THE MYTH OF MONOPOLY POWER

The essence of the free market lies in three fundamental and interrelated attributes: The private ownership of property, voluntary exchange, and the prohibition of force and fraud from the market. If these attributes do not exist in an economic system, there is neither freedom, nor, strictly speaking, a market.

If men are not free to own property then they have nothing to exchange. If commerce takes place under terms dictated by a person not a party to it, then there is no freedom of exchange. And if one group is allowed to use force or fraud to bar competitors from the market, get special subsidies or regulate producers, then there can be no free competition.

By these three criteria, monopolies and cartels obtained by market processes and without state intervention or assistance are fully consistent with the principles of a free market. In a sense every man is a monopolist since he alone offers his services, on his terms and from his place of business.

The History of Monopoly in America

Logically and historically a large economic monopoly can only come into existence and continue to exist when the monopolist is more efficient and charges a lower price than his competitors–existant and potential. When profits in any business–monopoly or otherwise–are exceptionally high, or when prices are steep because of inefficiency, the floodgates are opened to competitors. *And such competitors always exist in the free market.*

The largest market share held by any large American company in history was the 90% of oil refining controlled by Standard Oil in 1899. Even then there were some 66 other refining companies ready and able to expand production had Standard Oil become inefficient.

How did Standard Oil become so large (starting from 4% of the market in 1870) and what were the economic consequences of their market dominance? Dr. D. T. Armentano, in his book **The Myths of Antitrust**, provides a concise answer:

> *Efficient operations in the 1870s meant tank cars, pipe lines, adequate crude sources, cheap barrels, huge storage facilities, and export capabilities, all of which the Standard Oil Company had invested in heavily, and most of which the smaller competitors had not. Standard has frequently taken the blame for the fact that its competitors could not enjoy the efficiencies of a tank car fleet, access to cheap pipe lines, and large storage facilities; but surely, the fact the competitors* **would** *not or* **could** *not be as efficient as Standard in these areas is not Standard's responsibility. . . . While competitors who could not or would not do these things might have regarded these tactics as 'unfair,' their ultimate justification was proven again and again in the marketplace: such policies lowered the costs of production and the prices of the product and raised the profits of the Standard Oil Company.*
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> *Between 1870 and 1885 the price of refined kerosene dropped from 26 cents to 8 cents per gallon. In the same period, the Standard Oil Company reduced the costs per gallon from almost 3 cents in 1870 to .452 cents in 1885. Clearly, the firm was relatively efficient, and its efficiency was being translated to the consumer in the form of lower prices for a much improved product and to the firm in the form of additional profits.*

A company, like Standard Oil between 1870 and 1899, which is efficient and charges ever-lower prices for its products certainly cannot be considered "evil" by any rational person, regardless of how great their profits are. Standard's success, like the success of every company not protected or subsidized by the government, was achieved by providing a better product at a lower price than its competitors could offer. If Standard made high profits, it was certainly not at the expense of society. Profits are the proper and just reward for excellence. To abolish or restrict profits is to simultaneously abolish the excellence which they engender.

The alleged centralization of American business at the end of the 19th Century from which the anti-trust laws were supposed to have saved us, is in fact a complete myth. In his book, **The Triumph of Conservatism**, revisionist historian Gabriel Kolko states:

> *The new mergers, with their size, efficiency and capitalization were unable to stem the tide of competitive growth. Quite the contrary! They were more likely than not unable to compete successfully or hold on to their share of the market . . .*
>
> *From 1899 to 1904 the number of manufacturing firms in the United States increased 4.2 per cent, and from 1904 to 1909 they increased 24.2 per cent.*

There are in fact good economic as well as historical reasons for the number of firms in the market to increase as time goes by. As consumers become more wealthy, their tastes become more diverse and sophisticated. A peasant squatting in a mud hut may think of heaven as a warm room and a full stomach. But an American in the 20th Century can imagine no limit to his wants and needs. Recently many entirely new industries, all but undreamed of even a decade ago, have emerged to prominent positions in the American economy: fast foods, micro calculators, office computers, and synthetic clothing, to name a few. Further, since 1956 the bulk of consumer spending has been in the service industries. Health clubs, men's hairstyling, encounter sessions, weight watchers clubs, and lawn maintenance services hardly existed just 10 years ago.

In a world of increasing diversity, affluence and sophistication, the idea of dangerous, free market monopolies becomes more and more ridiculous.

The Nature of Monopoly

The word "monopoly" comes from the Greek words *monos* and *polein* which literally mean "the one and only seller". In an absolute sense, then, a monopoly is the *exclusive* control of a commodity (or service) in a given market. Even using a common sense concept of what constitutes a "single" commodity or service, such a market condition has been rare in the United States. However, the term "monopoly" is useful if its definition is modified to read: "a market condition in which one owner *predominates* in a given industry." I will use this definition for the remainder of this article.

Given this definition of monopoly, one may distinguish between three types of monopoly, according to their origin. They are monopolies by (1) innovation, (2) concentration, and (3) collectivization.

A **monopoly by innovation** occurs when, by the invention and exclusive development of some new process or device, a seller is able to offer a *new* good for which there is currently no close substitute, or when a seller is able to offer an *old* good at a lower price than any other company.

In such cases it is clear that the exclusive control of a product enjoyed by an innovative monopolist *reduces* the welfare of no one *from what it previously was* before he offered his new good or lower price in the market. If people value the new product (or lower price) more for some or all purposes than they valued the old product (or previously prevailing price), they will use the new product (or buy at the new price). If they do not value it more, they are free to continue using the old product or paying the higher price.

A **monopoly by concentration** occurs when, through the evolution of the market, one business either buys out other competitors or merges with them so that one firm now dominates the market. This type of monopoly will be discussed in more detail shortly.

The third type of monopoly is a **monopoly by collectivization.** This is a monopoly created by government, and which is legally protected from competition. Such monopolies may be created by public ownership, franchise, tariff, subsidy and so on. Current examples of such monopolies are AT&T, the post office, and most local power companies. Historically most monopolies in general and all harmful monopolies have been of this type. You might be interested to know, for example, that in 1977 the Virginia Electric Power Company (VEPCO) had *the highest after-tax profits of any company its size in the United States.* So much for the argument that government regulation prevents large profits.

I will now consider monopolies achieved by economic concentration, the most commonly cited form of 'harmful free market monopolies'.

The Economics of Monopoly

The economic objections to monopoly boil down to this: A monopoly, it is claimed, is economically undesirable because the monopolist can charge a *monopoly price.* Because a monopolist can control the production of a *complete* product (which no non-monopolist is able to do), the monopolist can exert a peculiar kind of "undue influence" in the market which benefits the monopolist at the expense of the public in general. In particular, it is claimed, a monopolist who was originally charging a "competitive price" for his product can simultaneously decrease production (reducing his costs and labor) and increase price, without decreasing his profits. Thus the monopolist *benefits* since he makes the same amount of money or even more money for less production, at the expense of the public which now must pay more for the same good, and less of the good at that!

The initial argument against "monopoly" per se has now become something quite different: now it is an argument against *monopoly price.* While those who use this theory to justify anti-trust laws seldom point it out, there are several pre-suppositions behind the theory which are not always true.

First, in order to charge a "monopoly price" there must be no close substitutes for a firm's products for if there *are* close substitutes, when the monopolist decreased production and increased price, consumers would start to buy the substitutes and thereby reduce the monopolist's sales to such

an extent that he would lose money. Second, a monopolist, for whatever reason, may choose not to exercise his ability to charge a monopoly price and thus society would not harmed economically by his monopoly. Third, if competitive firms are able as a class to reduce production and charge a monopoly price, by this theory they should be condemned as well for what is now at issue is not *the number of firms in the market*, but their ability to control price.

It is now clear that the argument against monopolies is in one sense invalid: An efficient, innovative monopolist who faces many close substitutes for his products or a monopolist who chooses *not* to exercise his ability to charge a monopoly price, *harms no one* even within the logic of the theory of monopoly price. On the contrary, he benefits all through his efficiency and innovation. His market dominance is greatly to be preferred to a condition of multiple, inefficient competitors who through ignorance, malice or whatever produce too few units of their product at too high a price. But what of the case where companies can and do charge a "monopoly price"?

As the great free market economist Dr. Murray Rothbard has brilliantly demonstrated in his treatise **Man, Economy & State**, it is not simply the application or ethics of the doctrine of "monopoly price" that is wrong, but *the concept itself*. As Rothbard shows, **in practice, in reality, it is impossible to ever determine if such a price exists, thereby making the entire concept of "monopoly price", and the only substantive economic objection to "monopoly" invalid.**

The crucial economic flaw in the doctrine of "monopoly price" is that the concept pre-supposes that there is in the real market such a thing as a given *competitive price* to which a monopoly price can be compared, at least conceptually. To establish what the competitive price is, it is first necessary to know the demand curve for a firm's products. Unlike the world of academic economic theory, in the real world, the demand curve for a firm's products is not precisely known, but only guessed at and approximated. Since a firm's demand curve is never precisely known, there is *in principle* no way to judge prices "monopolistic" or "competitive". Thus the doctrine of monopolyprice proves to be totally meaningless.

The exact same condition of increasing price, decreasing production and stable or increasing profits can and does occur in the market when a firm moves from a sub-competitive to a competitive price. That is, when a firm or an industry finds that the price they charge is so low that they cannot produce their units fast enough, the logical way to proceed is to increase price. This practice has the economically beneficial effect of conserving scarce resources (namely those saved by *not* producing the extra units) to be used for other, more pressing purposes, and it is a practice which no economist understanding the nature of supply and demand condemns. Since in the absence of a clearly established demand curve, this practice is not distinguishable from "charging a monopoly price," it is logically impossible to ever condemn the practice of decreasing production and increasing price.

The Myth of Monopoly Power

Ethically, historically and economically, the fear of free market monopolies reveals itself to be a great delusion. The market monopolist simply exercises the same rights of voluntary association, production and exchange which every free person has. His profits, when and if they occur, are his reward for taking risks and providing excellence.

Historically, increasing centralization of the American economy never occurred for any sustained period of time, despite lack of government intervention in the economy. With increasing affluence and diversity which the free market creates, and increasing demand for services as opposed to products, such centralization is even less likely today and in the future.

Economically the issue of monopoly proves to be illusory, with the sole substantive objection being not to monopoly *per se*, but rather to a "monopoly price". This too proved to be a meaningless concept, impossible to define in the real world.

Attempts to restrict and regulate "monopoly" thus amount to a witch hunt: They are as unjustifiable economically as they are objectionable morally, and in the long-run attacks upon arbitrarily defined market "monopolies" can only harm consumers and producers alike, and decrease everyone's freedom and prosperity.

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