mart's large number of low-income consumers gave it the leverage to demand unprecedented cuts in prices from manufacturers and even changes in the products themselves. If a high-quality product couldn't be made cheaply enough, Wal-Mart would demand a similar product made with cheaper (and less durable) materials. Wal-Mart refused to meet with wholesalers or manufacturing representatives, demanding instead direct contact with the producer. This eliminated the cost of middle men and gave Wal-Mart a further cut in price. And it was yet another blow to small retailers, who depend on wholesalers to keep their inventory low. Small retailers must

order in small quantities to conserve their limited working capital. With only one or two stores, they are in no position to buy in large quantities or assume the risks that come with big inventories.

Of course, Wal-Mart isn't the only "big box" retailer on the scene today. But it is the heavyweight. Last year, Wal-Mart's sales of \$345 billion exceeded the total for Target, Sears, J.C. Penny, Kohl's, Home Depot, Costco, and Best Buy combined. Its sales are six times larger than Target's, its nearest competitor. The major grocery and drugstore chains face the same dynamics. Wal-Mart runs way ahead, the others far behind. And this allows Wal-Mart to write new rules for the retail industry, the manufacturing industry, and the global economy.

Wal-Mart Is a Different Kind of Retailer

Wal-Mart does not wait to sell what manufacturers have to offer. Instead, it tells manufacturers what they must produce if they want Wal-Mart business. The sheer size of an order from Wal-Mart may well dwarf any one or all of those from other customers. Most retailers have one store; Wal-Mart has 3,900 stores in the U.S., over 6,600 worldwide. Manufacturers will go to great lengths to secure even a portion of a business that operates on this kind of scale, leaving Wal-Mart free to make demands that were never dreamed of in the old retail industry.

Wal-Mart determines not only what and how much to produce, but also the time and place of delivery. This may require a manufacturer to revamp his organization and make new investments to produce and deliver such a large number of items in the time allowed. The sticking point is price. Wal-Mart's offer will typically be very low, less than what would be acceptable from other retailers. But because the order is so large, the overall profit for the manufacturer is still very attractive, at least in the first round.

Huffy Bicycles, back in the early 1980s, received an order it couldn't fill even with its factories running on overtime. Wal-Mart wanted 900,000 low-end Huffy bikes—twice Huffy's production capacity. To keep Wal-Mart satisfied until it could expand its production capacity, the company turned its engineering and production plans over to competitors so that they too could make Huffy bikes and help Huffy meet the large order. But with subsequent orders came further demands from Wal-Mart on quantity, timing, and cost. Huffy couldn't make the grade in its unionized Celine, Ohio, factories. The only way to meet Wal-Mart's demands was to cut labor costs, so Huffy had to move.

The company's first move was to a non-union plant in Farmington, Mo., where it could pay \$2.50 an hour less. It wasn't enough. So Huffy left Missouri and moved to Nuevo Laredo, Mexico, where wages were half those in Ohio. Even that wasn't enough. Finally, Huffy contracted with the Shenzhen Bo-An Bike Company in Shenzhen, China, to make

its bikes. But it was too late: In 2004, Huffy filed for bankruptcy protection.

Today, the cloud of bankruptcy has been lifted by Sinosure, an agency of the Chinese government that promotes Chinese exports and foreign investments by offering export credit insurance. It is expected that Sinosure will have a 30 percent stake, and 70 percent will go to Huffy's creditors, led by Shenzhen Bo-An. Not only is Huffy no longer an American bike made by American workers, for all intents and purposes, it is now a company no longer managed by Americans. The only role left for an American is to buy a Huffy bike at Wal-Mart. Today, some 95 percent of all bikes for sale in the U.S. are made in China.

The story of Huffy's demise doesn't end there. Back in Celine, Ohio, with the help of the city fathers, the local Wal-Mart store expanded in May 2004 to a Supercenter on land formerly owned by Huffy. It is a story that so often follows Wal-Mart success. Wal-Mart drives away good jobs—and in so doing, creates a new crop of low-income families who must shop at Wal-Mart in order to stretch every dollar.

What happened to Huffy is, for Wal-Mart, a well-trod path. Once Wal-Mart has established a relationship with a manufacturer—and the manufacturer has made all of the changes and investments necessary to meet Wal-Mart's requirements—Wal-Mart again demands cuts in production costs, substantial cuts. Perplexed, the supplier examines each step in his production process. Some opportunities to become more efficient may be found, but such opportunities are limited; they are the result of research and development, which takes time.

But Wal-Mart is not about to wait.

The supplier again looks to see what other corners might be cut. How would less costly materials work? Might a design change lower costs, reduce unit labor costs? Too much is at stake not to find a way. But something else may be at stake if the manufacturer *does* find a way. Another famous American company—Levi Strauss—discovered this the hard way.

Levi Strauss jeans, at one time, sold themselves. Consumers saw James Dean, Bob Dylan, Elvis Presley, John Wayne, and Gary Cooper with the L-S logo on their back pocket. The company peaked in 1996 with about \$7 billion in sales. But then sales started to slide. The popularity of blue jeans drew in a wide range of competitors. As the market expanded, there was a demand for a new variety of design options. Designers met that demand with high-style jeans with big price tags. Levi was also hit on the low end. After the North American Free Trade Agreement went into effect in 1994, cheaper jeans started coming in from Mexico. Wal-Mart, with its enormous customer base, appeared to offer Levi-Strauss a

way to return to the glory days of the early 1990s.

At the end of 2002, Levi Strauss hooked up with Wal-Mart. For Wal-Mart, Levi offered a name long associated in the public mind with a quality blue jean. The line was to include jeans with all the variations: low rise, boot-cut, relaxed fit, and so on. It was a new line that Wal-Mart could brag about.

Charles Fishman, in his excellent book *The Wal-Mart Effect*, describes the negotiations between the two firms. Levi Strauss had a problem right off. Its clothes were too expensive; they did not fit the everyday low price parameters of Wal-Mart. But Levi needed the business, and Wal-Mart wanted something new. To meet Wal-Mart's demands, writes Fishman, "Levi Strauss had to assemble a 50-person design and sourcing team, whose job was to develop a 'value' line of Levi-branded products made in cheaper denim, with simpler designs, that were easier and less expensive to manufacture." This became the new Signature Levi Strauss line—inexpensive, not of the same quality traditionally associated with Levi Strauss, and not made in the U.S.

Today, Levi Strauss puts its name on a product made by other companies—foreign firms—located in Mexico and East Asia. In effect, Levi Strauss is now an importer rather than a manufacturer.

Levi must have known the risk it was taking to get a shot at Wal-Mart's high volume sales: Brand names, like machinery, can "rust" if not well maintained. Over time, deterioration in the quality of a product will reduce the appeal of a brand-name. For a while, Wal-Mart treated the Signature line with much fanfare, and Levi seemed to be holding its own. But then Wal-Mart decided to go after a more affluent customer—and that meant offering a higher quality jean. Since Levi was now identified with the lower quality Signature line on Wal-Mart's shelves, its name brand had become too rusty to draw in the more affluent customer. Wal-Mart selected Uncharted Territory as the new star. (That could well change by the time this article is printed.) On Wal-Mart's shelves, Levi Strauss is now down in a fight among the lowly brands, with some of its models at clearance prices.*

Wal-Mart itself is little affected by such changes. Wal-Mart's concern is not with this or that brand name, or with the loss of quality, or the collapse of American-made goods, or the demise of the small retailer. Wal-Mart has only two interrelated concerns: growth and profit.

Buy American, If It Does Not Cost More

In 1984, then-Governor Bill Clinton asked Sam Walton for help to save a small Arkansas firm—Farris Fashions, Inc. The company was about to lose its flannel shirt business to a cheaper factory in Latin America. Walton placed an order to keep Farris in business. The Governor called Walton a "patriot" for his help.

A year later, and aware that many Americans were nervous about losing American manufacturing jobs to overseas factories, Walton kicked off a "Buy American" campaign, prominently featuring Farris Fashions, that was to continue for the next 12 to 14 years. But the reality of the Wal-Mart-Farris partnership was quite different from the campaign slogan. Farris Fashions cut costs by switching from U.S.-made fabric to imported fabric.

Just what did "Buy American" mean to Wal-Mart? In his letter to domestic suppliers Walton argued: "Something must be done by all of us in the retailing and manufacturing areas to reverse the serious threat to our free enterprise system.... Our Wal-Mart Company is firmly committed to the philosophy of buying *everything possible* from suppliers who manufacture their products in the United States" [emphasis added]. Sam's idea of "everything possible" hinged on his definition of "possible." In his mind, if the American-made product cost even a little more than the foreign-made version, it simply wasn't "possible" to buy the American one. Over the next two decades, Wal-Mart steadily increased its purchases of goods from other countries around the world. Walton apparently had no problem simultaneously pursuing these two opposing tracks. As his friend and tennis partner George Billingsley said, "Sam was a tough man. I mean tough tough." Just as he never mentioned that the fabric for Farris Fashions' flannel shirts was imported, Walton did not discuss the second track in public: "Buy American" sounded a lot better than "Buy American only when it is the cheapest."

Well into the 1990s, the "Buy American" campaign remained a central focus of Wal-Mart advertising and its voice to the public. Meanwhile, in the early 1980s, Sam Walton quietly helped establish an independent firm with an office in Hong Kong and, soon thereafter, in Taipei, Taiwan, that could purchase foreign-made goods for Wal-Mart. This move was kept under wraps. During the "Buy American" campaign, Wal-Mart emphasized that it purchased only a small portion of what it sold from overseas suppliers. What Wal-Mart failed to say was that a great many of its "American" suppliers had their products made in other countries. Even worse, Wal-Mart outright lied about where some of its products were made: In 1992, the television program *Dateline* aired footage from a hidden camera showing foreign-made goods in Wal-Mart stores under signs that read "Made in America."

Setting up a "Buy American" façade while seeking out foreign-made goods was only one part of Wal-Mart's strategy. The other part was lobbying to open up new opportunities to manufacture goods overseas. As early as 1981, several years before the "Buy American" campaign started, Wal-Mart executives were in Washington, D.C., to oppose proposed tariff increases on Chinese goods.

One of Wal-Mart's greatest lobbying victories came in early 2000 when legislation normalizing trade with China passed both the House and Senate by wide margins and was signed

into law by then-President Clinton. This legislation was supposed to do two things: 1) open China (with its one billion consumers) to American goods and 2) smooth the path for China to become a member of the World Trade Organization (WTO). The WTO sets the rules of trade for its members and is the source of agreements to lower trade tariffs and other barriers in order to expand the volume and extent of international commerce. For Wal-Mart, China's entrance into the WTO would mean reduced tariffs on long lists of goods that Wal-Mart imports.

Just 14 months after the legislation passed, China did become a member of the WTO, and its goods now enter with lower tariffs. But the enormous Chinese market promised for American-made goods has yet to materialize. The fact is, the vast majority of Chinese people are not able to afford American-made goods. Last year, U.S. imports from China were \$287.8 billion, but our exports to China were a mere \$55.2 billion. The economic connection the Chinese people have to America is not as consumers, but as low-wage workers in the supply factories that make goods to export to American consumers (see sidebar, p. 41).

Wal-Mart continues to be an active supporter of various Free-Trade Agreements of the Americas. Its extensive lobbying network is currently focusing on the Central American Free Trade Agreement (CAFTA). As with China's entry into the WTO, what's in it for Wal-Mart is lower tariffs on foreign-made goods. Wal-Mart is also heavily involved in so-called "technical issues." These are exceptions to tariff requirements that allow some countries to export specific goods for a period of time without paying any tariffs. Not surprisingly, Wal-Mart asks for exceptions for goods that it wants to sell. In a 2005 letter to the U.S. House of Representatives' Ways and Means Committee, for example, Wal-Mart asked that the tariffs on 42 different goods be temporarily suspended.

Forget "Buy American," Just Buy Chinese

To truly understand Wal-Mart, one has to look at its partnership with China. Three decades ago, Wal-Mart's main use of China was to get a price quote from a foreign manufacturer with a factory in China and then use it to beat down the prices quoted by American manufacturers with factories in the U.S. In those days, Wal-Mart was often bluffing; using a foreign manufacturer was difficult because of unreliable factories, uncertain transportation, unstable governments, and volatile currencies. By the early 1980s, that started to change—China had created four "special enterprise zones" and opened 14 coastal cities to foreign enterprise. The Chinese government told foreign investors that factories would be built to their specifications.

Sam Walton saw the opportunity, and (as noted in the previous section) he helped establish a company in Hong Kong and Taiwan that purchased foreign-made goods for Wal-Mart. But by the late 1980s, Walton wanted even more control over his ties to Asia. He asked his friend, George Billingsley, to buy

the company out and create a new one, Pacific Resources Export Limited (PREL) in Hong Kong. Billingsley described it as “one-stop-shopping for the world.”

In every legal sense, PREL was independent of Wal-Mart. With this third-party status, Billingsley scoured the world for the lowest production costs. Meanwhile, Wal-Mart—his only customer—was still hyping its “Buy American” campaign. But, when an American company was desperate to meet Wal-Mart’s demands, PREL was there to help it find a cheap foreign manufacturer, thus not only satisfying Wal-Mart’s needs, but also often introducing the American company to the “advantages” of out-sourcing to low-wage, minimum-regulation countries. Wal-Mart could continue to claim that it purchased only a small portion of what it sold from overseas suppliers, not mentioning that it was helping more and more “American suppliers” find their way to foreign factories.

PREL operated as a separate entity until 2002, when it was officially bought out by Wal-Mart. By that time there were over 20 offices around the world, with the main center in Hong Kong. PREL then became Wal-Mart’s Global Procurement Center—and quickly moved across the border from Hong Kong to Shenzhen, China, the hub of China’s opening to the West and to a market economy.

The 1,600 people who now work for Wal-Mart’s Global Procurement Center are dispersed among 27 offices in 23 countries; they can get products made, cheaply, in over 70 countries. When a favorite American manufacturer just cannot cut costs any further, the Global Procurement Center steps in to find a foreign production facility for the American supplier. The American company, in essence, switches from being a manufacturer to an importer.

In all such decisions, China remains the paramount choice. Why? China’s enormous supply of low-cost labor, combined with its stable authoritarian government, easily convertible and stable currency, high degree of literacy among both men and women, technical skills and capacity to make more sophisticated products, improvements in infrastructure, and openness to foreign business make it more appealing than other developing countries.

China offers an immense pool of cheap labor unsurpassed by any other country; roughly 165 million people in China are looking for work. Most of the available workers come from rural areas, and either they or their parents used to work the land. Until 1979, China’s planned economy emphasized agricultural work, particularly grain production. As the government loosened the reigns on people’s economic activities in the 1980s, the share of the labor force in agriculture went down by 25 percent. Millions of Chinese poverty-stricken peasants left central and western China in search of employment in the east. The most recent official figures put these internal immigrants at 140 million, with many more to come. In addition, as China has made the

transition to a more open, market-based economy, many state-owned factories that offered higher wages, healthcare, and pensions have been closed. Twenty-five million people who lost their jobs in these factories now seek work.

Not only is the labor force extraordinarily large, but the stream of new entrants will keep a lid on wages for years to come, especially since China has unions in name only. What the Chinese call "trade unions" adhere to Vladimir Lenin's conception of unions: Their role is to increase production and stop any attempts to interfere with management, since management and government, according to Communist theory, are the true voice of what's best for the country and its people. Today's Chinese "unions" operate under the control of the Communist Party. Chinese workers have very little, if any, power to increase their wages, reduce the number of hours they are required to work, or improve their working conditions.

Wal-Mart is closely allied to China, not only as its largest customer, but also as a major player in China's \$841 billion consumer market—a market that promises to become the world's largest. Wal-Mart has already opened 71 stores in China, 66 of which are Supercenters. More are planned, and Wal-Mart is on the edge of much faster growth in China. It has bid \$1 billion for Trust Mart—a Taiwanese-owned retail chain of over 100 stores in China.

As Wal-Mart becomes more and more deeply embedded in China, its self-interest runs along the same lines as the government in Beijing. An authoritarian state, China opposes democratic change and regularly harasses and arrests democratic activists. Wal-Mart, in turn, is strongly wedded to the stability of the present regime. In fact, Wal-Mart has recently accepted the presence of Communist Party organizations in its Chinese national office in Shenzhen and in a number of its stores.

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It seems that just the day before yesterday, the titans on the economic scene were manufacturing companies. Their factories were symbols of American power and success. We thought of General Motors, for example, not only as the largest auto company but also as exemplifying the biggest and best of American manufacturing firms. Respected brands like Huffy and Levi Strauss were also icons, symbolizing American quality. Today, American manufacturers stagger, cut production, and lay off workers. Wal-Mart is the new symbol of American power.

Wal-Mart sells more and makes greater profits than any of America's former heavyweights. Wal-Mart expands; they contract. In turn, Wal-Mart's customer base expands again: As workers are laid off from the large manufacturers and forced to take lower-paying jobs with less benefits, they are the

perfect candidates to become the new customers at Wal-Mart. It is a final touch to the big success of the big retailers, and to the decline of manufacturing in America. In the old world, American manufacturers did well selling to their own well-paid workers. Now Wal-Mart welcomes the workers who lost those good jobs.

With the dominance of large retail chains over manufacturers, the power they now have to dictate the terms and location of production, the emergence of China as the first choice of supply, the atrophy of good jobs, the erosion of benefits, and the emergence of Wal-Mart as the leader of this transformation, it seems, to borrow the words of C.S. Lewis, "we have just turned some great corner, and that everything, for better or worse, will always henceforth be different."

(See related sidebar: ["Every Day Low Prices ... and Wages."](#))

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* Levi is currently struggling to scrape the rust off its brand name. Last year it launched a high-end line, "Capital E," which has been somewhat successful in department stores. But despite the higher price tag, these Levis are also being made overseas.