Answer to Mr. Birindelli: "Monopoly, Competition and Competitors"

Professor Pascal Salin

10 November 2009

> *"Competition means that there is free entry into a market, but it does not imply that it is actually possible to enter it"*

Mr Birindelli took the time to debate about one of my statements concerning competition and he is proposing some stimulating ideas to which I am eager to answer. He stresses that there are important differences between two monopoly situations which I had considered in the interview, namely the case of a successful firm like Microsoft and the case of a "natural monopoly" such as the case in which there is only one possible railway between two cities. He explains that, in the first case, competition would always exist since one may enter into the market for software programs at any time, whereas the "hypothetical private investor who invested in building the only possible railway between two cities 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 these two cities and he would own it.". This difference seems to be striking, but I am personally not convinced that there is a substantial difference between both. This is an important point, since one might say that if ever one accepts my definition of competition as a situation in which there is free entry, competition does not prevail in the second case, the case of the railway (and in many other cases of "natural monopolies"). From that, one may infer that interventions by the state or by the Courts are justified in order to avoid that the "natural monopolist" may use his monopoly power to exploit others.

To better assess the problem, let us take another example. Just assume that Mr A owns a piece a land on the top of a hill and the better use of it he has found is to let sheeps graze on it. Now, Mr B comes to him and offers a price for this piece of land which implies a better use of resources for Mr A who accepts the deal. Mr B builds a restaurant on this land with a beautiful view over the valley. His restaurant becomes most famous and brings him a lot of money. As in the case of the railway, one might say that competition is no more possible, since there is a barrier to entry into the market for restaurants at this precise location. And one might even say that it is unfair that other people do not have the right to build a restaurant on the top of this hill and to compete with the existing restaurant. In fact, it is obvious that there is no lack of competition and there is no "natural monopoly". There is only the fair implementation of a specific property right. As is well known, defining a property right is defining a right to exclude (others from the use of the owned good). Saying that other people have the right to build or to manage a restaurant at the very place of Mr B's restaurant would mean that these people have a right on the property of Mr B, which is not acceptable. Now, it may happen that Mr C invents a new use of this place - for instance building a TV station or an antenna tower for telecommunications - and he may offer a high price to Mr B who may accept the offer. Thus, there is no general freedom to enter into the property of Mr B - which is fair - but there is a freedom to buy and to sell this property. We are inclined to believe that this liberty means that, little by little, people find the most rewarding use of the piece of land (and, from this point of view, there is also a long run freedom to enter into the market for this piece of land). The problem is a problem of property rights and not a problem of competition (more or less precisely defined).

The case of the railway is not different. But we do not see it at once because we assume implicitly that, in this specific field, private property rights are not well defined. More precisely, in our time, the owner and creator of a railway company is benefiting from some authorization (or, rather, privilege) which may imply that the state expropriates legitimate owners in the name of the "public interest". It can be considered that it is unfair that newcomers cannot benefit from the same privilege. But the lack of competition does not come from the specific nature of a railway, but from the existence of an arbitrary privilege which is obtained by using constraint to destroy certain property rights and to create a new one. A privilege is unfair and those who do not enjoy this privilege are right to complain. But let us imagine now that the state does not intervene at all in the implementation of the railway. The creator of the railway has to buy all the pieces of land on which the railway will be built in a series of voluntary contracts (without any state constraint). In a way exactly similar to the case of Mr B, it would not be acceptable that other people come later and claim that they have a right on these pieces of land and that they have the right to build a railway on them. In other words, when the creator of the railway was buying all the pieces of land he needed, other people also had the right to offer a price for these pieces of land. But they did not do it ,or they offered too low a price. There is, therefore, no justification for their future claims about an hypothetical freedom to entry into the pieces of land and to take over the activity of the innovator who had first decided to take the risks of building a railway. As for the restaurant, there are property rights and property rights are rights to exclude. But the existence of rights to exclude does not mean that there is no competition. Competition is suppressed not by the fact that there cannot exist several different uses of a piece of land at the same time, but by the fact a privilege is granted to one person, while other ones are excluded. Thus, competition could be defined as a situation in which there is freedom to act but only within the limits resulting from others' property rights. From this point of view, the remarks made by Mr Birindelli are important, because they show that it is necessary to supplement the definition of competition which had been proposed.

However, for this same reason, I do not agree with his statement according to which, in a case such as the railway one, "there are no alternatives compatible with all the fundamental principles of classical liberalism... private monopoly 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". In fact, one ought to say that " individuals should always be free to use their own knowledge and capabilities for their own purposes, as far as they are respectful of others legitimate property rights". Mr Birindelli also says that, in such cases, "harm would not be avoidable". But, by using his property rights, the owner of the railway is not harming others, since they have no right on the railway and the pieces of land on which it is built. There are external effects – as in any human action – but they cannot be labelled as harmful as far as legitimate property rights have been defined.

This means that the fundamental principles of classical liberalism are concerned only with legitimate property rights. From this point of view we may not care about defining something called competition or something called (natural) monopoly. The only relevant problem is knowing whether people act freely or are compelled to obey discretionary constraints.

Mr Birindelli says that a situation like the one of the railway "tends to be extremely rare". In fact, it may not be, since, for instance, any location is unique, but this does not mean that there are monopolies each time someone owns a unique location. Therefore, it cannot be said that the owner of a unique location – the restaurant on the hill or the railway between two cities – may impose monopolistic prices; and, obviously, it cannot be said that the state has to intervene in order to prevent these so-called "monopolists" from imposing prices higher than competitive ones and from extracting a super-profit from their customers. The prices they are charging are competitive prices !

This also means that the definition of a market is necessarily arbitrary (so that the very notion of market shares – which is so often used by competition Courts - is meaningless). Should we, for instance, define a market such as "the market for locations of restaurants on tops of hills", or the "market for the restaurant located on the top of the hill owned by Mr B" ? There is freedom to enter – and, therefore, competition – on the first market, insofar as there are pieces of land available for a potential buyer, without any state intervention. There is potential but not actual competition on the second market. Competition means that there is free entry into a market, but it does not imply that it is actually possible to enter it.