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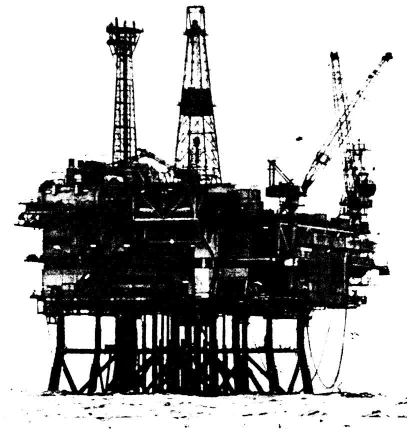
MONOPOLIES, CARTELS AND COMPETITION



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It is customary for the market economy to be condemned because it causes both competition *and* monopoly. Thus, for example, if there is frantic competition between oil companies leading to wildly fluctuating and disparate prices this is cited as evidence of the "anarchic" nature of the market. But cooperation between companies to attempt to stabilise prices is also condemned. However, we seldom hear such complaints about government price-fixing. In general, Conservatives are enthusiastic about competition and are eager to legislate it. Socialists want to abolish both competition and monopoly, though it is not clear how they propose to do this.

Much of the discussion about restrictive practices, monopolies and cartels is confused. It is seldom made clear what types of constraints are in operation in particular instances, for example, whether there is freedom of entry or whether entry is restricted or otherwise legally hampered. The Monopolies and Mergers Commission, rather than decreeing an arbitrary level of competition, should concentrate on removing all barriers to entrepreneurship. Abolishing the capital gains tax and permitting *worldwide* freedom of entry would be a start.

The clearest way of broaching the subject of monopolies and cartels is to argue from a position of private property rights and freedom of contract and see where it leads. In a social system in which these rights are broadly respected economic power is necessarily limited. The owner(s) of property has the right to set the terms and conditions for the use of that property. Potential residents or employees are free to seek better terms elsewhere. A property owner is free to enter into any contract he likes with whomever he likes provided that he does not initiate force or fraud in doing this. (Initiating force or fraud would be violating someone else's like rights.)

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FOR LIFE, LIBERTY AND PROPERTY

It follows that an oil company, for example, is entitled to set whatever price it likes for a gallon of petrol either singly or in collusion with other oil companies. Consumers are entitled not to purchase the petrol. Does this mean that the oil companies will get whatever price they like? No. If the colluding companies have only a small market share they will clearly lose out to their competitors. But suppose the state of the market is very favourable to the cartel. It will then be able to charge higher prices. However, if the consumers judge the price of petrol to be too high they will economise on its use. Colluding oil companies will strive for that price which maximises their profits taking into account both the behaviour of the consumers and of their competitors. With a large market share a cartel will be able to set a relatively high price but the fact that it does have *some* competitors sets a limit to just how high a price it can charge.

SUPPLY AND DEMAND

Let us examine this further. Suppose the supply of petrol is more-or-less monopolistic. That is, there is collusion between, say, Shell, Esso and BP who between them have about 60% of the market. This is what is regularly alleged to take place. For example, the average price of petrol in the UK during 1988 was fairly static even though the oil price was on an overall downward slope. Therefore, the petrol price was considered to be "too high". A too high price really means an undesirable price. From a buyer's point of view the desirable price is zero. But he usually cannot expect to be supplied at that price - except in a moneyless socialist utopia. From a seller's point of view the desirable price is indefinitely high. But he cannot expect to sell anything at that price. Prices are not determined by cost of production. This merely sets their lower bound. In a market free of government price controls they are determined by supply and demand. The only meaningful concept of a just price is any price agreed upon between a willing buyer and a willing seller in a free market. (The petrol supply industry undoubtedly only approximates to a free market for the purposes of this illustration. For example, it should be noted that the government takes more than half the price of a gallon of petrol.) If the oil price falls but the state of the petrol supply market is such that the oil giants can continue to set and get the same price for a gallon of petrol then so be it. Consumers are obviously still willing to pay for an unchanged quantity of petrol at the same prices as before. The demand for petrol, not surprisingly, is inelastic. What one might ask is: if the oil giants are so powerful why is it that the price they charge is not double what it is? Or triple? The answer is that the current price must be that price above which they would expect to make losses, as the result of a sufficient margin of undercutting by the smaller oil companies or by one of themselves. There certainly have been periods in which the oil giants have tried to obtain higher prices and have been unsuccessful.

Whenever the oil companies increase their petrol prices they are always quick to offer apologies and excuses, while from the motoring organisations we get the usual whining and whingeing. It would be much simpler if everyone just admitted that the oil companies are in business to make profits. They are not charities. To that end they will endeavour to get as high a price as market conditions dictate.

THE LIMIT OF A CARTEL'S POWER

Probably the main reason for anti-monopoly legislation is the general suspicion and fear of the power of large companies. Within its own industry IBM enjoys a dominance which is probably unrivalled by any other company within an industry of similar status. Its main area of dominance has been in mainframe computers. Yet despite IBM's power the computer market is intensely competitive. The market is moving away from mainframes and towards minicomputers and PCs in such a way that IBM's revenues from PCs are fast catching up with those from mainframes. Yet profit margins on PCs are far lower than those on mainframes because here there are more players in the game. Consequently IBM is currently finding the going more difficult than has hitherto been the case. Merely having a large market share is clearly no guarantee of an easy time.

In general, the more vital a commodity is considered to be the worse it is for the consumer if that commodity is supplied by a monopolistic producer or a cartel of producers. But it should be remembered that the market is not static. What effect cartels or monopolies can be expected to have depends on whether the market is free or controlled - whether there is freedom of entry or whether the number of producers is restricted by government. Companies will behave differently depending on whether this is the case. If there is freedom of entry then, even in today's conditions of government-hampered capital accumulation, a monopoly or cartel cannot *indefinitely* set prices which are too high as judged by the consumers. For this will make it more economic for other producers to enter the market, thus increasing supply and forcing prices down. Also high prices will force consumers to economise and/or turn to substitutes, again eventually forcing prices down. This has been the history of monopolies and cartels where there have been potential alternative suppliers. The OPEC oil cartel was very powerful for a decade but was unable to prevent the price of oil falling in real terms to lower than it was prior to their quadrupling of the oil price in 1973. This is because the high price encouraged both non-Middle East production and economy of consumption. In fact, if America had permitted a free market in its domestic oil production after 1973 the OPEC cartel would have disintegrated sooner.

In a market where there is freedom of entry monopolies and cartels can only maintain their positions as the result of low prices and/or high quality. A notable example of this was the Aluminium Company of America (ALCOA) which, prior to World War 2, was the only producer of aluminium in the USA but it did not charge monopoly prices.[1] (It did, however have an anti-trust suit brought against it for being so efficient and providing such a good service to its customers.)

There are cases even in a free market where there is restricted freedom of entry. Typical examples are what Ludwig von Mises calls "limited-space" monopolies,[2] e.g., public utility companies. We would call them natural monopolies. In a given area only one or a few such companies may operate. In which case they may gain by colluding with each other to the detriment of their customers. It is not inevitable that this arrangement will be indefinitely harmful to the consumers. It depends on how they respond to the high price and/or low quality of the commodity being supplied. They may economise to such an extent that prices have to fall. Or they may find substitutes. Or they may simply move to an area where prices are lower. It is not inevitable, and may even be detrimental to them in the long run, that natural monopolists will charge monopoly prices. Interest-ingly, governments usually cite natural monopolies as cases for state ownership or state-granted monopoly status. But if they *are* natural monopolies why the need to prohibit competition?

COMPETITION MUST BE ALLOWED: IT NEED NOT BE COMPULSORY

What is important in evaluating the merits of monopolies and cartels is whether the market is free or controlled. It is not necessary that there be competition *de facto* (though this is usually preferable) but that there be competition *de jure*. The dynamics of the free market, which are often overlooked, tend to undermine imperfections. Under conditions of restricted freedom of entry competition can be expected to be temporarily weak. One cannot imagine there being effective competition to, say, British Telecom if the government does not *force* it to cooperate with its competitors in the use of its lines. But, since the market is a discovery procedure, we should not always assume that there is no alternative way of supplying a particular commodity. Because competition is not allowed (except by Mercury) the market has not addressed the problem of figuring out how to compete with BT *without* having to share its lines. If competition were permitted the necessary technology would, no doubt, evolve. Of course, it would probably be a long time before a competitor or competitors could reap a sizeable share of the market. Nevertheless potential competition keeps a monopoly on its toes. In endeavouring to keep out competition it must strive to reduce its prices and/or improve its quality. But if competition is prohibited it has no incentive to do this. Instead its prices are usually regulated by the government. (And not always in a downward direction.)

Finally it should be realised that markets today are hampered in many ways, most of which make it more difficult for newcomers to enter a market than would be the case under free market conditions. Protectionism, barriers to the free movement of capital, and the penalisation of capital accumulation via taxation all contribute.

NOTES

1. Cf. Alan Greenspan, "Antitrust" in Ayn Rand, *Capitalism: The Unknown Ideal*, New American Library, 1966.
2. Cf. Ludwig von Mises, *Human Action*, Third Edition, Contemporary Books, Chicago, 1963, Ch. 16.