MONOPOLY — THE RULES OF THE GAME

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FOR WELL over forty years, most politicians, most economists, most government officials, and most of the press and other moulders of public opinion, have been busily contributing their talents and energies to the creation in this country of a protectionist state, beset by all manner of barriers to trade, both internal and external. So heavily involved has government become in all aspects of life, that businesses are only incidentally concerned with making better and cheaper products than their competitors, and the successful captain of industry to-day is he who has the ear of the people who matter in and around Westminster and Whitehall.

Against this background of ever-increasing government intervention, it is difficult to see the Fair Trading Act, 1973, and the Monopolies and Mergers Commission as other than cheap paste jewellery on a body politic grown leprous. Yet there is fascination in disease, and the morbid amongst us must be grateful to the Institute of Economic Affairs, and to George Polanyi, the author, for making available Research Monograph 30, *Which Way Monopoly Policy*?

The Fair Trading Act, 1973, has in essence perpetuated the apparatus and functioning of the Monopolies Acts of 1948 and 1965. In one respect, though, the new Act does aim to innovate. The objective set by the 1948 Act was the generalised one of improving the efficiency of the U.K. economy, and even this was only "amongst other things . . . which appear in the particular circumstances to be relevant". The new Act, however, specifically states that the public interest is to be secured by "maintaining and promoting effective competition between persons supplying goods and services in the United Kingdom" (clause 84). Efficiency is to be achieved by "promoting, through competition, the reduction of costs and the development and use of new techniques and new products and . . . facilitating the entry of new competitors into existing markets."

One does not have to be a cynic to suspect that there must be a catch, there must be more to follow. There is. The promotion of competition is to be taken into account only "among other things". Note "among", not "amongst", as in the old Act: one must take one's innovations where one can find them. Anyhow, these "other things" include "maintaining and promoting the balanced distribution of industry and employment in the United Kingdom". Again, as Mr. Polanyi points out, the Fair Trading Act's guidelines leave the way open for recommendations for price control rather than for improvement of the working of competition.

The author quotes Professor G. C. Allen, a former member of the Monopolies Commission, who has written in *Monopoly and Restrictive Practices,* (Allen and Unwin, 1968) of the public interest aspect of the investigations, that "the guidance given by the (1948) Act consisted of a string of platitudes which the Commission found valueless, and it was left for the members themselves to reach their own conclusions by reference to the assumptions, principles or prejudices which their training and experience caused them to apply to economic affairs." Mr. Polanyi does not hold out much hope that things will be very different now, referring to vagueness and generality, the risk of arbitrariness, and the lack of consistent direction in policy resulting from a multiplicity of objectives.

Mr. Polanyi would like to see a change in the character of monopoly inquiries. "Instead of wide-ranging investigations where neither the Commission nor the firms summoned before it can anticipate what will be the critical issue, it would be known from the start that whatever hinders competition will be subject to criticism, and all else will be irrelevant. Questions such as whether a firm is efficient (except insofar as this gives evidence of the degree of competition) would be left out of account, and considerations of regional policy or the rights of dismissed employees would be left to be dealt with by other parts of public policy".

This change in approach would "concentrate attention on the issues of what really constitutes 'the market' (what is the range of effective alternatives); what are the obstacles (other than the merits of the product of the leading supplier) to entry of new competitors or other forms of competition; what is the nature of the prevailing type of price competition and price leadership; and what, if any, are the specific aspects of conduct or structure that directly hamper competition. . . . Attempts to discover whether profits or prices are inherently too high or too low and therefore a sign of inefficiency," would be omitted altogether. "While the content of monopoly inquiries would thereby be altered to concentrate on the issues relevant to competition, their character as a quasi-

judicial process would also be moved closer towards a rule of law and away from discretionary interventions."

Mr. Polanyi has already examined the Monopolies Commission at work, in another I.E.A. Research Monograph, *Detergents: a Question of Monopoly?*

Here he looks in some detail at three recent cases, all of which were the subject of official reports published last year. All three were of course conducted on the 1948 criteria. One inquiry concerned asbestos and the firm of Turner and Newall: the findings were broadly favourable to the company. The second was an investigation into breakfast cereals and the activities of Kellogg Ltd. — here the verdict was akin to being let off with a warning as to future conduct. The third case, perhaps the only one of the three to receive wide public attention, was the inquiry into Roche Products Ltd. and the supply of the tranquillising drugs, librium and valium. The Commission in this case brought in a highly hostile verdict and recommended, *inter alia,* cuts of 60 per cent and 75 per cent in the respective selling prices of the products.

A basic criterion for the reference of a company to the Commission is its market share (one third used to constitute the qualifying condition of 'monopoly', but the Fair Trading Act has since lowered this to one quarter), yet size and market dominance have not been automatically linked with harm by the Commission, and, as the author points out, there is no such well-founded relationship.

In the Turner and Newall case, asbestos products were seen not to be one market, but many, in almost all of which the company had to compete with close substitutes. In the pharmaceuticals case, it was established that Roche had a 99 per cent share in the supply of products identical with librium and valium. Although supplies of these to the National Health Service amounted to over 60 per cent of the value of total purchases of drugs known as tranquillisers, this figure fell to only 13 per cent if a wider market including an effective range of substitutes were to be considered instead. In the author's view, "the case for a relatively narrow market definition is not clearly established." The report contained no "systematic analysis by the Commission of the factors determining the degree of substitutability which led them to accept the official view that the appropriate market is tranquillisers . . . and not the wider range of alternatives. . . .

"Nor is there detailed analysis of the strength of competition in either of these markets." In view of this, the fact that there is no provision for appeals against ministerial orders made following a recommendation by the Commission — in this case, the enforcement of very large price cuts — is particularly alarming.

In the Roche investigation, the concept of self-restraint in pricing and profits was an important part of the analysis leading to a verdict that a price reduction should be imposed. Mr. Polanyi's comments are worth quoting in full. "This doctrine of restraint, whether imposed by the firm itself or compulsorily by the state, is one of regulatory control, not of control of prices and profits by competition. The competitive approach is to let the price mechanism function freely and allow it to signal opportunities for the profitable use of additional resources where (because for example of successful innovation) exceptional profits are being earned. The role of competition policy is then to identify and remove barriers to the entry of these resources (tariffs, collusive practices, 'blocking' patents, etc.) and help the competitive process to exert downward pressure on profits and prices. This may be an imperfect method, and sometimes monopoly profits (for a time) persist in spite of the removal of obstacles to competition. But the alternative solution of regulatory control is clearly incompatible with promoting competition because it discourages new entry and the expansion of existing competing firms in the profitable sector."

The question of patents is given a substantial airing by Mr. Polanyi. The purpose of patents is to confer a temporary monopoly and to prevent direct price competition. Since Roche had patents for librium and valium, it is not surprising that the inquiry showed that the drugs were being sold at prices which were bringing in good profits against the costs of manufacture, research, and sales promotion. The Commission's final recommendations against Roche were, says the author, "based on the view . . . that patent rights cannot be exercised freely but must be subject to price control to limit the rate of return."

After noting that only one in 3,000 potential new drugs succeeds in going through all the stages to effective marketing, Mr. Polanyi draws attention to the report of the Sainsbury Committee, which thought that the patent period should be shortened: instead of full protection for sixteen years, there should be a shorter period of exclusive rights for the patentee followed by a generalised system of licences as of right for the rest of the sixteen years. In the Roche case, over two thirds of the patent right had expired and the Commission considered that a stage of "undue exploitation of success" had been reached. It might have been "undue", or it might not, but,

with the law as it stands, was Roche wrong in believing that it was legal?

The Commission's conclusions on Roche rest on what the author describes as "qualitative judgements of what profit or price is 'fair'. In terms of economic analysis this concept has no meaning because the only 'fair' price in this context is one arrived at in conditions of effective competition." He believes that "the only issue is the degree of competition and whether it is effective, and the Commission's analysis ought to be confined to this point. . . . The question is whether the rules of competition — in particular on length of patent rights and provisions for licensing — tend to reduce the temporary monopoly profit to no more than is required to induce innovation. . . . 'Fair' prices and profits have no part in it, and indeed inhibit the process by which competing suppliers aiming at maximum profit could achieve efficiency . . . under such conditions of effective competition."

For more on pharmaceuticals, and for a glimpse into the worlds of asbestos and breakfast cereals, Mr. Polanyi's slim volume is strongly recommended reading. One's final thought must be, though, relief that near the end the author has seen fit to put the Monopolies and Mergers Commission in perspective. "It is neither equitable nor efficient if, for example, in one aspect of policy, controls on the movement of prices and wages frustrate the working of competition in the entire economy, while in another, laborious inquiries are pursued over several years into the minutiae of a company's market situation and behaviour to discover whether they might in some aspect be monopolistic." Few readers will require to remind themselves about the swallowing of camels and the straining at gnats.

Anyone for monopoly?