Economic Efficiency and the Regulation of Competition

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Governmental regulation of substantial sections of the economy throughout the world testifies to a widespread belief that resource allocation cannot be left exclusively to the operation of unfettered competition. Under certain conditions free competition is alleged to cause too many (as well as too few) resources. The form which governmental regulation takes varies: probably the simplest and most common is the control of new entrants through some form of licensing. More complicated devices include the control of prices, the prohibition of price discrimination or rebates and production restriction schemes for maintaining prices as in American agriculture. It is rare that the intervention is not justified by appeal to the public interest.

The gain in economic welfare alleged to result from Government intervention obviously has a recognizable empirical manifestation. It is to be expected that either prices are lowered, quality improved or some combination of the two. Off-hand, however, it is hard to see how regulation can have any effect other than to raise prices. But this notion may reflect a bias emanating from a wholly unjustified application of a highly restricted economic model. It seems desirable, therefore, to initiate the discussion with an appraisal of the general problem of resource allocation. The paper is divided into four parts: (I) The Optimal Allocation of Resources; (II) "Wasteful" and "Cut-Throat" Competition; (III) the Intervention Mechanism; (IV) Concluding Observations.

The hypothesis considered is that under certain conditions government intervention in the competitive process eliminates "waste" and thereby improves on the allocation of resources. An alternative hypothesis to bear in mind is that because intervention must of necessity arbitrarily discriminate between different groups of citizens, rational allocation is impossible. In this latter view, government intervention and the optimal allocation of resources are incompatible.

I. The Optimal Allocation of Resources

As this is a familiar subject to the economically sophisticated the discussion which follows will be brief. The specification of an optimum necessarily commences with a statement of objectives. For some time, economists, including those of a
Socialist bent\(^1\), have recognized that a rational organization of resources implies a free price system. Though the same may be said of economic objectives as of taste—"de gustibus non est disputandum"—it is agreed on all sides that optimality in resource use consists in attempting to give consumers the goods and services they want. The problem is how these preferences are translated into demands on resources. A mechanism is required by which consumer preferences can be expressed. Thus should consumers prefer swimming pools and pleasure craft to new autos, and in a proportion different from the current allocation of productive resources, prices of swimming pools and boats will be driven up while the accumulation of unsold surpluses will drive auto prices down. With the change in relative prices and profits it pays the owners of resources to shift some of their resources from the manufacture of autos to that of swimming pools.

Thus when demand for a commodity increases the ultimate effect (assuming that at some point supply is not perfectly elastic) is a competitive increase in price in the sense that relatively higher prices trigger the shift of resources between industries. Of course, the process takes time; the more durable the necessary capital equipment the slower is the shift because producers, before they will tie up resources in processes having a rather long life, will seek some assurance that the current favorable demand is likely to continue. The longer it persists, the more confident they will feel. The expansion, when it comes, is brought about in two different ways: old firms will generally add to their capacities and new firms attracted by the increase in relative profits will enter the industry.

But, after the capacity of the industry has been increased, it may turn out that the estimates of producers have been too optimistic. Either too much capacity has been added or demand may have contracted. In a competitive industry, the pressure on supply brings about a lowering of price. As production most certainly falls there is a decline in profits which may even become negative. Should this state of affairs continue for some time, some producers will not find it possible to continue to claim resources in competition with other producers in this and other industries. Ultimately, resources will be re-allocated in line with the new relative profit opportunities.

The resource re-allocation is a response to consumer demand: when there are too many resources in an industry some producers lose their ability to compete for them simply because their costs exceed receipts. Other firms and industries can pay more for the scarce resources and it is this competition which, through stimulating relative efficiency, regulates the allocation of resources. But the process may take time—and this is the core of the problem as well as the concern of this paper.

II. "Wasteful" and "Cut-Throat" Competition

Because of a temporary period of high demand or miscalculation capacity may exceed demand for a considerable period of time. Producers burdened with the

pressure of redundant capacity may be forced into an aggressive competition which has been described as “cut-throat”. Should demand be unresponsive or inelastic, the relative increase in sales is less than the percentage reduction in price. The resulting price competition has been appropriately labelled a “beggar-thy-neighbor” policy.

From the standpoint of optimal resource use, this competition is thought “wasteful” as well as “cut-throat” in that the resources yielding such low returns would yield more elsewhere. The fact that they are not diverted suggests a waste which is often endemic to competitive markets.

The costs of competition in this sense are the opportunities foregone because resources have not shifted to industries where the value of their marginal products are greater. But unless there were reasons for believing that decisions by government always resulted in instantaneous optimal re-arrangements of resources and unless there were reasons for believing that government never erred in its forecasts, these costs must be considered “frictional”, normal and legitimate. Actually it is through them that competition operates, and their existence is as essential to the functioning of competition as the wages of policemen for the preservation of law and order. So long as supply and demand conditions change, and that is so long as economic progress occurs, these costs will appear.

The economist’s costs are the alternative opportunities sacrificed when resources are organized one way rather than another. They are never eliminated—only minimized in the sense that for given objectives any other arrangement results in a smaller production of the desired commodities. In technical language optimal allocation is reached when all marginal rates of substitution for any two resources are equal in all uses. For it is only with equality that all opportunities for increasing welfare are exhausted.

It is not, therefore, correct simply to identify “wasteful” competition with either partial or general disequilibrium. On the other hand, the continued diversion and maintenance of an excessive number of resources in an industry suggests an unhealthy situation. In the United States agriculture, cotton textile manufacturing, domestic watch manufacturing and coal mining are considered typical examples. It is alleged that the disequilibrium is sufficiently durable as to justify intervention. It is proposed, therefore, to examine a number of possible reasons why the competitive adaptive mechanism functions neither smoothly nor promptly. It is well, however, to keep in mind the definition of “waste” as a failure to exploit a more profitable alternative opportunity. Concern is not so much with the costs of competition as with the costs of alternative methods for moving toward an objective. Thus, against the relatively large number of food stores in contrast with household appliance outlets must be set the importance to the consumer of convenience of access where repetitive shopping is necessary. Consumer satis-

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faction appears to be optimal when stores are conveniently located even though there seems to be much idle and redundant capacity. At least, when consumers are given a choice they express a willingness to pay the greater prices usually associated with smaller volume operations.

1. Oligopolistic Calculations and Excess Capacity

Waste occurs when resources show no tendency to move in accord with relative profits. They remain, for example, in agriculture or textiles when they could earn more in capital goods or aluminum fabrication. How does such a remarkable imperviousness to profit opportunities develop and why would it persist for any length of time?

The renown of Harvard’s Professor Chamberlin is associated with one brand of redundant resources or “excess capacity” in his model of monopolistic competition. He suggests that where there is oligopoly or if calculations by sellers are appropriate to the small group price competition will be avoided. Each seller anticipates that whenever he cuts his price, his rivals will meet the competition, so that under certain conditions the most profitable procedure is to follow a “do-nothing-policy”. These calculations cause a situation akin to monopoly. But unlike ordinary monopoly, the high profits attract additional resources, and since price competition is eschewed, sales and profits must fall. Ultimately, prices must be raised, because, as sales and production contract, unit costs increase. The final result is an excess of producers and of prices relative to pure (or price) competition.

Here, it would seem, is a case for the government to intervene through limiting entry. Sales for each producer would increase while unit costs and prices might fall. The model, however, is limited by its assumption of price rigidity. Not only is it inconsistent with “cut-throat” price competition, but it does not correspond to the typical examples of “wasteful” competition such as agriculture, mining, textile manufacturing and the railroad rate wars. At any event, it hardly seems appropriate to characterize an imperfect market in which price competition is completely lacking as “wasteful” or “cut-throat” competition.

2. Indivisibilities

Here is the classical case. Assume a single track railroad line basing rates on the “value-of-service” principle with marginal costs usually less than price. At one time economists devoted much attention to the problems of such “decreasing cost” industries. It was urged that subsidies be offered by the state to encourage greater production. Better resource use was expected because with demand price larger than marginal costs, the marginal social net product exceeded the marginal

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3 See Alfred Marshall, Principles of Economics (8th Ed.), London 1920, Bk. IV.
social net costs. This proposal is particularly interesting because the “indivisibilities” involved in the current discussion involve too many not too few resources.

The problem of “cut-throat” competition appears when another railroad is built. Under the assumed conditions as neither can secure optimal utilization both suffer losses when they cut prices in order to attract customers from each other. It seems rather clear that in such a case the continuance of competition would be irrational and for this reason is usually manifested only in immature industries where firms are “feeling their way” for market position. Other examples of indivisibilities are provided by the communication industry and the transmission of electric power: in neither does there seem to be an advantage in the duplication of facilities. It is to be observed in passing, however, that somewhat more competition could be introduced through instituting a system of competitive bids for the privilege of managing the facilities for limited periods.

Indivisibilities are not so general as the ubiquity of large scale capital installations might suggest. Both the multiple-plant firm and the presence and survival of firms of different size in the same industry indicate that indivisibilities present no pervasive case for intervention.

There is an additional qualification to the indivisibility thesis. Admittedly, it is absurd and costly for three or four separate milk distributors to deliver to adjacent homes on the same street. A single distributor (i.e. a monopoly) would surely have lower costs. But the case against monopoly has never rested entirely on costs and, certainly, not the kind of costs which are reduced by the elimination of duplicate facilities. On the contrary, the objection to monopoly is that it allocates too few resources by charging higher prices. The resulting waste is indicated by the opportunity to transfer resources into the monopolized industry because the value of an additional unit devoted to that industry exceeds the marginal costs of that resource. That is, as indicated earlier, society wants more resources as revealed by a demand price greater than the price of the marginal unit of the resource. Judgments as to competitive waste arising from duplicate facilities err in ignoring the other side of the coin which is the preference of consumers for alternatives. (Parenthetically, it may also be remarked that such judgments are usually correlated with a rather puritanical disapproval of consumer wants. So Professor Galbraith, to give an example, condemns American consumers because of their high priority for chromium on their automobiles. It seems rather presumptuous of the professor to appoint himself arbitrator of the goods the consumer should enjoy. Unfortunately, the authoritarian economist is hardly archaic.)

Indeed, consumers may prefer to pay greater prices for the privilege of possessing alternatives. Actually the alleged unnecessary duplication of facilities is the “sine qua non” for efficiency as well as competitive efficiency. Lacking alternatives, a buyer is at the mercy of a seller who is under no compulsion to provide efficient service. Nor does government regulation of the seller seem to be relevant: at best, it is an improvement on monopoly, not on competition.

A case where independent behavior involves substantial social loss seems to be indicated in American oil drilling. Due to private property rights, drilling was highly individualistic and inefficient. Each owner of surface rights was under pressure to quickly extract all the oil he could from a common pool lest his neighbor gain it first leaving him nothing. It has been estimated that 85% of the oil was lost in the early days of the industry because of anarchic drilling practices. In recent years, recognition of mutual interests has corrected the situation without the necessity for government intervention.

3. Imperfect Information

Newcomers may enter an industry under the mistaken impression that a current abnormal demand will continue sufficiently long for them to recover their original investment. Or through an accumulation of errors too much capacity may be attracted into the industry. If, at the same time, resources cannot be easily withdrawn, price competition will change profits into losses. As long as the resources remain tied up in this industry when they could contribute more elsewhere, economic waste appears.

But, low profits in industries, which are easily accessible to newcomers, may be merely competitive profits. It is, therefore, incorrect to infer "waste" from the level of profits alone: competitive efficiency reflects relative profits rather than absolute. Even, should there be a persistent bias in the direction of over-optimism so that profits are consistently lower, this is as much a matter of competition as its alleged failure. In any event, if newcomers are acquainted with today's relatively higher profits, there is also no obvious reason why they would not also be aware of the industry's past profit picture. Furthermore, it is not clear that the newcomers need be any more wrong in their forecast as to the present value of additional resources than the incumbents who predict disaster if entry is not barred.

4. Immobility

Imperfect information does not present a problem if resources can be shifted easily and promptly. In that case, if capacity is larger than demand, prices and profits diminish thereby forcing resources to shift to other more remunerative areas. On the other hand, if information is perfect in the sense that foresight is perfect, differences cannot occur between individuals whether inside and outside the industry. Resources will always be directed to the most remunerative channels. It follows that "waste" cannot occur unless two conditions are given, i.e. (1) imperfect information which results in some individuals being "wrong", and (2) immobility of some resources in the sense that they are tied up in the industry for such a lengthy period that the loss is too substantial to ignore.

In what circumstances is this kind of immobility likely to develop? Large, expensive and indivisible capital goods seem to be characteristic in, say the steel, aluminum and electric power industries. Yet, these are not regarded as industries
easy to enter. On the contrary, it is alleged that difficulties in securing the necessary capital for efficient production effectively bars the appearance of newcomers. Furthermore, because they are capital-intensive the time element is of paramount importance. Unquestionably, the most exhaustive study of long run supply and demand factors is undertaken prior to new investment. Where such large sums are required, comprehensive information is sought. Consequently, where immobility is probable a compensating element is present in the form of a pressure for the most precise information. On the other hand, where information is likely to be least perfect, mobility is likely to be most perfect simply because the capital requirements are so much smaller. In a sense, this statement is tautological: when capital requirements are low there is less hesitance in entering new industries and less pressure from third parties for the most complete information concerning past industry performances. In other words, there is a positive and causal connection running from immobility in the form of tying up capital for lengthy periods to an urgent requirement for market information.

5. Predatory Behavior

In America, this phenomenon is the product of an asymmetrical market relationship in which a relatively large and dominant firm competes with a large number of smaller rivals—Gulliver against the Lilliputians. The conventional discussion is complicated by the addition of a number of implicit though realistic conditions surrounding the alleged advantage of the large producer. Thus because he is integrated and diversified it is alleged that he can “subsidize” his competitive losses in one market with his profits from other non-competitive markets. “Waste” allegedly results because efficient non-integrated producers are liquidated in the process of achieving a monopoly position. On the one hand, legitimate competition cannot survive while on the other monopolistic mis-allocation takes place.

A shortcoming of the model is that it is no easier for a “conglomerate” producer to subsidize his competition than it is for a smaller rival operating in only one market. Diversification guarantees neither extra profits nor monopoly. So long as producers, both large and small, operate in competitive markets they have no extra profits to use as a “war chest”. On the other hand, if monopoly power is possessed in some markets, the large producer may exercise the so-called “leverage” effect to increase his monopoly. The courts have invariably condemned such practices, e.g. in the motion picture and the tobacco cases. But as

the monopoly profit can only be taken at one level it is difficult to see that anything is gained by such practices. Furthermore, the model is incomplete in that the additional monopoly is a worthless pursuit if entry is so easy that government intervention seems to be necessary to prevent a redundancy of supply. Predatory behavior would make no sense under such conditions.

6. The Significance of Long Run Losses

The possibility of actual emergence of future losses provides no basis for negative investment decisions or government regulation. Granted that in the future losses may be substantial, it does not follow that an investment in the steel industry today is unjustified. The losses need never materialize because before they would have appeared receipts may have more than amply covered the original investment with the direct resources diverted to other uses. Present investment cannot be evaluated exclusively in terms of future losses.

Indeed, the value of an investment is only to be determined through a consideration of the discounted value of the stream of earnings today as compared to alternative investments. Though future losses may be extensive, present gains may be even more so. It is, therefore, quite incorrect to conclude that a "waste" of resources will occur should losses result in some indefinite future. Optimal resource allocation depends upon demand as much as supply; and current demand is often sufficient to justify extensive investment in propositions that in the long run will yield nothing. Human reproduction may be an illustration. Peak load capacity in transportation and electric power illustrate the problem from the view of a shorter cycle: in off-peak hours their yield is nothing. Investment of resources in the building of immovable equipment for the extraction of exhaustible resources as with the products of mines is another category. The critical element is the relative profits from alternative investments. Large future losses in themselves indicate little.

7. The Maintenance of Minimum Standards

As there is often a conflict between the social interest and the private interest, governments have traditionally insisted that certain minimum standards be recognized and followed. The recent disastrous incident in Marrakesh where jet engine oil was sold for vegetable oil is illustrative. It is to be noted that in insisting on an established minimum performance the government is not exercising power to support one economic group as against others or even the whole economy. The maintenance of minimum standards is usually possible with a minimum of intervention.

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1 Cf. Bork, op. cit.
III. The Intervention Mechanism

At the outset, it must be emphasized that when the market is superseded by government regulation a superior value system is implied. The existence of this system suggests the rather obvious question: why rely on an inferior competitive mechanism in any market? Can or should we be satisfied that competition, like democracy, while not the most perfect system in Aristotle's words, is the best of possible systems? I suspect that those most anxious to intervene in the competitive process pay scant heed to this principal argument. Though government regulation, like the monopoly of milk distribution, may be superior, there is not the compulsion towards efficiency which dominates competition. In the latter, while authority and responsibility are combined, authority itself is diffused in that there are alternative sources of supply. Of course, if it is postulated that the government is necessarily omniscient and beneficent, no necessity exists for the competitive diffusion. But not even Socialist economists think this any longer—at least explicitly 1.

1. The Sources of the Competitive Failure

There is some advantage in initiating the inquiry with delineation of a model in which government regulation would be unnecessary. The following conditions are postulated: (1) Producers are competitive, i.e. they avail themselves of a number of different devices, including price, to attract customers. The Chamberlinian “excess capacity” could not develop. Nor is there a divisibility problem inasmuch as the survival of a number of alternative producers indicates an exhaustion of large scale economies. Or, as suggested above, multiple plant operation and the survival of producers of varying size in the same industry reveals that larger producers have no advantage. (2) Information is perfect. As there would be no differences of opinion, errors are not possible. Resources would always be directed to the long run optimum.

These conditions, competition and perfect information, are sufficient for optimality. Actually, since it is only competition that is of concern, it is sufficient that producers possess all the relevant information—or at least as much as the government regulators are presumed to have at their command. In the event they do, intervention cannot improve on the competitive allocation. But even this restriction can be relaxed if an alternative condition is fulfilled. Even though information is uncertain and incomplete, “waste” will not result if (2a) resource mobility exists. Errors are then corrected by a rapid re-arrangement of resources. It is apparent that government intervention in the competitive process requires

1 On the abstract plane Socialist theorists have long since conceded the necessity of a price system for the rational allocation of resources. But both they and allies who favor greater government intervention in the market ignore their concessions to the price system whenever faced with a choice between the government provision of public goods as in the welfare state and reliance on impersonal market forces. Is this inconsistency between theory and policy characteristic of a twentieth century schizophrenia?
the prevalence of competition but under conditions which include both imperfect information and immobility. If either of the latter two is absent, intervention is unnecessary: mobility causes rapid adaptation while information prevents the need for adaptation from arising.

There is one further observation. Assuming that conditions are unfavorable for achieving the competitive optimum, does it then necessarily follow that government regulation of entry is sufficient to prevent the diversion of too many resources into the industry? The answer depends on the elasticity of supply over the long run for those in the industry. A competitive producer cannot be certain that his rivals will not expand. He is under the illusion that whatever he does the effect is too insignificant to make any difference for market price. Nor, if he should not want to expand because he sincerely believes capacity is adequate, does he have reason for believing that his rivals will be equally rational and mature. For these reasons, it is to the interest of each to increase his capacity when demand is greater than supply; and, though entry is regulated, supply is increased. The regulation is, therefore, impotent in achieving any rational goal.

It is clear that if “intervention” is to work another condition is required, viz. that incumbents act according to their own pessimistic forecasts. Accordingly, not only must the established concerns correctly view the future but they must also view it identically. Should heterogeneity prevail, some will expand, causing the allegedly undesirable increase in capacity. Six conditions are, therefore, necessary for successful government intervention: (1) competition; (2) imperfect information; (3) immobility; (4) omniscience of government; (5) unanimity of outlook; and (6) oligopolistic recognition of mutual self-interest by established producers.

2. Regulating Agriculture: The American Example

The price support program in the United States is operated through government purchases of certain so-called basic commodities, so as to place a floor or minimum on prices. A popular argument for this billion dollar expenditure is that it allegedly guarantees a healthy agriculture. If it were discontinued, it is feared that disaster would threaten the national food supply because of the disappearance of a relatively large part of the farm population.

Consider the model necessary for this “disaster” hypothesis. It is predicted that if the government ceases the expenditures which prop agricultural prices, the quantity offered will shrink at such an alarming rate as to threaten starvation. In order to make out the most favorable case for the hypothesis it will be assumed that it is not possible to import from abroad, e.g. Canada, in order to alleviate the developing distress. In technical language, quantitative response to price changes is a matter of supply elasticity. The “disaster” hypothesis postulates a very elastic supply, i.e. a disproportionate change in the quantity offered by farmers relative to the price change. In the conventional diagram the supply function is very close to the horizontal or parallel to the abscissa.

If this really is the supply function, farmers obviously experience little difficulty in ceasing to farm or in shifting into other occupations, either suitable alter-
natives are available or they possess private means permitting them to do nothing for considerable periods of time. In any case, the model implicitly assumes high resource mobility. But, if farmers are mobile so that supply is responsive to price, any necessity for government intervention is removed. Given the demand for food and the very elastic supply, prices could not possibly fall to any degree. Farmers would not accept them. On the other hand, long before the disaster became a reality supply would respond—because hungry consumers would bid up prices, thereby attracting more resources back into agriculture. This conclusion must follow because of the assumption that supply is so elastic. Of course, if that assumption is dropped, it does not matter if the government discontinues the program. The necessary food supplies are then available whatever happens to price.

The “disaster” hypothesis thus requires behavior on the part of farmers which makes price supports unnecessary. Furthermore, the required conditions are incompatible with the facts of farming: farmers are usually considered relatively immobile so that supply is inelastic or unresponsive to price changes. Nor does the price propping of peanuts or tobacco seem essential for the preservation of vital food supplies.

An alternative and more cynical hypothesis for the support program asserts that the farmers have used their disproportionate voting strength in the upper chamber or the Senate to gain a privileged status, and that, rather than eliminating the “wastes” of competition, the program, through increasing agricultural prices and incomes, has preserved a state of redundant resources. The misallocation originated with the notorious inelasticity of agricultural supplies. Slight increases in production either associated with natural forces, imports or technological improvements have been correlated with rather sharp declines in agricultural prices and incomes. Because farmers do not adapt quickly, this condition continues for some time. And, since the farmer is a potent political force, he has been successful in using the government to redistribute the nation’s wealth. The major reason for the program seems to be a successful attempt on the part of one group of producers to enrich themselves at the expense of other producers.

3. Government Regulation as Discrimination

Let us now return to the opposite case where the government has intervened in order to reduce the number of producers or at least limit a wasteful increase. A decision is required as a difference of opinion prevails between the incumbents and the new entrants as to the profitability of additional investment. If government intervention consists in restricting entry, the decision coincides with that of the established producers. What criteria justifies its coming down on their side? After all, newcomers are willing to risk a certain amount of capital that their forecast is the correct one. On the other hand, it is equally probable that incumbents prefer not to share profits: any device which restricts entry is to their interest.

The problem facing the government originates in uncertainty of the future. Were information perfect, there would be no difference of opinion between new and old producers; waste would not develop; and government intervention would
be unnecessary. While the incumbents have the advantage of greater experience, newcomers could support their plea with testimony from banks and suppliers who are not likely to be more biased than incumbents. Nor is there a necessary relation running from experience to pessimism. Indeed, it is proper to inquire if the incumbents would ever admit that there was a case for admitting newcomers. To do so is to make the proposition for regulation empirically meaningful. If it is impossible to specify the conditions favorable for new entrants, entry is barred not on the grounds of probable effects and waste but rather as an arbitrary judgment.

The government must distinguish between a legitimate attempt to prevent a redundancy of resources and a restriction aimed at monopoly return. Several tests for evaluating the sincerity of incumbents come to mind. First, are the incumbents following what they preach? Though they might be restricting in typical monopoly fashion, lack of evidence as to their expansion is at least consistent with a judgment that additional resources would be wasteful. Second, if the government should not support the incumbents’ plea for restriction of newcomers, what would the incumbents do? Since they are predicting long run waste some of their resources will be redundant as they could earn more elsewhere. Their sincerity would be apparent if there is some evidence of movement out of unregulated industries. Third, the government might consider the origin of mistaken calculations by the new entrants. The latter seek to enter when demand is strong. Why should the government not go to the heart of the problem and tackle the demand side which is the variable causing uncertainty? The simplest method is to control prices at long run levels: both new buyers might be denied supply as well as old buyers rationed.

The case for regulating buyers rests on the same logic as that of regulating the entry of newcomers. It has the advantage of removing one of the principal elements of disagreement between old and new producers. Indeed, to tie the noose a bit further for the incumbents it might be decreed that, since the entry of suppliers is free, newcomers could cater to new buyers and the excess demand of old buyers should the occasion arise. Something of this sort seems to have developed with the recognition of “official” black markets in the Soviet Union. But, though this plan would certainly test the sincerity of the incumbents, it would most certainly fail to prevent the alleged “waste” of resources.

The government’s problem as a regulator is one of securing complete and accurate knowledge. On what grounds can it legitimately discriminate in favor of one group at the expense of others? What criteria exists for determining the optimal number of producers? Here it should be noted that the problem of numbers is not identical with that of optimal capacity. As indicated earlier, numbers could be controlled without eliminating the waste if the incumbents merely expanded in the place of the newcomers. In fact, a competitive industry would expand. It may appropriately be asked what difference it makes if the government regulates entry since capacity will be the same? The difference is that though expansion may occur the industry is not as competitive as when entry is free. Newcomers upset established market positions.
The government has other problems. What criteria enables it to determine which industries to regulate? The decision to restrict entry denies a right to newcomers to risk their time and resources in what they believe to be their most attractive opportunity: the coercive power of government is used to discriminate between citizens. Obviously, the use of this power can only be justified on rational and equitable grounds.

Rational decision-making presupposes a mechanism for distinguishing between success and failure. Thus, should the decision to bar newcomers be unduly pessimistic, the industry would become profitable relative to other industries and waste would occur in the same sense as with too many resources. The difference is that it occurs in other industries. Consequently, the choice is not confined to waste vs. non-waste but to its location. Arbitrary decisions that limit entry shift the alleged waste to other industries as, for example, in crop-restriction American corn production has led to increased acreage in soybeans.

If governments, unlike humans, are omniscient, regulation would eliminate the waste associated with resource immobility. Omniscience, however, does not necessarily imply continued agreement with incumbents. On the contrary, the government is most likely to minimize waste when it follows the same guides as newcomers, viz. long run profit considerations. When that procedure is followed, profits and losses are identical with success and failure. This index is conceded by all economists to be the only criterion if the rational organization of resources is to be achieved. But, if the government can only be rational when it follows the same rules as newcomers, regulation is hardly necessary.

The problem is simplified if the Government can assume that the incumbent is always “on the side of the angels”. By deciding that the public interest necessarily coincides with the interests of incumbents, rationality need only consist of so acting as to maximize their income. The agricultural support schemes in the United States are illustrative. But when the problem is so simplified, discrimination becomes an unavoidable aspect of public policy: regulation, consequently, consists of nothing more than the selective favoring or discriminating in behalf of vested interests. Not only is this an abandonment of free competition—for no reason exists for confining the policy to only a few industries—but it is inconsistent with consumer welfare. Established producers free from outside pressure would be that less efficient.

IV. Concluding Observations

It is a cliché that in matters pertaining to public policy, the economist’s function is to emphasize the alternative opportunities. The doctrine of opportunity costs is one of the fundamental contributions of economics. Also because discrimination is necessarily arbitrary, the economist will avoid it in much the same way the clergyman avoids sin. As a substitute he urges a rational choice

which presupposes a mechanism by which consumers may express their preferences or objectives. The economist takes it for granted that the consumer is the best judge of what he wants. Regulation is confined to those relatively few areas where there is almost universal assent and no act of discrimination is required, e.g. in enforcing pure food and drug laws.

As an alternative to the regulation of entry, price control may be tried. If prices are not permitted to rise, profits will not attract outsiders; nor will incumbents have incentive for expansion. If the incumbents dissent to this proposal on the grounds that they require freely moving and higher prices to compensate for later losses, the rebuttal is that later losses would not appear because with price control redundant resources would not develop. An additional advantage of the method is that it tests the sincerity of the incumbents that their sole reason for limiting entry is to prevent the appearance of redundant capacity.

Historical experience with regulation suggests that its major contribution, apart from its objective, lies in the “protection of competitors from competition”⁴. The limits on entry inhibit a most important and dynamic element in competition. For it is newcomers trying to break into a market that destroy both established market positions and the oligopolistic tendency of mature firms to follow “live-and-live” policies. A review of the American experience shows the different forms regulation has taken to stifle competition. (1) Transportation: rates must be approved by the regulatory commission; discrimination is severely curtailed; and railroads are denied freedom to become general transportation agencies with the right to offer combined services by road, rail, water and air on the basis of the most efficient combination ². (2) Agriculture: prices are raised, production is restricted and subsidies involving a redistribution of national income are characteristic. (3) Labor: unions and minimum wage laws restrict competition and inhibit labor mobility ³. (4) Foreign trade: tariffs restrict competition from foreign suppliers and deny consumers access to cheaper and better quality supplies. (Is the moral too close to home when I cite the experience of Swiss watches in the United States?) (5) Anti-discrimination Laws: the Robertson-Patman Act in the United States prohibits price discrimination. It has been observed by one scholar that the effect of this law, if enforced, would be to suppress one of the most virulent and characteristic competitive outlets inasmuch as competition usually breaks out with the shading of price to gain a particularly important customer ⁴. Fortunately, it is practically impossible to enforce the law. (6) Re-sale price maintenance Laws: high cost, smaller producers are insulated from having to compete with never more economical methods of distribution. (7) Anti-Chain store taxes: penalties are placed on multiple unit operations not in the interests of consumers or efficiency but to protect small enterprise. (8) Import quotas on oil: higher cost domestic producers are ensured a market. Obviously consumer prices are raised.

¹ Adelman, “Vertical Integration”, op. cit.
⁴ Adelman, op. cit.
Nor is the restriction justified on the grounds of national defense when it acts to encourage the domestic production of an exhaustible resource. (9) Subsidies to lead and zinc producers: resources are kept in relatively less efficient industries while income is redistributed from consumers to the owners of those resources.

While the above cases suggest the gain is to the producer (or, at least, certain producers) no showing is made that "waste" is reduced. On the contrary, regulation appears to restrict production, mis-allocate resources and raise consumer prices. Indeed, there is a strong positive correlation between the government regulation of competition and inflation. The "wastes" which are revealed in the economy are not competitive but those arising from regulation. They are inevitable because government standards are arbitrary, discriminatory and restrictive rather than progressive and expansionary.