Ethics in the Marketplace:

Examples of bad behaviour in the market:

- Universal Music, Sony, Warner, Bertelsmann's BMG and EMI groups, Musicland, Tran World Entertainment, etc. fined $67.4 million and had to distribute $76 million in CDs to public/non-profit groups for overcharging consumers by $480 million
- Dow Chemical, DuPont and Bayer, among others, are being investigated or have been charged with price fixing and boosting prices in the chemicals required to make rubber
- In a five-year period, 10 per cent of companies on the New York stock exchange were involved in antitrust (antimonopoly) suits
- European & Japanese pharmaceutical companies (vitamins) charged $335 million for fixing prices from 1989 - 1998

1

Argument about when markets justified

1. If free (i.e., unregulated) markets are justified, then they "allocate resources and distribute commodities in ways that are just, that maximize…economic utility…and that respects the freedom of choice of both buyers and seller." (166-7)
2. If free markets allocate resources and distribute commodities as in (1) above, then free markets must be truly competitive.
3. If free markets are truly competitive, then firms don't combine together "to fix prices, drive out competitors with unfair practices, or earn monopolistic profits from their customers." (167)
4. (By contrast) if firms do combine together to fix prices, drive out competitors with unfair practices, or earn monopolistic profits from their customers, then free markets are not justified.

2

The range of Market competition:

monopoly → oligopoly → perfect competition

The Ideal of Perfect Competition: "A free market in which no buyer or seller has the power to significantly affect the prices at which goods are being exchanged" (167)

Perfectly competitive free markets require:

1. Many buyers & sellers; no one has a substantial share of the market
2. All buyers and sellers can freely and immediately enter or leave the market
3. Every buyer/seller has full & perfect information about each other's market activities + knowledge of prices, quantities, and quality of all goods
4. The goods being sold are so similar that no one cares from whom one buys/sells (i.e., no branding; goods are "commoditized")

3

5. The costs/benefits of producing goods are borne entirely by those buying/selling the goods, and not by external parties
6. All buyers/sellers maximize utility (get as much as possible for themselves for as little as possible)
7. No external parties (e.g., government) regulate price, quantity, or quality of goods

Free markets also depend on private property, systems of contracts and systems for the production of goods

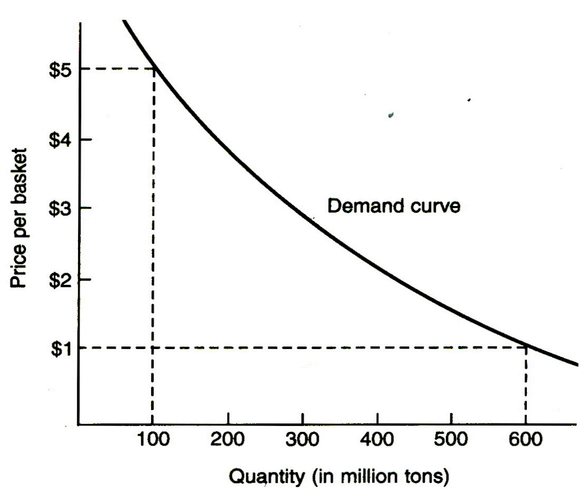
***Equilibrium point*:** In perfectly competitive markets "the point at which the amount of goods buyers want to buy exactly equals the amount of goods sellers want to sell, and at which the highest price buyers are willing to pay exactly equals the lowest price sellers are willing to take…every seller finds a willing buyer and every buyer finds a willing seller" (168)

Thus, perfectly competitive free markets achieve capitalistic justice, utility and rights.

Equilibrium in Perfectly Competitive Markets

Demand curve: a line on a quantity-price graph which shows the most consumers will pay for some product, depending on how much of that product they buy (168)

Demand curves slope down to show that the more units consumers buy of an item, the less they are willing to pay for more units of that item



Demand curve for potatoes

Comes from the *principle of diminishing marginal utility*: the more of a thing a person has, the less valuable it becomes to them

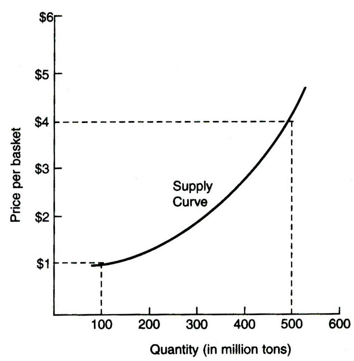
If the price of a good goes above the curve, consumers would pay more than they value the good; conversely, if prices go below the curve, they would pay less than they value it.

But if prices are above the curve, buyers won't buy, so prices will drop; conversely, if prices are below, buyers will quickly snap up the cheap goods, and drive their prices back to the curve

Supply curve: A line on a quantity-price graph which shows how much producers must charge to cover the average cost of supplying a unit of a good. (169)

After a certain point, the cost of producing a good rises; so the curve slopes upwards

7



Supply curve for potatoes

Based on the *principle of increasing marginal costs*: Since productive resources are limited, it soon becomes more costly to produce goods (the cheaper methods become exhausted)

8

The costs of producing a good include:

(a) *Ordinary costs*, such as labour, materials, distribution, etc.

(b) *Normal profits*: "the average profit producers could make in other markets that carry similar risks" (170)

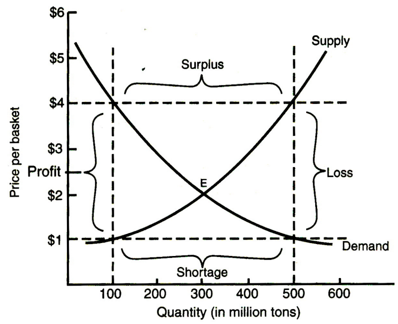
If prices fall below the supply curve, the producers aren't covering their costs, and will leave the market

If prices go above the curve, new producers will be attracted to the market

Buyers and sellers interests converge at the "equilibrium point" or "equilibrium price"

At this point, demand and supply curves intersect (171)

9



Are there any industries whose markets match this curve?

"Only a few commodity markets, including agricultural markets, such as grain and potato markets, come close to embodying the six features that characterized a perfectly competitive market" (172)

10

Idealizations express "laws of nature" as they *would* operate, without confounding factors: e.g., how objects *would* fall, without air resistance

On analogy, if we ignore that people are imperfect reasoners, with imperfect information, and that markets are vulnerable to monopolies and oligopolies, we can isolate the pure forces of market competition and see their value

Ethics and Perfectly Competitive Markets

Capitalist Justice recap: "…benefits and burdens are distributed justly when a person receives in return at least the value of the contribution he or she makes to an enterprise: Fairness is getting paid fully in return for what one contributes" (172)

The equilibrium point is where both buyers and sellers get exactly the value of their contribution as seen by everyone in the market, so free markets achieve objective ***capitalist justice***.

11

Competitive markets also maximize the ***utility*** of buyers and sellers because:

(1) The consumer is "sovereign," since consumer demand determines where industries and resources will flow, until they reach equilibrium

(2) Markets make maximal use of available resources; and

(3) Consumers will be maximally satisfied, since they will have received exactly what they want at the best price; so, no one will trade their resources

Free markets also respect buyers and sellers ***negative rights*** because:

(1) Each buyer and seller has perfect freedom to enter or leave the market

(2) No exchanges are coerced by externally set standards and others aren't forced to pay for them

12

(3) No seller/buyer is so dominant that they can force others to accept their terms

Some cautions:

(1) Free markets don't produce other forms of justice, such as those based on need or equality

(2) Free markets only maximize the utility of buyers/sellers, and not necessarily those of larger society (e.g., this broader utility might be increased by giving more to those who can't participate or by restricting the purchases of those with a lot of wealth)

(3) Free markets may diminish positive rights by consuming all the resources that those outside of the market need to flourish (i.e., develop their own freedom and rationality)

13

(4) Free markets ignore and even conflict with the demands of care by making it costly and inefficient to give special care to people (e.g., paying workers more can either make goods more expensive or leave less capital for development)

(5) Free markets can promote moral vices: e.g., encourage greed, selfishness, avarice; manipulation vs. loyalty, kindness & caring

(6) Free markets only achieve capitalist justice if there is perfect competition (our focus in this lecture)

Monopoly Competition: In a monopoly, there is only one seller; so other sellers are not free to enter the market (e.g., because of patent laws or high capitalization costs)

Classic example: Alcoa and the aluminum market

Alcoa held the patent for purifying aluminum until 1909, and later new comers lacked Alcoa's start-up capital and trade connections

14

Alcoa was successfully prosecuted in 1940s under Sherman Antitrust Act

Western Electric and telephone supplies

Mergers can also create monopolies (Standard Oil/Exxon & American Tobacco Co.)

In monopoly markets, the seller can control supply and keep the price above equilibrium

Why will monopolies invariably exploit their power to keep prices high?

Drug company monopolies (178-9)

Monopolies: Justice, Utility & Rights

Justice: Monopoly markets force buyers to pay higher prices for items than it costs to produce them; so they violate capitalist justice.

15

Utility: Monopoly markets are not efficient since:

(i) They produce shortages of goods (shown by high profit margins), and they prevent these shortages from being filled; a monopoly also forces consumers to pay inflated prices;

(ii) They don't encourage efficient use of resources — there is no need to find less costly ways to produce things;

(iii) They don't allow maximal satisfaction, since a monopoly can adjust its prices to the consumer (those who want something more, will pay more)

Rights: Monopolies restrict negative rights:

(a) Sellers cannot freely enter markets

(b) Buyers are forced to buy goods that are not what they want (if they want X, they must also buy Y, which they don't want)

16

(c) Monopolies set unfair prices and quantities

4.2 Oligopolistic Competition

Oligopolistic markets are "highly concentrated" = 3 to 8 firms

So: Too few sellers; and too difficult for new sellers to easily enter the market (high cost, existing contracts, ad-created loyalty)

Oligopolies tend to be large, well known corporations (182-3)

They tend to be formed by ***horizontal mergers*** (unification of competitors)

Oligopolies make it easier for managers to collude in price fixing and restricting supply

"It has been shown…that generally the more highly concentrated an oligopoly industry is the higher the profits it is able to extract.…

17

[It is] estimated that the overall decline in utility as a result of inefficient allocation of resources by highly concentrated oligopoly industries ranges between 0.5 percent and 4.0 percent of the nation's gross national product or between $10 billion and $80 billion per year" (182-3)

Explicit Agreements: managers can meet to set prices; this is easier if there are fewer corporations

When they collude, oligopolies duplicate the power and effect of monopolies

Unethical Market practices

Price Fixing: Table 4.3, p. 184

Manipulation of Supply (e.g., hardwood manufacturers and output policy meetings; OPEC)

18

Exclusive Dealing Arrangements: "when [a firm] sells to a retailer on condition that the retailer will not purchase any products from other companies and/or will not sell outside of a certain geographical area" (185)

Tying Arrangements: if you want one thing from us, you've also got to buy others (Chicken Delight: cooked chicken plus special cookers)

Retail Price Maintenance Agreements**:** forcing retailers all to sell for the same price (e.g. Kodak and "Kodachrome")

Price Discrimination: "To charge different prices to different buyers for identical goods or services" (185). E.g. in Salt Lake City, Continental Pie Co. used "predatory" pricing to get rid of a competitor

Tacit Agreements: Managers in oligopolies can realize that cooperation is in their common interest

So a leading corporation may raise prices signalling its intention not to get involved in competition

"To coordinate their prices, some oligopoly industries will recognize one firm as the industry's 'price leader.' Each firm will tacitly agree to set its prices at the levels announced by the price leader, knowing that all other firms will also follow its price leadership" (244)

4.4 Oligopolies and Public Policy

The Do-Nothing (Laissez-faire) View: Some economists argue that oligopolies have relatively little power, because:

(1) "although competition within industries has declined, it has been replace by competition between industries with substitutable products" (190) e.g., aluminum vs. steel and cement oligopolies)

(2) Other large corporate groups, such as governments and unions restrain the power of big businesses (big buyers against big sellers) (J. K. Galbraith);

(3) Unless oligopolies *actually* fix prices or form monopolies, they usually give consumers the products they want at an efficient price;

(4) Big is good, since this allows competition with large foreign companies and their "economies of scale"

The Antitrust View: We should divest large companies of smaller holdings

J. Fred Weston's reasons (pp 191-2):

1. If an industry is not atomistic (i.e., with many small competitors) there is likely to be administrative discretion over prices.
2. Concentration creates recognized interdependence, hence no price competition.
3. Concentration is unnecessary, since about 3 to 5 % of industry is sufficient for efficiencies of scale.
4. Industries with oligopolies tend to be much more profitable than they should be, and entry to them is very difficult.
5. Product differentiation and advertising concentrate industries, and produce (are correlated with) higher profits.
6. Oligopolistic coordination can be achieved via press releases, among other methods.
7. Breaking up corporations into smaller units will increase competition, decrease collusion, and prices, produce greater innovation, and cost cutting technologies.

22

The Regulation View: Large companies have benefits, such as mass production and distribution can only be achieved by large organizations. They are also better able to use large-scale production

So, rather than breaking up large firms, we should set up regulatory agencies specifically to monitor price fixing and other behaviour not in the public interest

When regulation doesn't work, use nationalization: "the government should take over the operation of firms in those industries where only public ownership can ensure that firms operate in the public interest" (192)

Others of the regulation bent, however, argue that public firms create "unresponsive and inefficient bureaucracies" and don't have to meet competitive pressures.

Velasquez: There doesn't seem to be enough information to decide which of these views is correct

23