

Government regulation of competitive firms creates monopolies

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Monopolies are believed to undermine individuals' well-being, including being the cause of large increases in the prices of goods and services. According to Jean Tirole, the 2014 Nobel winner in economics, monopolies undermine the efficient functioning of the market economy by influencing the prices and the quantity of products, making consumers worse off.

Thus, monopolies supposedly cause market conditions to deviate from the ideal state of "perfect competition." Effective enforcement of government regulations, then, is needed to control monopolies. Tirole has devised methods to strengthen the regulation of industries dominated by a few large firms.

The 'perfect competition' model

In the world of perfect competition, the following features characterize a market:

- There are many buyers and sellers in the market.
- Homogeneous products are traded.
- Buyers and sellers are perfectly informed.
- There are no obstacles or barriers to enter the market.

In the world of perfect competition, buyers and sellers have no control over the price of the product. They are price takers. The assumption of perfect information and thus absolute certainty implies that there is no room left for entrepreneurial activity. For in the world of certainty there are no risks and therefore no need for entrepreneurs. If this is so, who then introduces new products and how?

According to the proponents of the perfect competition model, any real situation in a market that deviates from this model is regarded as suboptimal to consumers' well-being. It is recommended that the government intervene whenever such deviation occurs.

Contrary to this way of thinking, we suggest that competition emerges not because of a large number of participants as such but because of a large variety of products.

Competition in products, not firms

The greater the variety, the greater the competition is going to be and therefore more benefits for the consumers. Once an entrepreneur introduces a product, he acquires 100% of the newly established market.

A product that makes a profit attracts competition. The producers of older products must come with new ideas and new products to catch the attention of consumers. The popular view that a producer that dominates the market could exploit his position by raising the price above the truly competitive level is erroneous. The goal of every business is to make profits, but producers must offer consumers a suitable price and, if possible, secure a price where the quantity that is produced can be sold at a profit.

According to [Henry Hazlitt](#), "In a free economy, in which wages, costs, and prices are left to the free play of the competitive market, the prospect of profits decides what articles will be made, and in what quantities—and what articles will not be made at all. If there is no profit in making an article, it is a sign that the labor and capital devoted to its production are misdirected: the value of the resources that must be used up in making the article is greater than the value of the article itself."

To set a suitable price, the producer-entrepreneur must consider how much money consumers are likely to spend on the product. He also has to consider the prices of competitive products and his production costs.

Any attempt by the alleged dominant producer to disregard these facts will cause him to suffer losses. Furthermore, how can one establish whether the price of a product charged by a dominant producer is above the so-called competitive price level? How could one establish what the competitive price is supposed to be?

[Murray Rothbard](#) wrote, "In the market, there is no discernible, identifiable competitive price, and therefore there is no way of distinguishing, even conceptually, any given price as a 'monopoly price.' The alleged 'competitive price' can be identified neither by the producer himself nor by the disinterested observer."

Furthermore, "There is no way to define 'monopoly price' because there is also no way of defining the 'competitive price' to which the former must refer."

Also, "On the free market there is no way of distinguishing a 'monopoly price' from a 'competitive price' or a 'sub competitive price' or of establishing any changes as movements from one to the other. No criteria can

be found for making such distinctions. The concept of monopoly price as distinguished from competitive price is therefore untenable.”

Definition of monopoly

Rothbard wrote, “Let us turn to its classic expression by the great seventeenth-century jurist, Lord Coke: A monopoly is an institution or allowance by the king, by his grant, commission, or otherwise ... to any person or persons, bodies politic or corporate, for the sole buying, selling, making, working, or using of anything, whereby any person or persons, are sought to be restrained of any freedom or liberty that they had before, or hindered in their lawful trade ...

“In other words, by this definition, monopoly is a grant of special privilege by the State, reserving a certain area of production to one particular individual or group. Entry into the field is prohibited to others and this prohibition is enforced by the gendarmes of the State.”

He concluded, “Hence, monopoly can never arise on a free market, unhampered by State interference. In the free economy, then, according to this definition, there can be no ‘monopoly problem.’”

It is obvious, then, that monopoly can never arise on a free market. If government officials attempt to enforce a lower price this price could wipe out the incentive to produce the product. So rather than improving consumers’ well-being, government policies will only make things much worse.

Again, in contrast to the perfect competition model, what gives rise to a greater competitive environment is not a large number of participants in a particular market but rather a variety of competitive products. Government policies, in the spirit of the perfect competition model, are destroying product differentiation and thus destroying competition.

Erroneous idea of homogeneous products

The idea that suppliers should offer a homogeneous product is not tenable. Since product differentiation is what the free market sets in motion, it means that every supplier of a product has 100% control as far as his product is concerned, making him a monopolist. What gives rise to a product differentiation is that every entrepreneur has different ideas and talents. This difference is manifested in the way the product is made, the way it is packaged, the place in which it is sold, and the way it is offered to the client.

For instance, a hamburger that is sold in a beautiful restaurant is a different product from a hamburger sold in a takeaway shop. So, if the owner of a restaurant gains dominance in the sales of hamburgers, should he then be restrained for this?

Should he then alter his mode of operation and convert his restaurant to a takeaway shop in order to comply with the perfect competition model? All that has happened here is that consumers have expressed a greater preference to dine in the restaurant rather than buying from the takeaway shop. What is wrong with this?

If consumers were to abandon takeaway shops and buy hamburgers only from the restaurant, does this mean that the government must step in and intervene? The whole issue of a harmful monopoly has no relevancy in the free-market environment.

A harmful monopolist is likely to emerge when the government, by means of licenses, restricts the variety of products in a market. (The government bureaucrats decide what products should be supplied in the market.) By imposing restrictions and thus limiting the variety of goods and services offered to consumers, government curtails consumers' choices, thereby undermining their well-being.

Conclusion

The idea that government can regulate monopolies to promote competition is a fallacy. If anything, such intervention only stifles market competition and lowers living standards. Furthermore, what matters for individuals' well-being is not the number of firms but the variety of goods and services. Harmful monopolies cannot emerge in a free market. Instead, we can expect monopolies to emerge when governments heavily regulate an industry and become involved in production and licensing firms and individual occupations.



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