Chapter 8—Monopoly and the Social Responsibility of Business and Labor

p.119: I keep forgetting this. Years of study of economics have drummed into my head the definition of the word "competition" Friedman states here. I rarely remember that non-economists take it to mean something different. Friedman's definition is the same as we used in our discussion of perfect competition.

p.120: "Monopoly raises two classes of problems for a free society." Friedman is setting up the chapter here. The first problem is that monopoly reduces people's choice and hence reduces freedom. The second is that forcing monopolies to behave responsibly--whatever that means--would destroy freedom altogether.

p.121: "The Extent of Monopoly--Monopoly in Industry" Friedman identifies the major problems in dealing with monopoly here. First, it's hard to identify monopolies in practice. Our textbook definition of monopoly--a single seller of a well-defined product with no close substitutes--is a good start but not sufficient. Does Microsoft have a monopoly in, say, PC spreadsheet software? No, since you can still buy Lotus 1-2-3 (my personal favorite, available for $322 from IBM, or $30 on eBay for the whole suite, including word processor and database) and Quattro Pro. But Excel has--I'm guessing here--a market share of 98% or so. Is this a monopoly?

p.122: Monopoly, like a lot of problems, is more noticeable than competition. Just as good news is never reported in the papers, ordinary people and politicians tend to see monopoly and ignore everything else.

p.123-124: An important point here. Just because an industry is unionized doesn't mean the union has any real effect on wages or anything else. If the X industry is nonunion, and productivity increases there drive up wages, people will come up with all sorts of reasons for the rise in pay. But if the same thing happens in unionized industry Y, everyone will attribute the pay raise to the union. Ultimately, as we'll see in the chapter on labor markets, wages are driven by labor productivity. A labor union cannot force wages higher than output per man-hour--at least not for long. Ask the former Delphi employees about that.

Also, labor union membership has declined sharply since 1962. Only 12.3% of all workers are unionized today (Source). As Friedman observed, the decline has come about largely as a result of the decline of heavily unionized industries--those that use a lot of unskilled labor--and the growth of non-unionized ones, particularly those using skilled labor and professionals. (Unskilled workers have an incentive to join a union. Their individual bargaining power against their employer is very weak, so they tend to organize and improve their position. Skilled workers have greater bargaining power--they can tell an employer "pay me well or I'll go elsewhere," and mean it--and consequently have little incentive to join unions.) Over half of union members today work for government, even though there are more than 5 times as many private sector workers. Government workers have realized that a union is just the thing to squeeze more money out of government. Government is the exception to the rule about wages in the previous paragraph, because unlike a private firm, which actually has to sell its output to cover its costs, government just soaks the taxpayers. And so you have the case of Greece, discussed in one of your upcoming readings, where government workers get paid for 14 months each year, retire on a full (14 month) pension at age 58, and, when the Greek government seeks to cut their pay to head off impending national bankruptcy, unionized government workers dig in and strike to preserve their pay and benefits. (Update, October 2010: See what's happening in France.)

p.124: The middle paragraph on this page summarizes the economic argument against labor unions very nicely.

p.126: As noted in the Chapter 2 discussion, the Interstate Commerce Commission (ICC) no longer exists.

p.127, 3rd full ¶: An important note here. Government policy choices change incentives and can affect economic behavior in profound and often obscure ways. If a research firm--say, a pharmaceutical company--has two types of potential research projects it can invest in, patentable and non-patentable ones, it will of course direct its resources to developing the ones it can patent. Those will definitely be the most profitable projects, but might not be the ones that generate the most social welfare.

p.128: What Friedman calls "technical" monopoly we have referred to as natural monopoly. In the last paragraph on this page, Friedman summarizes the problems with regulating monopoly. Government ownership is nearly impossible to reverse. (It'll be interesting to see how soon the feds let go of GM.) Government regulation tends to be captured by
the industry itself. Plus, regulation is difficult to change and fails to keep up with changing technology, eventually dragging down the industry it regulates.

**p.129:** One of the many damaging effects of import tariffs is that they reduce competition. American auto producers did not make serious efforts at improving the awful quality of their cars in the mid-twentieth century until foreign producers, mainly Japanese, began to capture the market with cars of better quality.

**p.130:** Yes, the US government still taxes corporate income twice: Once through the corporate income tax and again as stockholders' dividends are taxed by the personal income tax. This is unfair, but more important, it's *inefficient*, as Friedman explains. And given the current fiscal direction of the federal government, it's not likely that this double taxation will be eliminated. More likely, they'll try to cook up a way to tax it *three times* . . .

**p.131:** Unions are specifically exempted from US antitrust law (Sherman Antitrust Act). It's illegal for two steel companies to get together to set prices, or scheme up ways to force people to buy their products, etc. But it's perfectly legal for the employees of those two steel companies to join the United Steelworkers union to pressure their employers to pay higher wages and benefits, or push up the number of employees. Union violence during strikes often is ignored by law enforcement officials. (Old joke: "How many Teamsters does it take to change a light bulb?" "Ten. You gotta PROBLEM wid dat!")

Also same page--we'll study cartels in the chapter on oligopoly, but here's quick introduction. A cartel is a producers' organization formed to diminish competition by restricting output and controlling market price, allowing the members of the cartel to earn a share of monopoly profits. The problem with a cartel, for its members, is that, while firms in an industry have an incentive to form a cartel, once formed, each, or at least many, have an incentive to cheat--"chisel"--on the cartel agreement, thus bringing down the whole thing.

**p. 133ff:** Corporate responsibility was a big deal again in the early part of this decade. The recession seems to have pushed it into the background, but when good times return, it will too. Ultimately a corporation has to choose whether it wishes to be responsible to its stockholders or to someone else. If it chooses someone else, then stockholders will choose to go elsewhere. Also, if a company seeks to be more responsible, there are ultimately only two things it can choose to do: Change its prices or change its inputs and outputs. Setting prices artificially low, i.e., enforcing price ceilings, will create shortages and harm society. Hiring inputs that are less efficient will generate problems, as will producing goods that are different from what consumers actually want to buy. If a corporation produces the goods consumers most value at the least cost to society, that seems like a pretty responsible action to me. And that course of action will lead to maximum profits for stockholders. This is what Adam Smith had in mind with the invisible hand.

**p. 135:** Tax-deductible status for corporate charitable gifts is now so entrenched that it's hard to see it being removed, although a tax-hungry government with a huge debt to pay might just do it. Friedman's argument against all that is laid out clearly here. A related problem that has become more common since 1962 is that of targeted tax breaks. Let's see . . . you can get a tax credit of up to $1,500 a year for school expenses for the first two years of college (but not after that). If you insulate your house or install energy-efficient windows or heating, you can get a tax break, too. Or a windmill. Now, I'm not saying that any of this stuff is bad. (Well, maybe the windmill. Ask a bird.) But tax "incentives" of this type necessarily must do one of two things. Either they encourage people to do things they would do anyway, and hence accomplish nothing. Or they encourage people to do things they would *not* do otherwise, in which case they encourage people to do something which is not as beneficial as what they would freely choose to do. And in either case, overall tax rates must be raised in order to generate the same amount of income that would be raised in the absence of the tax break, and we've already seen that higher marginal tax rates discourage business investment and stifle economic growth. Not to mention that shifting tax policies--and they always shift over time--create an uncertain business environment, further reducing investment.

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