Chapter VIII: Monopolistic Practices

WHAT has been said so far is really sufficient to enable the reader to deal with the large majority of the practical cases he is likely to meet and to realize the inadequacy of most of those criticisms of the profit economy which, directly or indirectly, rely on the absence of perfect competition. Since, however, the bearing of our argument on some of those criticisms may not be obvious at a glance, it will be worth our while to elaborate a little in order to make a few points more explicit.

1. Myth of Monopoly Pricing & Output

1. We have just seen that, both as a fact and as a threat, the impact of new things – new technologies for instance – on the existing structure of an industry considerably reduces the long-run scope, and importance of practices that aim, through restricting output, at conserving established positions and at maximizing the profits accruing to them. We must now recognize the further fact that restrictive practices of this kind, as far as they are effective, acquire a new significance in the perennial gale of creative destruction, a significance which they would not have in a stationary state or in a state of slow and balanced growth. In either of these cases restrictive strategy would produce no result other than an increase in profits at the expense of buyers except that, in the case of balanced advance, it might still prove to be the easiest and most effective way of collecting the means by which to finance additional investment. 1 But in the process of creative destruction, restrictive practices may do much to steady the ship and to alleviate temporary difficulties. This is in fact a very familiar argument which always turns up in times of depression and, as everyone knows, has become very popular with governments and their economic advisers - witness the NRA. While it has been so much misused and so faultily acted upon that most economists heartily despise it, those same advisers who are responsible for this 2 invariably fail to see its much more general rationale.

1. Theorists are apt to look upon anyone who admits this possibility as guilty of gross error, and to prove immediately that financing by borrowing from banks or from private savers or, in the case of public enterprise, financing from the proceeds of an income tax is much more rational than is financing from surplus profits collected through a restrictive policy. For some patterns of behavior they are quite right. For others they are quite wrong. I believe that both capitalism and communism of the Russian type belong in the latter category. But the point is that theoretical considerations, especially theoretical considerations of the short-run kind, cannot solve, although they contribute to the solution of, the problem which we shall meet again in the next part.

Practically any investment entails, as a necessary complement of entrepreneurial action, certain safeguarding activities such as insuring or hedging. Long-range investing under rapidly changing conditions, especially under conditions that change or may change at any moment under the impact of new commodities and technologies, is like shooting at a target that is not only indistinct but moving - and moving jerkily at that. Hence it becomes necessary to resort to such protecting
devices as patents or temporary secrecy of processes or, in some cases, long-period contracts secured in advance. But these protecting devices which most economists accept as normal elements of rational management\(^3\) are only special cases of a larger class comprising many others which most economists condemn although they do not differ fundamentally from the recognized ones.

If for instance a war risk is insurable, nobody objects to a firm’s collecting the cost of this insurance from the buyers of its products. But that risk is no less an element in long-run costs, if there are no facilities for insuring against it, in which case a price strategy aiming at the same end will seem to involve unnecessary restriction and to be productive of excess profits. Similarly, if a patent cannot be secured or would not, if secured, effectively protect, other means may have to be used in order to justify the investment. Among them are a price policy that will make it possible to write off more quickly than would otherwise be rational, or additional investment in order to provide excess capacity to be used only for aggression or defense. Again, if long-period contracts cannot be entered into in advance, other means may have to be devised in order to tie prospective customers to the investing firm.

In analyzing such business strategy \textit{ex \textit{visu}} of a given point of time, the investigating economist or government agent sees price policies that seem to him predatory and restrictions of output that seem to him synonymous with loss of opportunities to produce. He does not see that restrictions of this type are, in the conditions of the perennial gale, incidents, often unavoidable incidents, of a long-run process of expansion which they protect rather than impede. There is no more of paradox in this than there is in saying that motorcars are traveling faster than they otherwise would \textit{because} they are provided with brakes.

2. In particular, it is easy to show that there is no sense, and plenty of harm, in a policy that aims at preserving “price parities.”

3. Some economists, however, consider that even those devices are obstructions to progress which, though perhaps necessary in capitalist society, would be absent in a socialist one. There is some truth in this. But that does not affect the proposition that the protection afforded by patents and so on is, in the conditions of a profit economy, on balance a propelling and not an inhibiting factor.

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2. This stands out most clearly in the case of those sectors of the economy which at any time happen to embody the impact of new things and methods on the existing industrial structure. The best way of getting a vivid and realistic idea of industrial strategy is indeed to visualize the behavior of new concerns or industries that introduce new commodities or processes (such as the aluminum industry) or else reorganize a part or the whole of an industry (such as, for instance, the old Standard Oil Company).

As we have seen, such concerns are aggressors by nature and wield the really effective weapon of competition. Their intrusion can only in the rarest of cases fail to improve total output in quantity or quality, both through the new method itself - even if at no time used to full advantage - and through the pressure it exerts on the preexisting firms. But these aggressors are so circumstanced as to require, for purposes of attack and defense, also pieces of armor other than price and quality of their product which, moreover, must be strategically manipulated all along so that at any point of time they seem to be doing nothing but restricting their output and keeping prices high.

On the one hand, largest-scale plans could in many cases not materialize at all if it were not from the outset that competition will be discouraged by heavy capital requirements or lack of experience, or that means are available to
discourage or checkmate it so as to gain the time and space for further development. Even the conquest of financial control over competing concerns in otherwise unassailable positions or the securing of advantages that run counter to the public’s sense of fair play - railroad rebates - move, as far as long-run effects on total output alone are envisaged, into a different light; they may be methods for removing obstacles that the institution of private property puts in the path of progress. In a socialist society that time and space would be no less necessary. They would have to be secured by order of the central authority.

On the other hand, enterprise would in most cases be impossible if

4. The qualification added removes, I think, any just cause for offense that the above proposition might conceivably cause. In case that qualification is not explicit enough. I beg leave to repeat that the moral aspect is in this case, as it must be in every case, entirely unaffected by an economic argument. For the rest, let the reader reflect that even in dealing with indubitably criminal actions every civilized judge and every civilized jury take account of the ulterior purpose in pursuit of which a crime has occurred and of the difference it makes whether an action that is a crime has or has not also effects they consider socially desirable.

Another objection would be more to the point. If an enterprise can succeed only by such means, does not that prove in itself that it cannot spell social gain? A very simple argument can be framed in support of this view. But it is subject to a severe ceteris paribus proviso. That is to say, it holds for conditions which are just about equivalent to excluding the process of creative destruction - capitalist reality. On reflection, it will be seen that the analogy of the practices under discussion with patents is sufficient to show this.

it were not known from the outset that exceptionally favorable situations are likely to arise which if exploited by price, quality and quantity manipulation will produce profits adequate to tide over exceptionally unfavorable situations provided these are similarly managed. Again this requires strategy that in the short run is often restrictive. In the majority of successful cases this strategy just manages to serve its purpose. In some cases, however, it is so successful as to yield profits far above what is necessary in order to induce the corresponding investment. These cases then provide the baits that lure capital on to untried trails. Their presence explains in part how it is possible for so large a section of the capitalist world to work for nothing: in the midst of the prosperous twenties just about half of the business corporations in the United States were run at a loss, at zero profits, or at profits which, if they had been foreseen, would have been inadequate to call forth the effort and expenditure involved.

Our argument however extends beyond the cases of new concerns, methods and industries. Old concerns and established industries, whether or not directly attacked, still live in the perennial gale. Situations emerge in the process of creative destruction in which many firms may have to perish that nevertheless would be able to live on vigorously and usefully if they could weather a particular storm. Short of such general crises or depressions, sectional situations arise in which the rapid change of data that is characteristic of that process so disorganizes an industry for the time being as to inflict functionless losses and to create avoidable unemployment. Finally, there is certainly no point in trying to conserve obsolescent industries indefinitely; but there is point in trying to avoid their coming down with a crash and in attempting to turn a rout, which may become a center of cumulative depressive effects, into orderly retreat. Correspondingly there is, in the case of industries that have sown their wild oats but are still gaining and not losing ground, such a thing as orderly advance.

5. A good example illustrative of this point - in fact of much of our general argument - is the postwar history of the automobile and the rayon industry. The first illustrates very
well the nature and value of what we might call “edited” competition. The bonanza time was over by about 1916. A host of firms nevertheless crowded into the industry afterwards, most of which were eliminated by 1925. From a fierce life and death struggle three concerns emerged that by now account for over 80 per cent of total sales. They are under competitive pressure inasmuch as, in spite of the advantages of an established position, an elaborate sales and service organization and so on, any failure to keep up and improve the quality of their products or any attempt at monopolistic combination would call in new competitors. Among themselves, the three concerns behave in a way which should be called co respective rather than competitive: they refrain from certain aggressive devices (which, by the way, would also be absent in perfect competition); they keep up with each other and in doing so play for points at the frontiers. This has now gone on for upwards of fifteen years and it is not obvious that if conditions of theoretically perfect competition had prevailed during that period, better [ * or cheaper cars would now be offered to the public, or higher wages and more or steadier employment to the workmen. The rayon industry had its bonanza time in the twenties. It presents the features incident to introducing a commodity into fields fully occupied before and the policies that impose themselves in such conditions still more clearly than does the automobile industry. And there are a number of other differences. But fundamentally the case is similar. The expansion in quantity and quality of rayon output is common knowledge. Yet restrictive policy presided over this expansion at each individual point of time.]

* bracketed section of footnote concludes on page 91

All this is of course nothing but the tritest common sense. But it is being overlooked with a persistence so stubborn as sometimes to raise the question of sincerity. And it follows that, within the process of creative destruction, all the realities of which theorists are in the habit of relegating to books and courses on business cycles, there is another side to industrial self-organization than that which these theorists are contemplating. “Restraints of trade” of the cartel type as well as those which merely consist in tacit understandings about price competition may be effective remedies under conditions of depression. As far as they are, they may in the end produce not only steadier but also greater expansion of total output than could be secured by an entirely uncontrolled onward rush that cannot fail to be studded with catastrophes. Nor can it be argued that these catastrophes occur in any case. We know what has happened in each historical case. We have a very imperfect idea of what might have happened, considering the tremendous pace of the process, if such pegs had been entirely absent.

Even as now extended however, our argument does not cover all cases of restrictive or regulating strategy, many of which no doubt have that injurious effect on the long-run development of output which is uncritically attributed to all of them. And even in the cases our argument does cover, the net effect is a question of the circumstances and of the way in which and the degree to which industry regulates itself in each individual case. It is certainly as conceivable that an all-pervading cartel system might sabotage all progress as it is that it might realize, with smaller social and private costs, all that perfect competition is supposed to realize. This is why our argument does not amount to a case against state regulation. It does show that there is no general case for indiscriminate “trust-busting” or for the prosecution of everything that qualifies as a restraint of trade. Rational as distinguished from vindictive regulation by public authority turns out to be an extremely delicate problem which not every government agency, particularly when in full cry against big business, can be trusted to solve. 6 But our argument, framed to refute a preva-

6. Unfortunately, this statement is almost as effective a bar to agreement on policy as the most thoroughgoing denial of any case for government regulation could be. In fact it may embitter discussion. Politicians, public officers and economists can stand what I may politely term the whole-hog opposition of “economic royalists.” Doubts about their competence, such as crowd upon us particularly when we see the legal mind at work, are much more difficult for them to stand.
lent theory and the inferences drawn therefrom about the relation between modern capitalism and the development of total output, only yields another theory, i.e., another outlook on facts and another principle by which to interpret them. For our purpose that is enough. For the rest, the facts themselves have the floor.

[3. Myth of Rigid Prices] *

3. Next, a few words on the subject of Rigid Prices which has been receiving so much attention of late. It really is but a particular aspect of the problem we have been discussing. We shall define rigidity as follows: a price is rigid if it is less sensitive to changes in the conditions of demand and supply than it would be if perfect competition prevailed. 7

Quantitatively, the extent to which prices are rigid in that sense depends on the material and the method of measurement we select and is hence a doubtful matter. But whatever the material or method, it is certain that prices are not nearly as rigid as they seem to be. There are many reasons why what in effect is a change in price should not show in the statistical picture; in other words, why there should be much spurious rigidity. I shall mention only one class of them which is closely connected with the facts stressed by our analysis.

I have adverted to the importance, for the capitalist process in general and for its competitive mechanism in particular, of the intrusion of new commodities. Now a new commodity may effectively bring down the preexisting structure and satisfy a given want at much lower prices per unit of service (transportation service for instance), and yet not a single recorded price need change in the process; flexibility in the relevant sense may be accompanied by rigidity in a formal sense. There are other cases, not of this type, in which price reduction is the sole motive for bringing out a new brand while the old one is left at the previous quotation - again a price reduction that does not show. Moreover, the great majority of new consumers’ goods - particularly all the gadgets of modern life - are at first introduced in an experimental and unsatisfactory form in which they could never conquer their potential markets. Improvement in the quality of products is hence a practically universal feature of the development of individual concerns and of industries. Whether or not this improvement involves additional costs, a constant price per unit of an improving commodity should not be called rigid without further investigation.

Of course, plenty of cases of genuine price rigidity remain - of

7 This definition suffices for our purposes but would not be satisfactory for others. See D. D. Humphrey’s article in the Journal of Political Economy, October 1937, and E. S. Mason’s article in the Review of Economic Statistics, May 1938. Professor Mason has shown, among other things, that contrary to a widespread belief price rigidity is not increasing or, at all events, that it is no greater than it was forty years ago, a result which in itself suffices to invalidate some of the implications of the current doctrine of rigidity.

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prices which are being kept constant as a matter of business policy or which remain unchanged because it is difficult to change, say, a price set by a cartel after laborious negotiations. In order to appraise the influence of this fact on the long-run development of output, it is first of all necessary to realize that this rigidity is essentially a short-run phenomenon. There are no major instances of long-run rigidity of prices. Whichever manufacturing industry or group of manufactured articles of any importance we choose to investigate over a period of time, we practically always find that in the long run prices do not fail to adapt themselves to technological progress - frequently they fall spectacularly in response to it 8 - unless prevented from doing so by monetary events and policies or, in some cases, by autonomous changes in wage rates which of course should be taken into account by
appropriate corrections exactly as should changes in quality of products. And our previous analysis shows sufficiently why in the process of capitalist evolution this must be so.

What the business strategy in question really aims at - all, in any case, that it can achieve - is to avoid seasonal, random and cyclical fluctuations in prices and to move only in response to the more fundamental changes in the conditions that underlie those fluctuations. Since these more fundamental changes take time in declaring themselves, this involves moving slowly by discrete steps - keeping to a price until new relatively durable contours have emerged into view. In technical language, this strategy aims at moving along a step function that will approximate trends. And that is what genuine and voluntary price rigidity in most cases amounts to. In fact, most economists do admit this, at least by implication. For though some of their arguments about rigidity would hold true only if the phenomenon were a long-run one - for instance most of the arguments averring that price rigidity keeps the fruits of technological progress from consumers - in practice they measure and discuss primarily cyclical rigidity and especially the fact that many prices do not, or do not promptly, fall in recessions and depressions. The real question is there-

8. They do not as a rule fall as they would under conditions of perfect competition. But this is true only \textit{ceteris paribus}, and this proviso robs the proposition of all practical importance. I have adverted to this point before and shall return to it below (§5).

9. From a welfare standpoint, it is proper to adopt a definition different from ours, and to measure price changes in terms of the hours of labor that are currently necessary to earn the dollars which will buy given quantities of manufactured consumers' goods, taking account of changes of quality. We have already done this in the course of a previous argument. A long-run downward flexibility is then revealed that is truly impressive. Changes in price level raise another problem. So far as they reflect monetary influences they should be eliminated for most of the purposes of an investigation into rigidity. But so far as they reflect the combined effect of increasing efficiencies in all lines of production they should not.

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fore how this short-run rigidity may affect the long-run development of total output. Within this question, the only really important issue is this: prices that stay up in recession or depression no doubt influence the business situation in those phases of the cycles; if that influence is strongly injurious — making matters much worse than they would be with perfect flexibility all round — the destruction wrought each time might also affect output in the subsequent recoveries and prosperities and thus permanently reduce the rate of increase in total output below what it would be in the absence of those rigidities. Two arguments have been put forth in favor of this view.

In order to put the first into the strongest possible light, let us assume that an industry which refuses to reduce prices in recession goes on selling exactly the same quantity of product which it would sell if it had reduced them. Buyers are therefore out of pocket by the amount to which the industry profits from the rigidity. If these buyers are the kind of people who spend all they can and if the industry or those to whom its net returns go does not spend the increment it gets but either keeps it idle or repays bank loans, then total expenditure in the economy may be reduced thereby. If this happens, other industries or firms may suffer and if thereupon they restrict in turn, we may get a cumulation of depressive effects. In other words, rigidity may so influence the amount and distribution of national income as to decrease balances or to increase idle balances or, if we adopt a popular misnomer, savings. Such a case is conceivable. But the reader should have little difficulty in satisfying himself that its practical importance, if any, is very small.

The second argument turns on the dislocating effects price rigidity may exert if, in the individual industry itself or elsewhere, it leads to an additional restriction of
output, i.e., to a restriction greater than that which must in any case occur during depression. Since the most important conductor of those effects is the incident increase in unemployment - unstabilization of employment is in fact the indict-

10. It should, however, be observed that this short run may last longer than the term “short run” usually implies - sometimes ten years and even longer. There is not one cycle, but there are many simultaneous ones of varying duration. One of the most important ones lasts on the average about nine years and a half. Structural changes requiring price adjustments do in important cases occur in periods of about that length. The full extent of the spectacular changes reveals itself only in periods much longer than this. To do justice to aluminum, rayon, or motorcar prices one must survey a period of about forty-five years.

11. The best method of doing this is to work out carefully all the assumptions involved, not only in the strong case imagined but also in the weaker cases that are less unlikely to occur in practice. Moreover, it should not be forgotten that the profit due to keeping prices up may be the means of avoiding bankruptcy or at least the necessity of discontinuing operations, both of which might be much more effective in starting a downward “vicious spiral” than is a possible reduction in total expenditure. See the comments on the second argument.

Quite irrespective of this however, the argument is inconclusive because it is again vitiated by a ceteris paribus clause that is inadmissible in dealing with our process of creative destruction. From the fact, so far as it is a fact, that at more flexible prices greater quantities could ceteris paribus be sold, it does not follow that either the output of the commodities in question, or total output and hence employment, would actually be greater. For inasmuch as we may assume that the refusal to lower prices strengthens the position of the industries which adopt that policy either by increasing their revenue or simply by avoiding chaos in their market – that is to say, so far as this policy is something more than a mistake on their part – it may make fortresses out of what otherwise might be centers of devastation. As we have seen before, from a more general standpoint, total output and employment may well keep on a higher level with the restrictions incident to that policy than they would if depression were allowed to play havoc with the price structure. In other words, under the conditions created by capitalist evolution, perfect and universal flexibility of prices might in depression further unstabilize the system, instead of stabilizing it as it no doubt would under the conditions envisaged by general theory. Again this is to a large extent recognized in those cases in which the economist is in sympathy with the interests immediately concerned, for instance in the case of labor and of agriculture; in those cases he admits readily enough that what looks like rigidity may be no more than regulated adaptation.

Perhaps the reader feels some surprise that so little remains of a doctrine of which so much has been made in the last few years. The rigidity of prices has become, with some people, the outstanding defect of the capitalist engine and – almost - the fundamental factor in the explanation of depressions. But there is nothing to wonder at in this. Individuals and groups snatch at anything that will qualify as a discovery lending support to the political tendencies of the hour. The
12. The theorist’s way to put the point is that in depression demand curves might shift downwards much more violently if all pegs were withdrawn from under all prices.


4. Another doctrine has crystallized into a slogan, viz., that in the era of big business the maintenance of the value of existing investment - conservation of capital - becomes the chief aim of entrepreneurial activity and bids fair to put a stop to all cost-reducing improvement. Hence the capitalist order becomes incompatible with progress.

Progress entails, as we have seen, destruction of capital values in the strata with which the new commodity or method of production competes. In perfect competition the old investments must be adapted at a sacrifice or abandoned; but when there is no perfect competition and when each industrial field is controlled by a few big concerns, these can in various ways fight the threatening attack on their capital structure and try to avoid losses on their capital accounts; that is to say, they can and will fight progress itself.

So far as this doctrine merely formulates a particular aspect of restrictive business strategy, there is no need to add anything to the argument already sketched in this chapter. Both as to the limits of that strategy and as to its functions in the process of creative destruction, we should only be repeating what has been said before. This becomes still more obvious if we observe that conserving capital values is the same thing as conserving profits. Modern theory tends in fact to use the concept Present Net Value of Assets (= capital values) in place of the concept of Profits. Both asset values and profits are of course not being simply conserved but maximized.

But the point about the sabotage of cost-reducing improvement still calls for comment in passing. As a little reflection will show, it is sufficient to consider the case of a concern that controls a technological device - some patent, say - the use of which would involve scrapping some or all of its plant and equipment. Will it, in order to conserve its capital values, refrain from using this device when a management not fettered by capitalist interests such as a socialist management could and would use it to the advantage of all?

Again it is tempting to raise the question of fact. The first thing a modern concern does as soon as it feels that it can afford it is to establish a research department every member of which knows that his bread and butter depends on his success in devising improvements. This practice does not obviously suggest aversion to technological progress. Nor can we in reply be referred to the cases in which patents acquired by business concerns have not been used promptly or not used at all. For there may be perfectly good reasons for this; for example, the patented process may turn out to be no good or at least not to be in shape to warrant application on a commercial basis. Neither the inventors themselves nor the investigating economists or government officials are unbiased judges of this, and from their remonstrances or reports we may easily get a very distorted picture. 13

But we are concerned with a question of theory. Everyone agrees that private and socialist managements will introduce improvements if, with the new method of production, the total cost per unit of production, is expected to be smaller than the prime cost per unit of product with the method actually in use. If this condition is not fulfilled, then it is held that private management will not adopt a
cost-reducing method until the existing plant and equipment is entirely written off, whereas socialist management would, to the social advantage, replace the old by any new cost-reducing method as soon as such a method becomes available, i.e., without regard to capital values. This however is not so. 14

Private management, if actuated by the profit motive, cannot be interested in maintaining the values of any given building or machine any more than a socialist management would be. All that private management tries to do is to maximize the present net value of total assets which is equal to the discounted value of expected net returns. This amounts to saying that it will always adopt a new method of production which it believes will yield a larger stream of future income per unit of the corresponding stream of future outlay, both discounted to the present, than does the method actually in use. The value of past investment, whether or not paralleled by a bonded debt that has to be amortized, does not enter at all except in the sense and to the extent that it would also have to enter into the calculation underlying the decisions of a socialist management. So far as the use of the old machines saves future costs as compared with the immediate introduction of the new methods, the remainder of their service value is of course an element of the decision for both the capitalist and the socialist manager; otherwise bygones are bygones for both of them and any attempt to conserve the value of past investment would conflict as much with the rules following from the profit motive as it would conflict with the rules set for the behavior of the socialist

13. Incidentally, it should be noticed that the kind of restrictive practice under discussion, granted that it exists to a significant extent, would not be without compensatory effects on social welfare. In fact, the same critics who talk about sabotage of progress at the same time emphasize the social losses incident to the pace of capitalist progress, particularly the unemployment which that pace entails and which slower advance might mitigate to some extent. Well, is technological progress too quick or too slow for them? They had better make up their minds.

14. It should be observed that even if the argument were correct, it would still be inadequate to support the thesis that capitalism is, under the conditions envisaged, “incompatible with technological progress.” All that it would prove is, for some cases, the presence of a lag of ordinarily moderate length in the introduction of new methods.

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It is however not true that private firms owning equipment the value of which is endangered by a new method which they also control - if they do not control it, there is no problem and no indictment - will adopt the new method only if total unit cost with it is smaller than prime unit cost with the old one, or if the old investment has been completely written off according to the schedule decided on before the new method presented itself. For if the new machines when installed are expected to outlive the rest of the period previously set for the use of the old machines, their discounted remainder value as of that date is another asset to be taken account of. Nor is it true, for analogous reasons, that a socialist management, if acting rationally, would always and immediately adopt any new method which promises to produce at smaller total unit costs or that this would be to the social advantage.

There is however another element 15 which profoundly affects behavior in this matter and which is being invariably overlooked. This is what might be called ex ante conservation of capital in expectation of further improvement. Frequently, if not in most cases, a going concern does not simply face the question whether or not to adopt a definite new method of production that is the best thing out and in the form immediately available, can be expected to retain that position for some length of time. A new type of machine is in general but a link in a chain of improvements and may presently become obsolete. In a case like this it would obviously not be rational to follow the chain link by link regardless of the capital loss to be suffered
each time. The real question then is at which link the concern should take action. The answer must be in the nature of a compromise between considerations that rest largely on guesses. But it will as a rule involve some waiting in order to see how the chain behaves. And to the outsider this may well look like trying to stifle improvement in order to conserve existing capital values. Yet even the most patient of comrades would revolt if a socialist management were so foolish as to follow the advice of the theorist and to keep on scrapping plant and equipment every year.

[5. Myth of Monopoly] *

5. I have entitled this chapter as I did because most of it deals with the facts and problems that common parlance associates with monopoly or monopolistic practice. So far I have as much as possible refrained from using those terms in order to reserve for a separate section some comments on a few topics specifically connected with them. Nothing will be said however that we have not already met in one form or another.

(a) To begin with, there is the term itself. Monopolist means Single

Seller. Literally therefore anyone is a monopolist who sells anything that is not in every respect, wrapping and location and service included, exactly like what other people sell: every grocer, or every haberdasher, or every seller of “Good Humors” on a road that is not simply lined with sellers of the same brand of ice cream. This however is not what we mean when talking about monopolies. We mean only those single sellers whose markets are not open to the intrusion of would-be producers of the same commodity and of actual producers of similar ones or, speaking slightly more technically, only those single sellers who face a given demand schedule that is severely independent of their own action as well as of any reactions to their actions by other sellers. The traditional Cournot-Marshall theory of monopoly as extended and amended by later authors holds only if we define it in this way and there is, so it seems, no point in calling anything a monopoly to which that theory does not apply.

But if accordingly we do define it like this, then it becomes evident immediately that pure cases of long-run monopoly must be of the rarest occurrence and that even tolerable approximations to the requirements of the concept must be still rarer than are cases of perfect competition. The power to exploit at pleasure a given pattern of demand - or one that changes independently of the monopolist’s action and of the reactions it provokes - can under the conditions of intact capitalism hardly persist for a period long enough to matter for the analysis of total output, unless buttressed by public authority, for instance, in the case of fiscal monopolies. A modern business concern not so protected - i.e., even if protected by import duties or import prohibitions - and yet wielding that power (except temporarily) is not easy to find or even to imagine. Even railroads and power and light concerns had first to create the demand for their services and, when they had done so, to defend their market against competition. Outside the field of public utilities, the position of a single seller can in general be conquered - and retained for decades-only on the condition that he does not behave like a monopolist. Short-run monopoly will be touched upon presently.

Why then all this talk about monopoly? The answer is not without interest for the student of the psychology of political discussion. Of course, the concept of monopoly is being loosely used just like any other. People speak of a country’s having a monopoly of something or other 16 even if the industry in question is highly competitive and so

16. These so-called monopolies have of late come to the fore in connection with the
 proposal to withhold certain materials from aggressor nations. The lessons of this discussion have some bearing upon our problem by way of analogy. At first, much was thought of the possibilities of that weapon. Then, on looking more closely at it, people found their lists of such materials to be shrinking, because it became increasingly clear that there are very few things that cannot be either produced or substituted for in the areas in question. And finally a suspicion began [*to dawn to the effect that even though some pressure can be exerted on them in the short run, long-run developments might eventually destroy practically all that was left on the lists.] * bracketed section of footnote concludes on page 100

on. But this is not all. Economists, government agents, journalists and politicians in this country obviously love the word because it has come to be a term of opprobrium which is sure to rouse the public’s hostility against any interest so labeled. In the Anglo-American world monopoly has been cursed and associated with functionless exploitation ever since, in the sixteenth and seventeenth centuries, it was English administrative practice to create monopoly positions in large numbers which, on the one hand, answered fairly well to the theoretical pattern of monopolist behavior and, on the other hand, fully justified the wave of indignation that impressed even the great Elizabeth.

Nothing is so retentive as a nation’s memory. Our time offers other and more important instances of a nation’s reaction to what happened centuries ago. That practice made the English-speaking public so monopoly-conscious that it acquired a habit of attributing to that sinister power practically everything it disliked about business. To the typical liberal bourgeois in particular, monopoly became the father of almost all abuses - in fact, it became his pet bogey. Adam Smith, 17 thinking primarily of monopolies of the Tudor and Stuart type, frowned on them in awful dignity. Sir Robert Peel - who like most conservatives occasionally knew how to borrow from the arsenal of the demagogue - in his famous epilogue to his last period of office that gave so much offense to his associates, spoke of a monopoly of bread or wheat, though English grain production was of course perfectly competitive in spite of protection. 18 And in this country monopoly is being made practically synonymous with any large-scale business.

(b) The theory of simple and discriminating monopoly teaches that, excepting a limiting case, monopoly price is higher and monopoly output smaller than competitive price and competitive output. This is true provided that the method and organization of production - and everything else - are exactly the same in both cases. Actually how-

17. There was more excuse for that uncritical attitude in the case of Adam Smith and the classics in general than there is in the case of their successors because big business in our sense had not then emerged. But even so they went too far. In part this was due to the fact that they had no satisfactory theory of monopoly which induced them not only to apply the term rather promiscuously (Adam Smith and even Senior interpreted for instance the rent of land as a monopoly gain) but also to look upon the monopolists’ power of exploitation as practically unlimited which is of course wrong even for the most extreme cases.

18. This instance illustrates the way in which the term keeps on creeping into illegitimate uses. Protection of agriculture and a monopoly of agrarian products are entirely different things. The struggle was over protection and not over a non-existent cartel of either landowners or farmers. But in fighting protection it was just as well to beat up for applause. And there was evidently no simpler means of doing so than by calling protectionists monopolists.
there are advantages which, though not strictly unattainable on the competitive level of enterprise, are as a matter of fact secured only on the monopoly level, for instance, because monopolization may increase the sphere of influence of the better, and decrease the sphere of influence of the inferior, brains or because the monopoly enjoys a disproportionately higher financial standing. Whenever this is so, then that proposition is no longer true. In other words, this element of the case for competition may fail completely because monopoly process are not necessarily higher or monopoly outputs smaller than competitive prices and outputs would be, at the levels of productive and organizational efficiency that are within the reach of the type of firm compatible with the competitive hypothesis.

There cannot be any reasonable doubt that under the conditions of our epoch such superiority is as a matter of fact the outstanding feature of the typical large-scale unit of control, though mere size is neither necessary nor sufficient for it. The units not only arise in the process of creative destruction and function in a way entirely different from the static schema, but in many cases of decisive importance they provide the necessary form for the achievement. They largely create what they exploit. Hence the usual conclusion about their influence on long-run output would be invalid even if they were genuine monopolies in the technical sense of the term.

Motivation is quite immaterial. Even if the opportunity to set monopolist prices were the sole object, the pressure of the improved methods or of a huge apparatus would in general tend to shift the point of the monopolist’s optimum toward or beyond the competitive cost price in the above sense, thus doing the work - partly, wholly, or more than wholly - of the competitive mechanism, even if

19. The reader should observe that while, as a broad rule, that particular type of superiority is simply indisputable, the inferior brains, especially if their owners are entirely eliminated, are not likely to admit it and that the public’s and the recording economists’ hearts go out to them and not to the others. This may have something to do with a tendency to discount the cost or quality advantages of quasi-monopolist combination that is at present as pronounced as was the exaggeration of them in the typical prospectus or announcement of sponsors of such combinations.

20. The Aluminum Company of America is not a monopoly in the technical sense as defined above, among other reasons because it had to build up its demand schedule, which fact suffices to exclude a behavior conforming to the Cournot-Marshall schema. But most economists call it so and in the dearth of genuine cases we will for the purposes of this note do the same. From 1890 to 1929 the price of the basic product of this single seller fell to about 12 per cent or, correcting for the change in price level (B.L.S. index of wholesale prices), to about 8.8 per cent. Output rose from 30 metric tons to 103,400 . Protection by patent ceased in 1909. Argument from costs and profits in criticism of this “monopoly” must [* take it for granted that a multitude of competing firms would have been about equally successful in cost-reducing research, in the economic development of the productive apparatus, in teaching new uses for the product and in avoiding wasteful breakdown. This is, in fact, being assumed by criticism of this kind; i.e., the propelling factor of modern capitalism is being assumed away.] * bracketed section of footnote concludes on page 102

restrictive is practiced and excess capacity is in evidence all along. Of course if the methods of production, organization and so on are not improved by or in connection with monopolization as is the case with an ordinary cartel, the classical theorem about monopoly price and output comes into its own again. So does another popular idea, viz., that monopolization has a soporific effect. For this, too, it is not difficult to find examples. But no general theory should be built upon it. For, especially in manufacturing industry, a monopoly position is in general no cushion to sleep on. As it can be gained, so it can be retained only by alertness and energy. What soporific influence there is in modern business is due to another cause that will be mentioned later.
In the short run, genuine monopoly positions or positions approximating monopoly are much more frequent. The grocer in a village on the Ohio may be a true monopolist for hours or even days during an inundation. Every successful corner may spell monopoly for the moment. A firm specializing in paper labels for beer bottles may be so circumstanced - potential competitors realizing that what seem to be good profits would be immediately destroyed by their entering the field - that it can move at pleasure on a moderate but still finite stretch of the demand curve, at least until the metal label smashes that demand curve to pieces.

New methods of production or new commodities, especially the latter, do not per se confer monopoly, even if used or produced by a single firm. The product of the new method has to compete with the products of the old ones and the new commodity has to be introduced, i.e. its demand schedule has to be built up. As a rule neither patents nor monopolistic practices avail against that. But they may in cases of spectacular superiority of the new device, particularly if it can be leased like shoe machinery; or in cases of new commodities, the permanent demand schedule for which has been established before the patent has expired.

Thus it is true that there is or may be an element of genuine monopoly gain in those entrepreneurial profits which are the prizes offered by capitalist society to the successful innovator. But the quantitative importance of that element, its volatile nature and its function in the process in which it emerges put it in a class by itself.

The main value to a concern of a single seller position that is secured by patent or monopolistic strategy does not consist so much in the opportunity to behave temporarily according to the monopolist schema, as in the protection it affords against temporary disorganization of the market and the space it secures for long-range planning. Here however the argument merges into the analysis submitted before.

21. See however supra § 1.

[6. Myth of Perfect Competition] *

6. Glancing back we realize that most of the facts and arguments touched upon in this chapter tend to dim the halo that once surrounded perfect competition as much as they suggest a more favorable view of its alternative. I will now briefly restate our argument from this angle.

Traditional theory itself, even within its chosen precincts of a stationary or steadily growing economy, has since the time of Marshall and Edgeworth been discovering an increasing number of exceptions to the old propositions about perfect competition and, incidentally, free trade, that have shaken that unqualified belief in its virtues cherished by the generation which flourished between Ricardo and Marshall – roughly, J. S. Mill’s generation in England and Francesco Ferrara’s on the Continent. Especially the propositions that a perfectly competitive system is ideally economical of resources and allocates them in a way that is optimal with respect to a given distribution of income – propositions very relevant to the question of the behavior of output – cannot be held with the old confidence.

Much more serious is the breach made by more recent work in the field of dynamic theory (Frisch, Tinbergen, Roos, Hicks and others). Dynamic analysis is the analysis of sequences in time. In explaining why a certain economic quantity, for instance a price, is what we find it to be at a given moment, it takes into consideration not only the state of other economic quantities at the same moment, as static theory does, but also their state at preceding points of time, and the expectations about their future values. Now the first thing we discover in working out the propositions that thus relate quantities belonging to different points of time is the fact that, once equilibrium has been destroyed by some disturbance, the
process of establishing a new one is not so sure and prompt and economical as the old theory of perfect competition made it out to be; and the possibility that the very struggle for adjustment might lead such a system farther away from instead of nearer to a new equilibrium. This will happen in most cases unless the disturbance is small. In many cases, lagged adjustment is sufficient to produce this result.

All I can do here is to illustrate by the oldest, simplest and most familiar example. Suppose that demand and intended supply are in equilibrium in a perfectly competitive market for wheat, but that bad weather reduces the crop below what farmers intended to supply. If price rises accordingly and the farmers thereupon produce that quantity of wheat which it would pay them to produce if that new price were the equilibrium price, then a slump in the wheat market will ensue in the following year. If now the farmers correspondingly restrict production, a price still higher than in the first year may result to induce a still greater expansion of production than occurred in the second year. And so on (as far as the pure logic of the process is concerned) indefinitely. The reader will readily perceive, from a survey of the assumptions involved, that no great fear need be entertained of ever higher prices’ and ever greater outputs’ alternating till doomsday. But even if reduced to its proper proportions, the phenomenon suffices to show up glaring weaknesses in the mechanism of perfect competition. As soon as this is realized much of the optimism that used to grace the practical implications of the theory of this mechanism passes out through the ivory gate.

But from our standpoint we must go further than that. If we try to visualize how perfect competition works or would work in the process of creative destruction, we arrive at a still more discouraging result. This will not surprise us, considering that all the essential facts of that process are absent from the general schema of economic life that yields the traditional propositions about perfect competition. At the risk of repetition I will illustrate the point once more.

Perfect competition implies free entry into every industry. It is quite true, within that general theory, that free entry into all industries is a condition for optimal allocation of resources and hence for maximizing output. If our economic world consisted of a number of established industries producing familiar commodities by established and substantially invariant methods and if nothing happened except that additional men and additional savings combine in order to set up new firms of the existing type, then impediments to their entry into any industry they wish to enter would spell loss to the community. But perfectly free entry into a new field may make it impos-

24. It should be observed that the defining feature of dynamic theory has nothing to do with the nature of the economic reality to which it is applied. It is a general method of analysis rather than a study of a particular process. We can use it in order to analyze a stationary economy, just as an evolving one can be analyzed by means of the methods of statics (“comparative statics”). Hence dynamic theory need not take, and as a matter of fact has not taken, any special cognizance of the process of creative destruction which we have taken to be the essence of capitalism. It is no doubt better equipped than is static theory to deal with many questions of mechanism that arise in the analysis of that process. But it is not an analysis of that process itself, and it treats the resulting individual disturbances of given states and structures just as it treats other disturbances. To judge the functioning of perfect competition from the standpoint of capitalist evolution is therefore not the same thing as judging it from the standpoint of dynamic theory.
possible to enter at all. The introduction of new methods of production and new commodities is hardly conceivable with perfect – and perfectly prompt – competition from the start. And this means that the bulk of what we call economic progress is incompatible with it. As a matter of fact, perfect competition is and always has been temporarily suspended whenever anything new is being introduced – automatically or by measures devised for the purpose – even in otherwise perfectly competitive conditions.

Similarly, within the traditional system the usual indictment of rigid prices stands all right. Rigidity is a type of resistance to adaptation that perfect and prompt competition excludes. And for the kind of adaptation and for those conditions which have been treated by traditional theory, it is again quite true that such resistance spells loss and reduced output. But we have seen that in the spurts and vicissitudes of the process of creative destruction the opposite may be true: perfect and instantaneous flexibility may even produce functionless catastrophes. This of course can also be established by the general dynamic theory which, as mentioned above, shows that there are attempts at adaptation that intensify disequilibrium.

Again, under its own assumptions, traditional theory is correct in holding that profits above what is necessary in each individual case to call forth the equilibrium amount of means of production, entrepreneurial ability included, both indicate and in themselves imply net social loss and that business strategy that aims at keeping them alive is inimical to the growth of total output. Perfect competition would prevent or immediately eliminate such surplus profits and leave no room for that strategy. But since in the process of capitalist evolution these profits acquire new organic functions – I do not want to repeat what they are – that fact cannot any longer be unconditionally credited to the account of the perfectly competitive model, so far as the secular rate of increase in total output is concerned.

Finally, it can indeed be shown that, under the same assumptions which amount to excluding the most characteristic features of capitalist reality, a perfectly competitive economy is comparatively free from waste and in particular from those kinds of waste which we most readily associate with its counterpart. But this does not tell us anything about how its account looks under the conditions set by the process of creative destruction.

On the one hand, much of what without reference to those conditions would appear to be unrelieved waste ceases to qualify as such when duly related to them. The type of excess capacity for example that owes its existence to the practice of “building ahead of demand” or to the practice of providing capacity for the cyclical peaks of demand would in a regime of perfect competition be much reduced. But when all the facts of the case are taken into consideration, it is no longer correct to say that perfect competition wins out on that score. For though a concern that has to accept and cannot set prices would, in fact, use all of its capacity that can produce at marginal costs covered by the ruling prices, it does not follow that it would ever have the quantity and quality of capacity that big business has created and was able to create precisely because it is in a position to use it “strategically.” Excess capacity of this type may – it does in some and does not in other cases – constitute a reason for claiming superiority for a socialist economy. But it should not without qualification be listed as a claim to superiority of the perfectly competitive species of capitalist economy as compared with the “monopoloid” species.

On the other hand, working in the conditions of capitalist evolution, the perfectly competitive arrangement displays wastes of its own. The firm of this type that is compatible with perfect competition is in many cases inferior in internal,
especially technological efficiency. If it is then it wastes opportunities. It may also in its endeavors to improve its methods of production waste capital because it is in a less favorable position to evolve and to judge new possibilities. And, as we have seen before, a perfectly competitive industry is much more apt to be routed – and to scatter the bacilli of depression – under the impact of progress or of external disturbance than is bog business. In the last resort, American agriculture, English coal mining, the English textile industry are costing consumers much more and are affecting total output much more injuriously than they would if controlled, each of them, by a dozen good brains.

[7. Conclusion] *

Thus it is not sufficient to argue that because perfect competition is impossible under modern industrial conditions - or because it always has been impossible - the large-scale establishment or unit of control must be accepted as a necessary evil inseparable from the economic progress which it is prevented from sabotaging by the forces inherent in its productive apparatus. What we have got to accept is that it has come to be the most powerful engine of that progress and in particular of the long-run expansion of total output not only in spite of, but to a considerable extent through, the strategy which looks so restrictive when viewed in the individual case and from the individual point of time. In this respect, perfect competition is not only impossible but inferior and has no title to being set up as a model of ideal efficiency. It is hence a mistake to base the theory of government regulation of industry on the principle that big business should be made to work as the respective industry would work in perfect competition. And socialists should rely for their criticisms on the virtues of a socialist economy rather than on those of the competitive model.
Capitalism, Socialism, and Democracy. A Symposium. by William Barrett. Earlier this year, the editors of COMMENTARY addressed the following statement and questions to a group of intellectuals of varying political views: The idea that there may be an inescapable connection between capitalism and democracy has recently begun to seem plausible to a number of intellectuals who would once have regarded such a view not only as wrong but even as politically dangerous.\[4pt\] The association by anti-socialists of capitalism and democracy perhaps dates from Friedrich von Hayek’s The Road to Serfdom, a virtual contemporary of Schumpeter’s work. The argument has been given in one version by Milton Friedman in Capitalism and Freedom. Capitalism, Socialism, and Democracy. is above all an exercise in prediction. Born in the English Industrial Revolution and thrust into prominence by its successes in France, Germany, and the United States, capitalism had existed for more than a century when Schumpeter began to assemble the material for his book. Socialism had a much shorter history. A constant theme in workers’ movements, socialism first became tangible through the establishment of the Soviet economic system scarcely twenty-five years before Schumpeter wrote.\[4pt\] Capitalism, Socialism and Democracy. is single-mindedly focused on one question: under what conditions can creative and effective leadership emerge in political and economic systems?