Mises on Monopoly Prices - An Austrian Critique

Juraj Karpiš

INESS – Institute of Economic and Social Studies

Summary:

In my paper I criticize Mises theory of monopoly prices from an Austrian perspective. I attempt to show, that the purpose of identifying monopoly prices in an unhampered market isn't worth following, because the concept of hurt consumer supremacy by not acting on the side of producers is not compatible with universal property rights. Further I argue that lack of knowledge about the demand elasticity and the real purpose of the supply restriction (which are two main monopoly price creating factors) make the quest for monopoly prices identification a highly subjective venture, on which no antitrust action can be based.

Introduction

Theory of monopoly prices presents an issue where Professor Ludwig von Mises slightly deviates from his typical strong confidence in unhampered market mechanism as the best available tool for solving the omnipresent scarcity problem. Mises argues that in the case of monopoly prices, the consumer is being hurt and therefore market doesn't operate efficiently[1]. As I consider Mises as the most important figure in promoting free market ideas in the 20th century and a great thinker of his time, this deviation is worth a closer examination. I argue that his position in this particular case is in conflict with Austrian methodology[2], to which he otherwise strictly adheres. Mises stand on monopoly prices has been already criticized inside the Austrian camp (Block 1977, Armentano 1978).

Monopoly prices

Mises doesn't attempt to identify monopoly as an economic subject with dominant position on the market, but focuses on monopoly prices as the problem instead. To be fair his treatment of monopoly issue is far from the mainstream neoclassical static model of prefect competition. He argues that there are only two kinds of prices on the unhampered market: monopoly and competitive prices. The tricky part is how to distinguish them.

If a commodity is controlled by a single seller or a group of sellers, which act in concert and they decide to restrict their production of this commodity, not because they have better use for the resources, but solely for the reason that they face an inelastic demand and hope to receive higher proceedings from selling lower number of units than they would normally sell, then the price, at which the market will clear is called monopoly price. Monopoly price is higher than would a competitive price be.[3]

"Monopoly prices are only prices at which it is more advantageous for the monopolist to restrict the total amount to be sold than to expand his sales to the limit which a competitive market would allow. "[4]

[1] The stance of Kirzner on this issue is similar but I will focus solely on Mises here. See KIRZNER, Israel M.: Competition and Enterpreneurship, University of Chicago Press 1973
[2] See for example MISES, Ludwig von: Human Action: A Treatise on Economics, Fox & Wilkes 1996
[3] MISES, Ludwig von: Human Action: A Treatise on Economics, Fox & Wilkes 1996
[4] MISES, Ludwig von: Human Action: A Treatise on Economics, Fox & Wilkes 1996 p. 359.

Consumer Supremacy

First, let’s look at the purpose of dividing prices emerging on the unhampered market between competitive and monopoly prices. Producer who restricts production not for the reason of discovering more profitable alternative use for his resources but because of expected monopoly gain acts “in defiance of the wants of the consumers”[5]. According to Mises

“the monopoly prices are an infringement of the supremacy of the consumers and the democracy of the market. “[6]

Leaving aside the difficulty of separating the producers and consumers[7], this view presupposes inferiority of a producer position in the market. But if a producer voluntary decides not to enter a trade (he restricts his production) for whatever reason, which right of a consumer has been infringemented? If we stick to negative[8] definition of rights, the answer has to be none. As Armentano notes

“…consumers are at all times in complete control of (fully soverign over) their own property at any given price output combination.”[9]

Property rights by definition allow anybody (there is no difference between property rights of consumers and producers) to do with her property whatever she pleases, unless she doesn’t restrict use of other property. Therefore producers’ withdrawal of resources from the market cannot be viewed as violation of any of consumer’s rights.

Problematic is also comparison of utilities in which we have to engage, if we want to say whether the monopolistic gain of the producer is lower or higher than the loss of consumers who were excluded from the trade by higher than competitive price including the loss of consumers who bought the product, but at higher prices. If we agree that interpersonal comparison of utility is impossible, [10] how to decide whether the production restriction and

[5] MISES, Ludwig von: Human Action: A Treatise on Economics, Fox & Wilkes 1996 p.371.
[6] MISES, Ludwig von: Human Action: A Treatise on Economics, Fox & Wilkes 1996 p. 358
[7] Everybody is producer and consumer at the same time.
[8] Everybody has the right not to be robbed, not to be restricted in the use of his property etc.
[9] ARMENTANO, D.T.: A Critique of Neoclassical and Austrian Monopoly Theory, New Directions in Austrian Economics, Luis M. Spadaro, Sheed Andrews and McMeel 1978, pp.94-110
[10] And nobody saw it clearer than Mises did at his time.

following monopoly prices actually hurt the society? Because of subjective origin of value, we have to abstain from this kind of judgments.

We cannot take the "dictate" of consumers in the market economy by word. Yes, producers really have to follow consumers' wishes. But only if they voluntary decide to engage into production and follow the monetary stimulus of profit rewarded to them for fulfilling consumers demand. But they can stop producing any time they wish[11]. In fact every producer is more or less guilty of restricting production.

"All suppliers in free markets restrict their supplies in the sense that they only supply as much of a good or resource as they determine will maximize their monetary or psychic income. But, importantly, this is precisely what the "monopolist" does.[12]

So even if we accept the concept of emergence of monopoly prices, it doesn't necessarily follow that they present a market failure hurting the consumer and that needs to be dealt with.

Supply restriction

According to Mises, to label some price as monopoly price, supply restriction on the side of the monopolist producer has to take place. But even Mises acknowledges that not everything what looks like supply restriction has to be one. One can for example withdraw resources from the production of a commodity P and place them in the production of more profitable good R. Mises further specifies, that for monopoly prices to occur, there has to be a specific monopolized (controlled exclusively or in big part by this producer) factor of production left "unused". But again, how can an outside observer decide, whether the monopolized factor withheld is really unused or serves some other purpose? The resources can be simply withdrawn because of intertemporal allocation (preservation or speculation) or consumption by the producer[13][14]. In some cases the withdrawal may even be unintentional. Take for example monopolistic owner of a mine, who is too lazy or just not smart enough to run the mine at its full potential. Are the resulting higher prices monopolistic? In other cases the

[11] ROTHBARD, Murray N.: Man, Economy and State with Power and Market, Ludwig Von Mises Institute 2004 p. 629-630 see also BLOCK, Walter: Total Repeal of Antitrust Legislation: A Critique of Bork, Brozen, and Posner, The Review of Austrian Economics Vol. 8, No.1

[12] ARMENTANO, D.T.: A Critique of Neoclassical and Austrian Monopoly Theory, New Directions in Austrian Economics, Luis M. Spadaro, Sheed Andrews and McMeel 1978, pp.94-110

[13] Diamante producer may want to keep part of his treasure for the looks of his vainglorious wife.

[14] See BLOCK, Walter: Total Repeal of Antitrust Legislation: A Critique of Bork, Brozen, and Posner, The Review of Austrian Economics Vol. 8, No.1for details.

production may be restricted[15] not by decreasing production but just by not increasing enough[16].

Unless we are able to peek into producers head, it is impossible to say, what are the motives of a producer, leaving some of his monopoly factor of production unused and whether he is really aiming at the monopoly gain. Labeling some prices monopoly, has to be therefore based on our subjective judgment of guessed motives of the producer. But that makes this distinction wholly arbitrary and our subjective judgment cannot serve as sufficient precondition for an antitrust action. Furthermore it opposes the very Misesian notion, that the object of study of praxeology is not the supposed motive but the action by itself.

„The field of our science is human action, not the psychological events which result in an action. It is precisely this which distinguishes the general theory of human action, praxeology, from psychology. The theme of psychology is the internal events that result or can result in a definite action. The theme of praxeology is action as such.“[17]

Motives and values of people cannot be guessed but are only revealed in action[18].

Elasticity of Demand

Apart from resource withdrawal second important condition for appearance of monopoly prices is small elasticity of demand. But how can I as a wannabe monopolistic producer or as an antitrust bureaucrat know, what the shape of the demand curve is? Based on past trades, we know some points of it, but they are already history. Preferences, substitute products, technology, knowledge, environment changes every moment and so changes the elasticity of demand for every commodity[19].

Even if we dare to state that demand for some commodity is inelastic, we have to specify the time scope. As Block writes

[15] In the terms used by Mises.
[16] For example if a monopoly owner of a mine discovers new resources.
[17] MISES, Ludwig von: Human Action: A Treatise on Economics, Fox & Wilkes 1996 p. 11, 12
[18] MISES, Ludwig von: Human Action: A Treatise on Economics, Fox & Wilkes 1996, for more detailed critique of this point see BLOCK, Walter: Total Repeal of Antitrust Legislation: A Critique of Bork, Brozen, and Posner, The Review of Austrian Economics Vol. 8, No.1.
[19] See BLOCK, Walter: Total Repeal of Antitrust Legislation: A Critique of Bork, Brozen, and Posner, The Review of Austrian Economics Vol. 8, No.1

"…it is well known that the greater the length of run, the higher the elasticity. If the price of x rises, the quantity demanded of substitutes cannot rise by very much, if at all, immediately; in the short run, it can rise more; in the long run, and particularly in the very long run, it can increase by a very much greater amount. So which is the "proper" length of run?"[20]

So we cannot state elasticity as a reliable and objective measure for an action. Entrepreneurs make this guess every day, but they risk their own property and are punished by the loss if they err. No antitrust authority has been ever punished for its mistakes.

However Mises seems to be fully aware of this problem. He writes in the paragraph about misuse of mathematics in the treatment of monopoly:

"But the monopolist does not know the shape of the curve of demand. What he knows is only points at which the curves of demand and supply intersected one another in the past. He is therefore not in a position to make use of the mathematical formulas in order to discover whether there is any monopoly price for his monopolized article and, if so, which of various monopoly prices is the optimum price."[21]

He just doesn't draw the conclusion from this absence of knowledge on either producer or antitrust authority side.

Conclusion

The attempt to identify Misesian monopoly prices (as opposed to competitive prices) on the unhampered market will eventually break down on the impossibility to find out objective information about demand elasticities. Second-guessing intentions of potential monopolistic producer and arbitrary labeling his market action as monopolistic resource withdrawal is in conflict with praxeological focus on action rather than psychic motives and intentions. Even if the attempt to identify monopoly prices wasn't futile, its goal opposes Austrian methodology, which doesn't valuate the gain of producer differently than gains of consumers. Consumer

[20] BLOCK, Walter: Total Repeal of Antitrust Legislation: A Critique of Bork, Brozen, and Posner, The Review of Austrian Economics Vol. 8, No.1

[21] MISES, Ludwig von: Human Action: A Treatise on Economics, Fox & Wilkes 1996 p.378

supremacy and protection isn't compatible with supremacy of every individual as accepted in methodological individualism.

Because of these substantial problems in identifying monopoly prices on the free market I consider more appropriate for practical use and not in conflict with Austrian methodology monopoly definition by Rothbard. He defines monopoly as " a grant of special privilege from the State reserving a certain area of production to one particular individual or group."[22].

Literature

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[22] ROTHBARD, Murray N.: Man, Economy and State with Power and Market, Ludwig Von Mises Institute 2004 p. 669