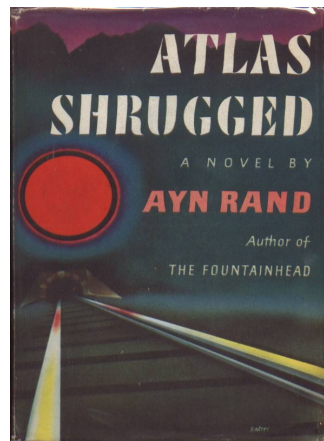


Monopoly, competition, and competitors

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Dear Professor Salin,

First of all, let me thank you for giving our association the opportunity of interviewing you for such a long time, in such friendly and relaxed circumstances. It was a pleasure and an experience (both intellectual and human) that those of us who were there will hardly forget.

Because Catallaxy Institute is intended also as an instrument to foster discussion on liberal principles and as a place where to exchange ideas, I am taking the liberty to comment briefly one of the passages of your interview, namely the one concerning the so-called “natural monopoly”.

In that passage you appear to suggest a similarity between two cases of monopoly, in particular the case of the only possible railway between two cities, and the case of Microsoft. In my opinion, these two examples are structurally different, and therefore I am not entirely sure that the conclusions that

can be reached for one of them (Microsoft) are necessarily valid also for the other (the only possible railway between two cities).

In the case of Microsoft (here, for simplicity, assumed to have no competitors), monopoly is the product of the combined use of the company's knowledge, resources and capabilities (also in managing risk), and so is the case for the company owning the only possible railway between the two cities, provided that it was the first one to successfully invest in it.

However, on the one hand, when Microsoft created Windows it knew that it was investing in a market that would be always open to competition: that is in a market where, in case someone had a better and/or cheaper and/or better marketed product to offer, it could always try to force Microsoft out of the market. The continuous upgrades of Microsoft software are also one concrete expression of this *constant* openness.

On the other hand, however, when the hypothetical private investor invested in building the *only possible* railway between two cities, he knew that he was investing in a sector which, *after his entrance*, would be highly protected by entry barriers, for there is only one possible railway between those two cities and he would own it. If, after a few years, another company could operate better and cheaper trains, it could find it impossible to try to do it for it would not have access to the only possible railway connecting those two cities and belonging to the monopolistic company (which, being able to impose monopolistic prices, would not be likely to sell it).

In other words, while in the first case there would always be competition, even if there were no competitors, in the second case, after the creation of the railway, there could hardly be any competition. While in the first case prices would *always* tend to express the peripheral knowledge and capabilities (or lack of them) of all those who participate in the market (effective or potential buyers and sellers), in the second case prices would tend to express this knowledge only in the moment of the creation of the railway: after that moment, they would express much less this peripheral knowledge and capabilities, and much more the strength of the entry barriers protecting the economic position of the only possible supplier.

Now, the point that I want to make is not that the case of the railway necessarily requires state intervention, but that this case is structurally different from the case of Microsoft or, to use an even more extreme example, from the case of the pharmaceutical company that invents the vaccine for HIV and which is *constantly* exposed to the possibility of the invention of a cheaper and/or better (e.g. with less negative side effects) product by a competitor, and therefore that the conclusions that are unequivocally valid for one are not necessarily so for the other.

While in the case of Microsoft (or of the pharmaceutical company) considerations of principle univocally point in the same direction, in the case of the only possible railway between two cities it is possible that there are no alternatives compatible with *all* the fundamental principles of classical

liberalism. Nationalization or regulation would violate, as you explained, the property rights of the creator of the railway; private monopoly, on the other hand, may violate for example the principle according to which individuals should always be free to use their own knowledge and capabilities for their own purposes (e.g., the better competitor should not be prevented from trying to compete – which does not mean that he should have a right to a portion of the market). In this case, which of the three possible solutions (private monopoly, regulation or nationalization) would produce less harm, would depend on the particular characteristics of each case.

In other words, in the case of the only possible railway between two cities, harm would not be avoidable. On the moral ground, policy choices would be much more complicated for they would have to (arbitrarily?) balance and weight opposing principles. On the ground of expediency, policy choices would have to try and reduce harm as much as possible. As a consequence, I am inclined to believe that in these extraordinary situations it would be hardly possible to draw general, *a priori* conclusions, and this could be in my opinion one of the main differences between this case of monopoly and a case such as Microsoft.

Fortunately, cases of monopoly such as the one of the only possible railway between two cities tend to be extremely rare; and if we take away from them those for which, because of their particular circumstances, private monopoly is believed to be the less-worse solution, those that require government intervention are even fewer.

In conclusion, I strongly agree with you that alleged monopolies such as that of Microsoft which, even in absence of competitors, are constantly open to competition, should not be the object of any form of government intervention: in fact, in this case, not only the latter would be against the long-term economic interests of society (e.g. by discouraging innovation and, paradoxical as it may appear, competition) but it would also violate some of the fundamental principles of liberalism, such as the property rights of the creator of the business, as you explained.

However, I am inclined to believe that monopolies such as the one of the only possible railway between two cities, that is monopolies where, after their creation, competition is by definition impossible or in any case extremely limited, however we want to call them, are more complicated to assess.

Perhaps our views may diverge either on the assumption that, if between two cities there is only one possible railway, and a monopolist can impose monopolistic prices on it, the entry barriers are exceedingly strong, or alternatively on the fact that you appear to consider the freedom to enter the market to be relevant only in the moment of the creation of the monopoly, while I tend to consider it to be always relevant.

In *Libéralisme* (2000, Odile Jacob) you claim that the basic question is that the action can either be free or coerced by public powers (p. 173) and that only the second kind of action generates a

monopoly: “monopoly has necessarily a public origin” (p. 175). I agree that monopolies which are the result of free action, being open to competition, are not in fact monopolies; and I also agree that monopolies generated by public coercion are indeed monopolies. However, I believe that the case of the only possible railway between two cities configures a case in between, where action is constrained, not by the state, but by “natural” factors, and where a monopoly can exist which does not necessarily have a public origin. How to deal with these (presumed) in-between cases, is a different, and I fear very complex, question.