Monopoly

Our final interference with competitive pricing is monopoly collusion. Again, the effect is production inconsistent with consumer choice. Consider Fig. 2-10. The competitive outcome would be p_1, q_1. Under monopolistic collusion, firms in the industry agree on a higher price, p_2. But, to avoid surplus production which, when sold, would drive the price down, they must restrict output to q_2. And to restrict output, they will generally divide the market amongst one another and try to prevent outsiders from entering the industry. All of these collusive arrangements regarding price, output, and entry are violations of the Federal anti-trust laws.

We shall not prove it, but in *any* competitive industry, firms would benefit from monopolizing–if we ignore the costs of maintaining the agreement and penalties for anti-trust convictions. But these costs and penalties are quite high. The misallocative effects of monopoly should be obvious. At p_2, q_2, the market-clearing price exceeds the marginal cost; so the value to consumers of more of this product is greater than the value of goods foregone to produce more.[30] In the final chapter, we return to the effects, extent, and remedies for monopoly. The curious are welcome to read ahead.

Another fault of monopoly besides missallocation of productive efforts is that, to sustain the output restriction, infringements of producer, consumer, and investor freedom are often required. Such limitations are frequently imposed by government. As already noted, the ICC restricts entry

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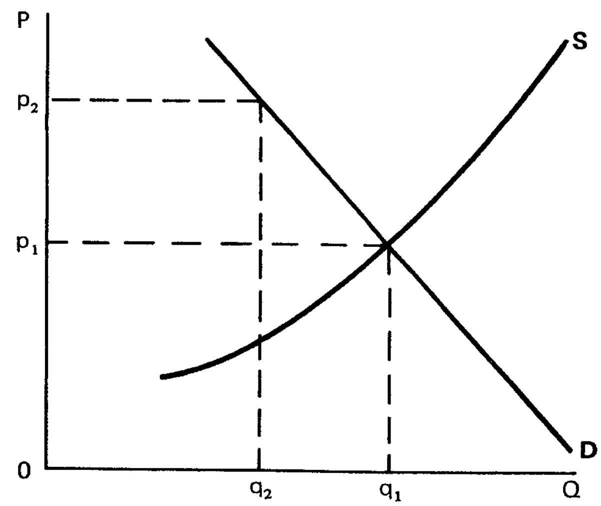
be able to bring more productions in music, theater, literature, readings, and dance to millions of citizens *eager* to have the opportunity for such experiences. . . . We would be able to . . . support hard-pressed cultural institutions, such as museums, symphony orchestras, to meet the demands of new and *expanding audiences.*" (Emphasis added.) If consumers are so eager and the audiences so expanding, why are subsidies needed? The \$40-million was appropriated, but in 1971 the chairman of the newly formed Partnership for the Arts opened a campaign for a \$200-million appropriation, pointing to higher per capita arts subsidies in other nations. (*New York Times*, Jan. 6, 1971). A *Times* article of July 29, 1971 noted the virtual absence of Congressional resistance to subsidies for arts and humanities. The demand for such subsidies is limitless, of course. America has 1100 symphony orchestras, many with expensive new halls, powerful labor unions, and long seasons. The big five each give about 200 concerts annually, compared with 20 by the Vienna Philharmonic. All this is in addition to the public's access to inexpensive records, tapes, and FM programming.

In a similar vein, a *Times* reader, lamenting the demise of *Look* magazine, called for Federal subsidies of periodicals to be financed by taxing television broadcasters. What does all this imply about consumer choice?

[30] The diagram refers to an *industry* with monopolistic collusion. The effect of monopoly in *one company* is essentially the same–lower output and a higher price than under competition.

FIGURE 2-10 Monopoly Collusion



The effects of monopoly collusion are:
Higher price, p_1 to p_2
Reduced output, q_1 to q_2
misallocation of production
Restricted entry into the industry

into the trucking industry, encourages trucking companies to collude in setting prices, and prevents railroads from competitive price cutting which would offend trucking (or barge) interests. The Interior Department sets quotas limiting oil imports, while state governments where oil is extracted restrict domestic oil production in order to keep prices above the competitive level.[31] Monopoly-like restrictions of consumer freedom also result from import tariffs which reduce imports and lead to higher prices.

It is interesting to compare monopoly, Fig. 2-10, with price supports, Fig. 2-7. What is the main difference? With price supports, the farmer not

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[31] Testimony before Congress in January 1972 estimated that Federal oil import restrictions were costing the average American family about $100 annually in higher prices of gasoline and home fuel, a national total of some $5-billion a year. (*New York Times*, Jan. 11, 1972.) This is another example of a special interest policy with high benefits to a few and a small cost to many.

While the average American consumer can do little about higher oil prices, American producers of petrochemicals (which go into paint, plastics and other items) are talking of opening plants abroad so they can buy oil and only gets a monopoly price, but can produce all he wants and sell it to the government. It's a better deal than any private monopoly could bring about. If monopoly is a crime if created by chemical, steel, or electrical equipment manufacturers, why is it public policy to bring it about in farm production, which without government action would be highly competitive?[32]

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natural gas cheaper to compete with Japanese and European companies (whose oil costs are much lower than theirs). Interference with competitive pricing can have broad consequences. America's oil import quota program is discussed at some length in Chapter 10 under government by law.

[32] Another commodity where government promotes monopoly prices is milk. In 13 states (it used to be 32), it is a crime to sell milk below legal limits. In 1971, people paid $1.21 a gallon in Pennsylvania while across the border in Ohio milk sold for $1.02. (*Wall Street Journal,* May 24, 1971.) In spite of the law, intended to benefit dairy farmers, many store chains and coöps frequently receive illegal rebates and discounts and interest free loans from dairies competing for business, in effect lowering the price of milk illegally. New Jersey won't even allow S&H Green Stamps given for milk purchases, lest this constitute illegal price shading. So milk must be totaled separately at the checkout counter. In support of higher milk prices, one Congressman said in 1966, "Farmers are going out of dairying at a startling rate. We will find ourselves with an even greater shortage of milk unless something isn't done to make dairying more attractice." (*New York Times,* Nov. 18, 1966.) If there is a shortage, consumers will bid up the price, so why does the government need to hold it up? But if there's a surplus, what's wrong with an exodus from dairying?

If the Congressman needs a course in economics, he's not alone. In 1968, George Wallace's agriculture platform promised "to rely heavily on a competitive market structure rather than on prices administered or fixed by bureaucratic procedures." This, the platform explained, meant raising price supports about 30% to 50% above their prevailing levels.

In 1967, a Michigan dairy farmer wrote a plaintive letter to Ann Landers about his cows' unhappiness with low milk prices. Miss Landers got Agriculture Secretary Orville Freeman to reply: "Please don't give up. Tell this to your cows too." He promised to raise milk prices so more farmers would want to produce more milk. But what would more milk do to milk prices without laws preventing the prices from falling? And with such laws, who would buy the milk?

One more from the food area. U.S. Government advice and finance helped develop a thriving tomato industry in Mexico, much for export to America. But in 1969, the Florida Tomato Committee, a private grower group using authority granted by the Department of Agriculture, ruled that tomatoes picked *green* must be at least $2\frac{9}{32}$ inches in diameter, while those picked *ripe* from the vine had to be at least $2\frac{17}{32}$ inches in diameter. Although consumers prefer the tastier vine-ripened fruit, this ruling barred 30% to 50% of the smaller, vine-ripened Mexican crop, but affected only 15% to 20% of the Florida crop, more of which is picked green. Predictably, tomato prices rose sharply from the decreased supply, tons of Mexican tomatoes rotted, and America was roundly berated for bullying poor Latin American farmers. "Curbs on Tomatoes From Mexico Cause U.S. Prices to Rise," *Wall Street Journal,* March, 4, 1969.

In conclusion, why are there interferences with competitive prices and output? They derive from a combination of four sources: (1) the advantages to producers (including workers) of suppressing competition and freedom to get more income for themselves (true of monopoly and price supports); (2) inefficient pursuit by government of worthwhile objectives (price ceilings to curb inflation, commodity taxes to gain revenue, anti-scalping and usury laws to protect consumers); (3) deliberate efforts to redirect production away from that determined by consumer choice, on the grounds that consumer choice is wrong (commodity taxes and subsidies); (4) public ignorance of the existence and/or effects of such interference.

The Invisible Hand

It is widely recognized that if an individual pursued his own self-interest without any social restraint, he might harm others. To provide order, tranquility, and justice, society prohibits individuals from coercing others and from damaging others' persons or property.

Suppose then we assume that appropriate laws are enforced against violence, fraud, and contract violation. It has been asserted that under these conditions, if individuals do pursue their self-interest, as they will generally do if free, they will unintentionally serve the general interest of society, that there is not a conflict between pursuit of self-interest and the legitimate collective ends of society. In his famous work *The Wealth of Nations,* published in 1776, Adam Smith said that individuals, pursuing their own interests, were guided by an "invisible hand" to promote the welfare of others. The invisible hand is the price and profit system. This claim, applied mainly to economic activities–buying, selling, hiring, renting, lending, investing, and organizing businesses–has been a major argument for a "laissez faire" political philosophy, that government need not and should not interfere with economic activities.[33]

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[33] In Smith's words: "As every individual . . . by directing that industry in such a manner as its produce may be of greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. . . . By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good.

". . . The statesman, who should attempt to direct private people in what manner they ought to employ their capitals, would not only load himself with a most unnecessary attention, but assume an authority which could safely be entrusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it." *The Wealth of Nations,* Book IV, Chapter II.