The Political Concept of Monopoly

1. The rational versus the anarchic concept of freedom: what violates freedom? Initiation of physical force or “obstacles” in the way of desires?

2. The distinction applied to “censorship,” the “freedom of competition,” and “barriers to entry.”

The actual significance of high capital requirements.

3. The political versus the economic concept of monopoly. Monopoly as politically versus economically imposed.

4. Meaning of the political concept: *A market or part of a market reserved to the exclusive possession of one or more sellers by means of initiation of physical force by the government.*

The political concept is the original concept: *an exclusive grant of government privilege*—Charles I—East India Co., guilds.

5. Leading examples of monopoly according to the political concept:

a. Exclusive government franchises.
b. Licensing laws.
c. Tariffs.
d. Minimum wage and pro-union legislation.
e. Government owned or subsidized enterprises.
f. The antitrust laws.

6. Four points to remember about monopoly on the political concept:

a. Monopoly can be many protected against one or a few (e.g., New York City taxicabs and large fleets vs. many driver owners).
b. Is not necessarily profitable—high cost producers protected, as in tariff monopolies and subsidies.
c. Patents and copyrights are *not* monopolies—merely give legal recognition to property rights and in the long-run reduce costs and prices by virtue of promoting economic progress.
d. All monopoly is based on government intervention, which restricts the freedom of entry and competition.

7. Significance of monopoly on this concept—less choice, higher cost and price, lower quality, because of restricted freedom of the sellers and potential sellers.

The Economic Concept of Monopoly

1. A single seller of a given good in a given territory—embraces hardly anything (1920’s) or almost everything (now).

2. “Monopolistic competition” and “oligopoly.” Only wheat farming left as “pure competition.”

3. The myth of past pure and perfect competition.

Significance of Monopoly on the Economic Concept

1. Alleged tendency toward a single firm controlling the entire economic system—General Bullmoose rules the world, via mergers and predatory pricing.

2. Influence: Marx and the alleged inevitability of socialism; the antitrust laws; fears about the marriages of the wealthy.

3. In fact such a state of affairs exists only under socialism—established and maintained by force.

4. Why no tendency toward such situation under capitalism—critique of the merger route.

a. Anti-division of labor—bad mergers.
b. Prospects—the talented can't be merged; application to conglomerates.
c. Successful mergers create new capital for new firms.
d. More new firms all the time anyway—still more without tax problems of executives and insider trading restrictions; in addition, the tax laws restrict the growth of small business, as do regulations and the costs they impose in terms of time and need for staffs of accountants and lawyers.
e. Tax stimulus to uneconomic mergers: already large firms expand for capital gains treatment, medium size sell out for capital gains treatment; absorb loss makers.

5. Positive reasons for mergers: more division of labor and economies of scale, including wider application of better management, access to the capital market, advertising, complementarity of products (better use of salesmen's time); transportation economies.

6. Truth about 19th century—higher production, lower prices—the reverse of what led to expect on basis of monopoly on the economic concept.

7. The trust movement: earliest merger device.

a. Necessary to achieve benefits of improved transportation methods, which favored larger scale manufacturing. Example: Assume a large scale plant has a manufacturing cost per unit of $1, while a small scale plant has a manufacturing cost of $10 per unit. Consider the implications if transportation cost for both is initially 50¢ per mile and then falls to 1¢ per mile.
b. Trusts represented pooling of capital to make possible replacement of small, inefficient facilities with large-scale, efficient facilities.
c. The Supreme Court in decision breaking up Standard Oil: "Much has been said in favor of the objects of the Standard Oil Trust, and what it has accomplished. It may be true that it has improved quality and cheapened the costs of petroleum and its products to the consumer. But such is not one of the usual or general results of a monopoly; and it is the policy of the law to regard not what may, but what usually happens." Ironically, the record of Standard Oil is usually thought to be the leading evidence of the bad consequences of the trusts!

The Predatory Pricing Doctrine

1. Statement of the doctrine: the large firm can allegedly afford losses which the small firm can't, so it allegedly temporarily slashes price to force the small firm to sell at a loss, in order to drive it out and then jack prices up to higher levels than before. Potential newcomers supposedly kept out by threat of further ruinous price cuts. All achievements of big firms in reducing prices and improving quality seen as a prelude to this kind of gouge.

2. Problems with the doctrine:

a. The narrow market case: e. g., A & P and the chain stores. The limited nature of the potential extra profit from any one location, even if it could be obtained. Most of big firm's capital *irrelevant* to what it can afford to lose in any one location. Many on just as good a footing. Exposure to competition of newcomers who haven't lost anything yet. Pouring money down a bottomless hole. Not a formula for growing rich. Actual fact is lower real prices in retailing, not higher, and brought about largely by the chains.
b. Doctrine ignores fact that in degree the large firm is larger in the same market, it must take the price cut and loss or profit reduction on a correspondingly larger volume. E. g., if "Big John" [Rockefeller] wants to make Little Joe take a loss on the latter's ten percent share, he must take a loss or a profit reduction on his *ninety percent* share.
Big John must sell below little Joe's operating costs—for as long as the latter's capacity lasts. And then, when little Joe is gone, he still can't get more than a new comer's full costs plus the going rate of return.
c. Not possible to keep small firms out by intimidation of threat of ruinously low prices—forward contracting at manufacturing and wholesaling level, niches of competition at retailing level that can't be driven out even with *permanently* lower prices, and which prevent rise in prices. Also, support from suppliers and producers of complementary goods, who stand to lose volume if higher price imposed.

3. Implication of above is that it doesn't pay a large firm to seek 100% of the market by cutting price—unless there will be a vast increase in volume. The small firm's minor market share not a sufficient reward by itself. (Fact is that the small firm has much more to gain by being aggressive in cutting price against the large firm—the latter's market represents a major potential for its expansion, while its market doesn't offer much prospect for the large firm's expansion.)

4. This is a further reason for industries usually having more than one firm, simply because it doesn't pay anyone to go for the whole market unless there is a radical expansion in that market at a lower price.

5. Historical confirmation: According to John S. McGee, in "Predatory Price Cutting: The Standard Oil (NJ) Case," (*Journal of Law and Economics*, October 1958), Standard Oil actually never practiced predatory price cutting—because it would have been unprofitable.

The Doctrine of Marginal Revenue and Higher Prices in the Single Industry

1. Example of the doctrine: See *Capitalism*, Table 10-1, p. 409

Price	Quantity	Total Revenue	Unit Cost	Total Cost	Profit
$15	100	$1500	$8	$800	$700
9	200	1800	8	1600	200

Large firm supposedly "restricts" output in order to profit more from a smaller number of units than a larger number, even though the second 100 units are independently profitable and should be produced. It allegedly takes into account *the marginal revenue* attaching to the extra units, rather than their price. The marginal revenue is the change in total revenue that accompanies a change in quantity sold. Marginal revenue takes into account the drop in price on the quantity that is already being sold. In degree that a firm is large, it will supposedly restrict production, because of its concern with the effect on the price of what it already is selling.

2. Fact: unless it has legal protection from outside competition, the firm's real choice is not between 100 at $15 or 200 at $9, but between 100 at *$9* or 200 at $9. So long as the second 100 units are profitable in their own right, they will be produced. The only question is whether they will be produced by the firm that is already producing the 100 or by another firm. In the latter case, the first firm ends up selling at $9, but only 100 units instead of 200 units.

Note:

a. No firm subject to the competition or potential competition of others can view the industry demand curve as its own. It cannot lastingly get a price higher than outsiders' costs plus an allowance for the going rate of return, as a maximum. No matter what the elasticity of the industry demand curve, the long-run demand curve to it specifically is highly elastic at any price above outsiders' costs plus an allowance for the going rate of return.

b. In the case of a new industry, founded by one firm, it might be that it will decide that it does better by getting the higher price as long as it can, and waiting for competition to reduce the price. If so, this is a further reason why there is no tendency toward the formation of a single giant firm.

c. Paradoxically, although the marginal revenue argument is directed against "big business," the actual meaning of the argument is a denunciation of big business for refusing to become still bigger. If the firm goes ahead and produces the 200 units, the marginal revenue argument will not apply. Then, however, it will be denounced for being a monopoly. If it doesn't produce the 200 units, and thereby creates the opportunity for another firm to produce some of them, it is denounced for restricting production.

The Cartel Doctrine

1. With few exceptions (where there are very few physical sources of supply, such as is the case with diamonds), the only time cartels pay is when they serve *merely to reduce the extent of losses, i.e., raise price from a point of more severe losses to a point of less severe losses or modest profits.* This is because, in addition to the problem of deciding which producers must curtail production how much,

which is difficult enough in itself, profitable cartels have two further problems, which tend to make their success impossible:

a. The problem of controlling the investment of the profits. If the firms are profitable and want to reinvest their profits, the industry will expand and the cartel price will crash.
b. A profitable price attracts outside entrants to the field, which will make the cartel price crash. But if the cartel is not profitable, these problems do not arise, and so the cartel may succeed. If it is profitable, the only way it can succeed is if outside entrants can't enter and if the members' reinvestment policy can be controlled. In the light of these facts, the following passage from Richard Caves' *American Industry: Structure, Conduct, Performance* should not be surprising: "We even have evidence suggesting that large firms caught engaging in illegal collusion earn *lower* profits than other large firms. Perhaps collusion is most commonly attempted in situations where some adversity has depressed profits below a normal level." (p. 59, 4th Edition.)

2. Cartels as a serious problem are the result of government intervention:

a. The OPEC oil cartel today. Its success was the result first of price controls and then of confiscatory taxation applied against its leading competitors, the American oil companies. In their absence, its high prices would have made these competitors extraordinarily profitable and enabled them to expand, thereby reducing prices or forcing the cartel to further restrict its output, which would have given the American industry high profits on a still greater volume, permitting further expansion, until ultimately either the price came down or the cartel was forced out of the market. The cartel's success is also due to American government policies restricting oil exploration and development, such as on the continental shelf, and in wildlife and wilderness areas. The extra oil from these sources would either reduce the price or force the cartel to reduce its own output still more. Price controls on natural gas, restrictions on the strip mining of coal, restrictions on the development of atomic power add to the demand for oil. So does the requirement that automobiles use unleaded gasoline. In the absence of these regulations, OPEC would have to restrict its own output still further in order to maintain the present price of oil. The amount of restriction of its output required would be so large as to make it not worthwhile. The major benefit of any higher price would simply go to the cartel's competitors. Our policies did most of the work of making oil scarcer, and then prevented the cartel's competitors from profiting from the high prices it was able to impose.
b. The German cartels before World War I (which were the classic case of cartelized industry) were promoted by the Imperial German Government. Mises shows in *Human Action* how social legislation raised production costs in Germany relative to those in other countries, which had not adopted this legislation. The result would have been that German manufacturers could not have sold profitably either at home or abroad. To deal with this problem, the German government enacted protective tariffs and encouraged the formation of domestic cartels, which could thus sell at high prices in the German market. At the same time, the extra profits reaped in the domestic market permitted the subsidization of German exports, which could then be sold abroad at competitive prices or even below competitive prices ("dumping"). The exports were necessary to permit Germany to import vital raw materials and food stuffs not available domestically. (See Ludwig von Mises, *Human Action,* Third Edition, pp. 366-368.)
c. U.S. agriculture under government price supports

The Pure and Perfect Competition Doctrine

1. A denunciation of business as "monopolistic" for refusing to sustain unnecessary losses.

2. The meaning of pure and perfect competition (ppc): *the set of conditions required to drive price to equality with marginal cost.*

3. The meaning of marginal cost: *the extra cost required to produce an additional unit of output;* usually this is the cost of labor, materials, and fuel.

Marginal cost means different things in different contexts. Can equal full cost, or zero, or anything in between, depending on the context.

4. The alleged significance of marginal cost: a measure of value of output forgone in order to produce the output in question. Price equal MC seen as desirable because of alleged optimization of use of re-

sources: so long as price greater than MC, value of product gained greater than value of product lost. Thus ppc seen as conditions required to optimize use of resources.

5. The treatment of fixed costs—analogous to Ricardian land rent: only properly recoverable as and when that category of plant and equipment becomes “scarce”. Any allowance for fixed costs other than in case of plant and equipment being “scarce” is “monopolistic withholding of supply”: The fish case. The machine case: A machine has the capacity to produce 1 million units of product—renders 1 million service units. (See *Capitalism*, Table 10-2, p. 428.)

Quantity Supplied and Demanded (in thousands)	Price	Marginal Cost	Implied Machine Rent
500	$10	$8	$2
600	9	8	1
700	8	8	0

Implied machine rent justified only if quantity demanded at price of $8 is greater than 1 million units. Then machine’s services are “scarce” and deserve a price.

6. The need for the huge number of sellers and product uniformity as the principal conditions for getting sellers to drive price to marginal cost. Why rivalry seen as antithetical to competition.

7. Effects if price did equal MC

a. In many cases, price = zero; no supply or nationalize and subsidize.
b. Smaller industries that would operate at capacity more often.

8. The alleged lack of price competition because price not driven to MC.

The omnipresence of price competition: 200 years of lower real prices everywhere. Chrysler, American Motors—anyone driven out of business. The omnipresence of price competition even in inflation—the quest for higher productivity and the need to match others’ lesser price increases based on improvements in efficiency. The consequent need to improve one’s own efficiency.