The Sources of Monopoly

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IN THIS ARTICLE I wish to examine, very briefly, the tacit assumption universally made, even by free-market writers, that monopoly is a natural market phenomenon, arising out of normal market processes. I hope to show that, on the contrary, the conditions of monopoly cannot arise except in connection with government intervention.

The characteristics of monopoly are usually given as follows: (a) exclusive control over the whole—or a very high proportion—of the output of a commodity lacking close substitutes (or control over a group of commodities that are close substitutes to each other); arising out of, and maintained by, (b) barriers to entry that are tacitly assumed to be spontaneously thrown up by normal market forces; or (c) the two together (exclusive control over supply and barriers to entry), enabling the monopolist to restrict output below, and thus raise prices above, the competitive level.

For our purposes the most important assumption to consider is the second, barriers to entry.[1] Before going on to examine some of these, I should first like to suggest that exclusive control over the supply of a (physically distinct) commodity does not mean that the "monopolist" is isolated from, or insulated against, the effects of competition—using the term to indicate a dynamic market process. The range of substitution open to the consumer is not something which is fixed once and for all, and which can be ascertained by simple "observation." We seem to have here a confusion between the economic and the technological notions of substitution. Whether commodities are to be regarded as complementary or as substitutes depends not on their technological characteristics, nor on the opinion of the economist, who is only an observer, but on the real actions of individuals taken in their aspect as consumers. Products may be treated differently by different consumers at different times: a housewife may today treat cornflakes and shredded wheat as perfect (economic) substitutes, while tomorrow she may differentiate sharply between them if in the meantime her family has acquired a taste or a dislike for either. Again, wash-and-wear shirts may be seen as providing substitutes for laundry services; and home canning may similarly provide competition for the large firms producing canned goods. In short, there may be all sorts of unexpected sources of competition on the market.

To return to the notion of bars to entry: It has been argued that costs may form a barrier, in the sense that the optimal size of the plant in a particular field may be "large" compared to the size elsewhere. The necessity of having to raise large amounts of capital,

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1 See, for instance, the long and comprehensive list compiled by J.S. Bain, "Conditions of Entry and the Emergence of Monopoly," in E. H. Chamberlin, ed., *Monopoly and Competition and Their Regulation* (New York: Macmillan, 1954). Also see the discussion by E.A.G. Robinson, *Monopoly* (London: Nisbet and Co., 1941), chaps. i and ii.

however, cannot be said to prevent entry, since if sufficient profits were anticipated the capital would be forthcoming, either from savings or by withdrawing it from other uses; and if sufficient returns were not anticipated, this would indicate that the existing firm was efficient enough in meeting the demand so that the setting up of another firm would be unprofitable, or at least less profitable than using the resources elsewhere.

Nor can it be said that cut-throat competition can establish a monopoly by driving all firms except one out of business: since whenever the "monopolizing" firm attempted to raise its prices again, it would be inviting other firms to enter the field.[2]

WHAT ABOUT MONOPOLY arising out of exclusive control over some essential factor of production—e.g., a natural resource or a trade secret? Now here again, a rise in relative prices would render profitable the search for substitutes,[3] or the use of techniques or factors that would not otherwise be profitable. Moreover, the possession of a "trade secret" by a firm must be counted as part of the skills forming its owner's property.

Goodwill, advertising, and product differentiation are said to create monopolistic positions and barriers to entry by, so to speak, "attaching" consumers to a particular supplier, so they do not readily turn to alternative sources of supply. Here, too, the economist cannot decide for the consumer his range of substitution, since this would depend on the latter's own preferences (including his laziness or other costs involved in acquiring information about possible substitutes). It would always be open to competing firms to try and persuade consumers of the superiority of their own products and services, since presumably the "attachment" of the consumer to a particular firm bears some relation to its performance, or to his beliefs about its performance. Moreover, to speak of such things as advertising and good will as creating monopolistic positions would seem to imply that consumers react like puppets. The function of these two is probably better described as conveying information to consumers. The concept of product differentiation is subject to the same ambiguities as that of the range of substitution: is the product "different" from the viewpoint of the technologist, the engineer, the economist-observer, or the consumer; and whose viewpoint is most relevant?

For these considerations, I will suggest that the sources of monopoly cannot be found in market processes, as their working has usually been interpreted; and I will propose that the chief sources are governmental acts of intervention, for here we have a clearly identifiable and unambiguous class of barriers to entry. We can clearly and unambiguously identify a restriction of market supply below the competitive level, and the corollary of raising prices above the level they might otherwise have attained.

In the case of such interventions as exclusive patents, grants, charters, concessions, permits, licenses, tariffs, and quotas, this restrictive effect is quite plain. All of these reduce the number of sources of market supply—the number of firms that would otherwise be present in the market. Yet we may also perceive this restrictive effect arising out of such interventions as progressive taxation, labor legislation, and the special privileges granted to labor unions. Progressive taxation prevents the accumulation of additional capital, to the comparatively greater

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2 See W. A. Leeman, "The Limitations of Local Price-cutting as a Barrier to Entry," *Journal of Political Economy*, LXIV (1956), 329-34; for the classic Standard Oil story, see J. S. McGee, "Predatory Price Cutting: The Standard Oil (N.J.) Case," *Journal of Law and Economics*, I (1958), 137-69; J. Chamberlain, *The Enterprising Americans: A Business History of the U.S.* (New York: Harper and Row, 1963), pp. 146-56.

3. An excellent example is Indian jute: The Indian Government believed that since India had exclusive control of jute production, it was safe to charge heavy export duties and thus raise prices. The outcome of this was not the reaping of monopoly revenues, but a great expansion of production of substitutes for jute, such as kraft paper.

detriment of those firms and individuals seeking to establish themselves, and to the advantage of established firms and the already-wealthy. Firms cannot expand except as they save out of their rising incomes or borrow out of the rising incomes of others. Insofar as these incomes are taxed away at progressive rates, new firms and individuals seeking to rise are placed at a comparative disadvantage to those who may fall back on previously accumulated capital. If "large" firms and "wealthy" individuals are prevented from growing larger or wealthier, the comparatively smaller firm and poorer individual are prevented from rising at all.[4]

The effect of labor legislation is to raise total costs above the level they would have otherwise attained. This in turn implies that fewer firms will be able to continue in, or newly enter, the fields where such legislation is applied. In other words, we have here a formidable cost barrier to entry.[5] Labor unions have been granted the special privilege of using private coercion; they may use this power to cartelize an industry, or give de facto monopoly to a single firm, by preventing the entry of firms who would seek to cut costs, or by driving certain firms out of the field. That unions in the United States have used their special privileges to cartelize numerous areas of economic activity seems to be one of the major conclusions emerging from such investigations as those of Senator McClellan and his Committee.[6]

SO-CALLED "FAIR TRADE" laws, which set minimum prices or purport to set minimum standards, also operate to reduce competition and thereby create semi-monopolistic positions.[7] And then there are, of course, the cartels and monopolies, especially in the agricultural sectors of developed economies, that have been deliberately organized by governments.[8] For these reasons, we find that, historically, government intervention has almost invariably been connected with the emergence of monopolies. We may examine some specific examples of this:

In the United States, the presence of tariffs on manufactured goods almost certainly facilitated the emergence of monopoly-like situations in the manufacturing sector of the economy in the latter half of the last century by limiting the effectiveness of international competition. The remedy, however, was sought in further intervention, in the form of antitrust legislation. This at least prevented further monopolization, by making cartelizing contracts unenforceable at law, thus permitting domestic competitive forces to operate;[9] but legal opinion in the country does not seem certain whether uniform pricing by independent firms should be taken as evidence of competition or collusion, while every attempt at price cutting seems to be taken as evidence of a desire to monopolize.[10]

In Germany, contracts in restraint of trade were declared enforceable at law by the Supreme Court, thus eliminating the emergence of competition via the activities of "chiselers"; later,

4 For a discussion of the various results of progressive taxation, see especially F. A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960), chap. xx and the references given there.

5 See the brief remarks by P. T. Bauer, "Regulated Wages in Under-developed Countries," in P. Bradley, ed., *The Public Stake in Union Power* (Charlottesville: University of Virginia Press, 1962), pp. 348, 353; see also the discussion in W. H. Hutt, *The Theory of Collective Bargaining* (Glencoe, Ill.: The Free Press of Glencoe, 1954), and in H. C. Simons, "Some Reflections on Syndicalism," *Economic Policy for a Free Society* (Chicago: University of Chicago Press, 1948), pp. 121-59.

6 See Simons, *ibid.*, and also S. Petro, *Power Unlimited: The Corruption of Union Leadership* (New York: Ronald Press, 1959).

7 See especiallv Simons, *loc. cit.*

8 See L. C. Robbins, "The Inevitability of Monopoly," *The Economic Basis of Class Conflict* (London: Macmillan, 1939), and the remark by Hayek, *op. cit.*, p. 265, and also chap. xxiii.

9 See W. Roepke, *The Social Crisis of Our Time* (London: Wm. Hodge and Co., 1950), p. 251n; J. Chamberlain, "The Morality of Free Enterprise," in F. S. Meyer, ed., *What is Conservatism?* (New York: Holt, Rinehart and Winston, 1964). But also see S. Petro, "The Menace of Antitrust," *Fortune*, November 1962, pp. 128-31.

10 See the brief remarks by F. A. Hayek, "Unions, Inflation and Profits," in Bradley, *op. cit.*, pp. 54-56, and *The Constitution of Liberty*, p. 265.

the government actively engaged in the formation of cartels, even making cartelization compulsory.[11]

In South Africa, diamond mining was gradually becoming a more competitive industry when the government, alarmed at the prospective loss of revenue from its share of the profits of one of the companies, decreed that thenceforward mining was to be by license only.[12]

In Great Britain, monopoly was never a serious problem during the free trade period of the nineteenth century; it became a problem only with the abandonment of free trade in the early twentieth century, and with the acceptance by the courts at about the same time of the enforceability of restrictive contracts, if the restrictions were "reasonable."[13] In Britain, also, the government has engaged actively in the cartelization of the trucking and coal mining industries, as well as of agriculture.[14]

In India, comprehensive exchange and import controls, together with comprehensive and detailed regulation of every aspect of business life, insure that competition is never allowed to emerge.[15]

The conclusion to which all these considerations would seem to lead is that monopoly is not, as so many have supposed, a natural, market phenomenon at all; but that, on the contrary, it does not arise except in conjunction with government intervention.

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11 See especially F. Boehm, "Monopoly and Competition in Western Germany," in Chamberlin, *loc. cit.*

12 See the account given by E.A.G. Robinson, *op. cit.*, pp. 49-53.

13 See the account given by Robinson, *op. cit.*, pp. 49-53.

14 See J. B. Heath, *STILL Not Enough Competition?* (Hobart Paper No. 11; London: Institute of Economic Affairs, 1963), p. 22.

15 See B. R. Shenoy, *Indian Planning and Economic Development* (Bombay: Asia, 1962); and by the same author, "A Report on Ten Years of Economic Planning in India," *New Individualist Review*, Winter 1964, pp. 13-20, also see P. T. Bauer, *Indian Economic Policy and Development* (London: Allen and Unwin, 1960) for a more general discussion.