ECON 272: Economic History of North America to 1913

Antitrust and Monopoly in the Gilded Age

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Outline

1. The backdrop
2. The rise of big industry
   - The SCP model
   - Monopoly is a hard thing to achieve
   - Market Shares Tell Us Little
   - Barriers to Entry and Contestability
3. Antitrust and Rent-seeking

The gilded age

- There is a backdrop that is crucially relevant here: the gilded age.
- The term is quite smart. It plays on the idea of a "golden age" but the use of the term gilded suggests that sheeted gold was placed on a baser metal to hide a deeper truth.

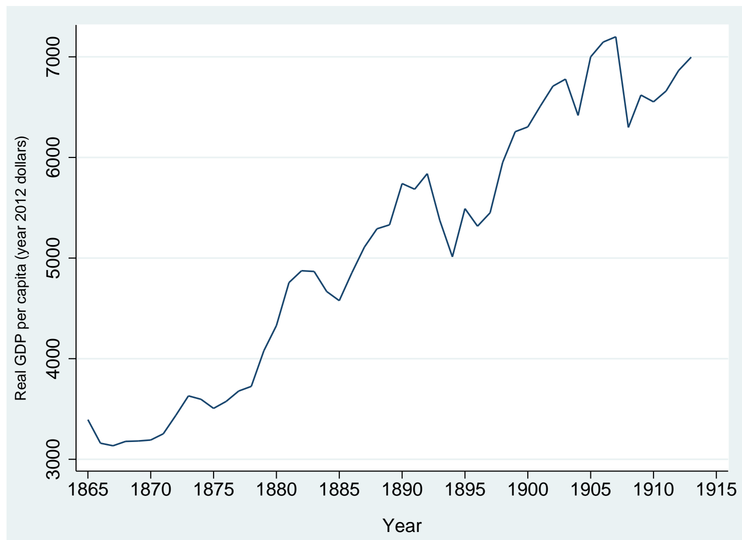
A caricature

The gilded age

- It is however just a caricature.
- There was rising inequality, but also clear signs of improving living standards for those at the bottom.
- There were in fact signs of *rising* equality on certain dimensions (such as cost of living).
- The image is now invoked to reflect high inequality and it is tied very intimately to "robber barons" or "captains of industry" who got wealthy at the expense of consumers and workers.
- Thus, we tend to exagerate the rise in inequality.
- Some of the rising inequality was actually a *good* sign (Kuznets, 1955; Williamson, 1991; Lindert and Williamson, 2016).

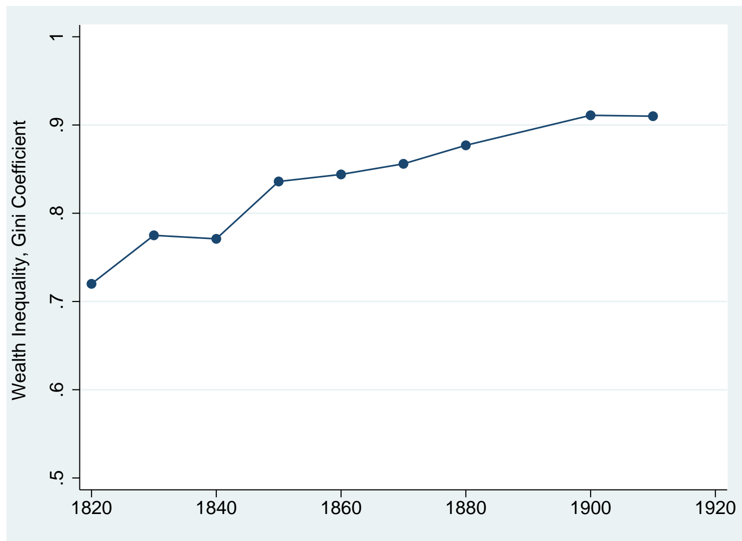
Rising GDP per capita

Figure: GDP per capita in the United States, 1865 to 1913



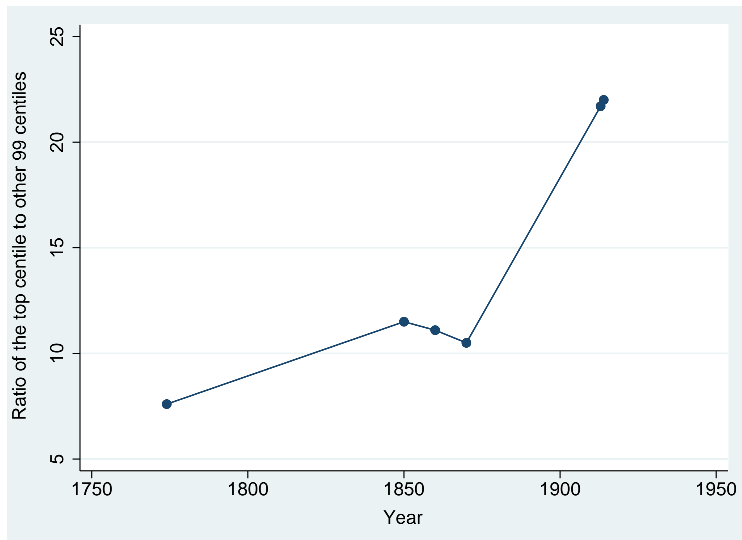
Rising wealth inequality

Figure: Wealth inequality in Massachussetts (Steckel and Moehling, 2001).



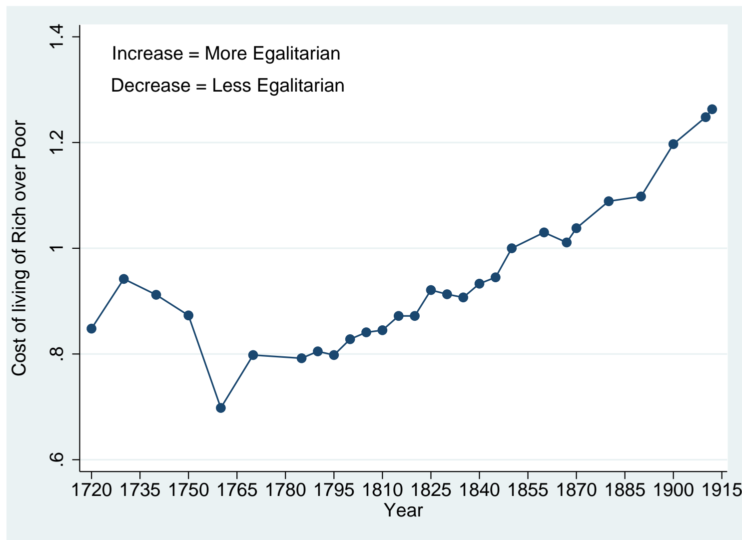
Income Inequality

Figure: Income inequality in the United States (Lindert and Williamson, 2016).



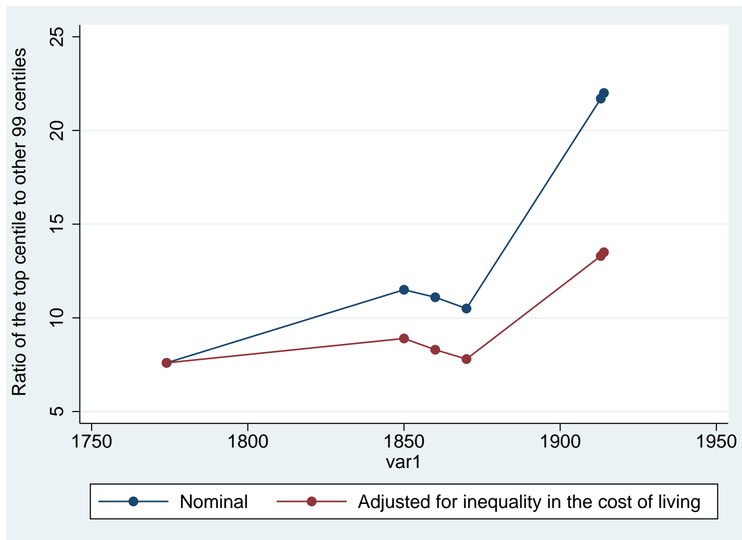
Cost of Living Inequality

Figure: Cost of living inequality in the United States (Geloso and Lindert, 2019).



Cost of Living Inequality

Figure: Adjusted Income Inequality (Geloso and Lindert, 2019).



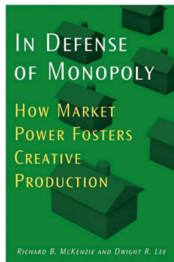
The gilded age

- Yet, we ought not dismiss the backdrop. It is tied intimately to the narrative on antitrust and competition.
- The rise of large scale industry was perceived as being the cause of inequality. The connection between the "trusts" (or what FDR would later call the "economic royalists") and inequality was clear in most political discourse (albeit in different terms that today).
- For good reason - imagine your intro-micro graph of a monopoly firm. Draw the extra profits it makes relative to competitive equilibrium. That is a transfer from consumer to producers. In terms of well-being, it would increase inequality! Although this may seem a simplistic way to summarize the issue, but it is along those crudely summarized lines that the gilded age connects inequality and monopoly.

The SCP model

- The performance of a market (e.g. price, quantity outcomes) will depend on the conduct of frms (e.g. advertising, pricing behavior, bundling goods, output restriction, collusive agreements), which depends upon the structure of the market (i.e. number of firms, oligopolistic, monopolistic)
- Structure $\hookrightarrow$ Conduct $\hookrightarrow$ Performance = SCP model
- Perfectly competitive (monopolistic) $\hookrightarrow$ Price-taking(setting) behavior $\hookrightarrow$ low(high) prices = SCP model
- Tends to emphasize market share or/and number of firms

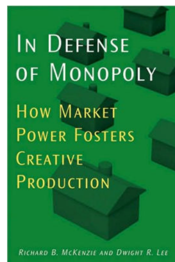
Monopoly is a hard thing to achieve



- Imagine a competitive market where a firm manages to obtain monopoly (i.e. 100% share).
- Monopolies = Rent. The rent alters the behavior of actors (the cost curve changes places), notably employees. This is notably why unions *love* to unionize firms that are monopolies - they are sharing rents.

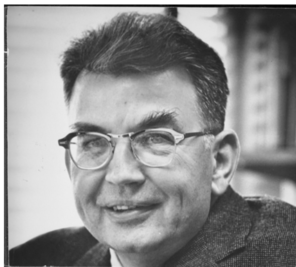
- Thus, the monopoly cannot contract output too much because the more it contracts output, the more employees and shareholders seek to capture the rent. Consequently, the costs of managing principal-agent problem increase. Thus, there is a milder than predicted contraction in output in monopoly because there is a coordination problem associated with monopoly (McKenzie and Lee, 2008).

Monopoly is a hard thing to achieve



"The free riding within a cartel, if left unchecked, will cause the cartel to collapse; the free riding within a monopoly, if left unchecked, will drain the monopoly of all its rents (...) hence the extent of monopolization (NDLR: restriction of output) depends on more than external barriers (NDLR: natural or government-made) to entry. It also depends on coordination or, what amounts to the same thing, agency costs" (McKenzie and Lee, 2008)

Durable goods

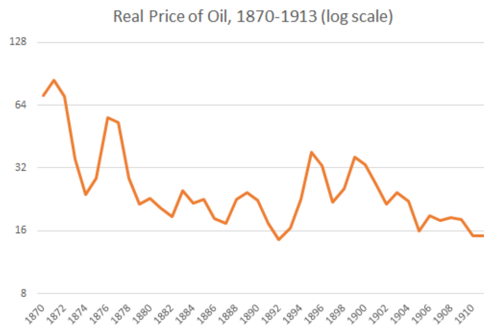


- Firms that produce durable goods and face patient patient consumers cannot easily be monopolies. "This is because the monopoly is, in effect, in price competition with itself over several periods and the consumer with the highest valuation, if he is patient enough, can simply wait for the lowest price. Thus the monopolist will have to offer a competitive price in the first period which will be low." (Coase, 1972).

Market Shares

- Firms may achieve market shares that are large because they are efficient (Demsetz, 1973). When this is the case, a firm is not a monopoly. "Demsetz argues that the empirical relationship does not necessarily imply causation. Indeed, he suggests that the positive relationship arises because larger firms are more efficient. They increase industry concentration and earn higher profits". (See summary here)

Historical Example: Standard Oil



- Oil products were being produced increasingly by one firm (Standard Oil with J. Rockefeller at its head) (McGee, 1955, 1958, 1971). However, prices were falling rapidly (see above) - suggesting a need to go beyond market shares.

Barriers to Entry and Contestability

- Assume: An industry with free entry, one incumbent monopolist, one potential entrant, same MC
- Monopolist first sets its price. Entrant decides whether to enter, and if so, at what price (just below the incumbent's price).
- Consumers buy from the lower-priced firm. In a Nash Equilibrium, the incumbent will equalize MR and MC just like the entrant. Thus, the issue is not market share but contestability and barriers to entry (Baumol, 1982; Demsetz, 1982).
- Barriers to entry can be natural or government-imposed.

The importance of contest: example 1 - the Whiskey Trust (Troesken, 1998)

Exclusive Dealing and the Whiskey Trust, 1890–1895

WERNER TROESKEN

This article uses the history of the Whiskey Trust to explore the competitive effects of vertical restraints such as exclusive dealing. The Whiskey Trust distilled alcoholic spirits and bribed distributors not to carry competing brands of spirits. For the Whiskey Trust, exclusive dealing was an ineffective predatory strategy. Despite the trust's market dominance and manifold predatory strategies, it failed to preempt entry. The trust failed, in part, because its rivals could vertically integrate at low cost. Competition disciplined the trust more effectively than did numerous antitrust suits.

The importance of contest: example 2 - the Canadian cotton industry (Geloso, 2018).

CANADA'S GRAY GOODS TRADE.

MONTREAL, June 1.—A meeting of the gray goods section of the Dominion Cotton Manufacturers' Association was held here to-day to consider the question of over-production. It was estimated that before the mills have executed their orders for export, gray goods, instead of being over-abundant, will be scarce. A unanimous determination was expressed to continue the present association, and in view of the present condition of trade a slight concession in price was decided on. A committee to regulate production was appointed.

The importance of contest: example 2 - the Canadian cotton industry (Geloso, 2018).

- The cotton industry was unable to collude prior to 1879 because of low tariffs on imports.
- The national policy of 1879 (which increased tariffs) made collusion easier. However, attempts at collusion repeatedly broke down when certain members were willing to contest internally the monopoly and because there existed substitutes such as wool.
- Prices continued falling rapidly (faster than overall prices) and output increased faster than the overall economy.

Innovation as a contest

- Contest can also come from innovation : i.e. the invention of new products that replace a given product. This is Joseph Schumpeter's concept of creative destruction.
- Schumpeter argued on this basis that some degree of monopoly is preferable to perfect competition. Competition from innovations, he argued, is an "ever-present threat" that "disciplines before it attacks" (Schumpeter, 1943).
- In fact, for innovation, large market shares are an incredible lure for innovators and it is thus desirable to have such large shares (see next slides). Thus, the market may be - at all points of comparative statics - inefficient. However, it is efficient in a dynamic sense.

Creative Destruction according to Nicholas (2003).

Why Schumpeter was Right: Innovation, Market Power, and Creative Destruction in 1920s America

TOM NICHOLAS

Are firms with strong market positions powerful engines of technological progress? Joseph Schumpeter thought so, but his hypothesis has proved difficult to verify empirically. This article highlights Schumpeterian market-power and creative-destruction effects in a sample of early-twentieth-century U.S. industrial firms; his contention that an efficiently functioning capital market has a positive effect on the rate of innovation is also confirmed. Despite market power abuses by incumbents, the extent of innovation stands out: 21 percent of patents assigned to the firms sampled between 1920 and 1928 are cited in patents granted between 1976 and 2002.

A lesser known view: the Austrians

- Monopolies are problems. Problems are costs. Costs are a form of price. Prices affect behavior.
- Markets respond to the information contained within those prices and may induce people to reallocate resources to "bust" monopolies. If they succeed, they earn greater profits (Kirzner et al., 1997).
- In the view of the Austrians, competition generates solutions - this is why they emphasize the "market process" or the idea of competition as a "discovery process".
- However, their view still hinges on contestable markets and barriers to entry (which they sum only to government-imposed). Thus it is a close cousin of other views.

Competition Policy can be rent-seeking

- The process described above can generate discontent with firms that are being pushed out of the market. In turn, these firms can rent-seek to obtain intervention that reduce the optimal size of the firm.
- This is the case in the example provided by Libecap (1992) in the case of the meat packers. There are similar examples provided by the Pure Food and Drug Act (Law and Libecap, 2006).
- In his work on the origins of antitrust laws, DiLorenzo finds that consumers were rarely mentioned in the justification for the laws. In fact, the bulk of the attention went to smaller producers (DiLorenzo, 1985; DiLorenzo and High, 1988). This view has since received support from scholars such as Werner Troesken (2002).

Competition Policy can be rent-seeking

- State antitrust laws were perceived as a larger threat than federal antitrust laws so that the larger trusts actually pushed for this legislation in order to limit damages (Troesken, 2000).
- At the state-level "the political impetus for some kind of antitrust law came from the farm lobbies of mostly mid western, agricultural states, such as Missouri. Rural cattlemen and butchers were especially eager to have statutes enacted that would thwart competition from the newly centralized meat processing facilities in Chicago. The evidence on price and output in these industries (...) these industries were fiercely competitive because of relatively free entry and rapid technological advances" (Boudreaux and DiLorenzo, 1993).
- A more exhaustive study by DeLorme et al. (1997) suggest the pattern is true for a larger number of industries: prices were falling and output was increasing .They add: "regulation was tioo broad, penalizing efficient as well as inefficient competitors, or regulation spawned a massive merger movement that decreased the vigor of competition".

Competition policy can be rent-seeking

- The latter portion of the citation by DeLorme et al. (1997) is particularly revealing. It suggests that mergers were a result of antitrust laws which is to say that the laws *reduced* competition. This is a debated proposition that warrants more research historically to establish with certainty (I am personally unconvinced that the wave of mergers is explained by the federal antitrust laws) (Hovenkamp, 1991; Kolko, 2008, 2015).
- However, there are cases where it is clear that regulatory actions reduced competition and were used to that purpose (Newman, 2018; Harbeson, 1967).
- We also know that trade tariffs made it easier for industries to collude and attempt anticompetitive schemes (Grant and Thille, 2001).

About the robber barons, inequality and the gilded age

- The issue of the robber barons comes down to a distinction between political entrepreneurs and market entrepreneurs (Folsom, 1991). Political entrepreneurs try to erect barriers to competition (i.e. reducing the contest to their incumbent status).
- When these barriers exist, they redistribute income from consumers to producers. Thus, they are bound to increase inequality.
- Thus, the gilded age ought refer to the idea that some were getting rich via rent-seeking.

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