A Case for Regulation of Monopolies and Oligopolies

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Abstract

This paper makes the argument that monopolies and oligopolies should be regulated in the best interest of the public. This is done in light of various theories of ethics. The paper also recommends some fundamental issues that must guide policy makers in the effort to regulate the marketplace.

1. Introduction

This paper argues in favor of regulation of monopolistic and oligopolistic markets. This is done in light of various theories of ethics. The paper also recommends some fundamental issues that should guide policy makers in the effort to regulate the marketplace.

Let us begin by clarifying some basic terms. According to Manuel Velasquez (2006, 167), a market is a forum where people exchange goods and services. Classical textbooks of economics describe three kinds of markets — a perfect competition, a monopoly, and an oligopoly (Henderson and Pole 1991, 277 - 360). A perfect competition is defined to be a market with the following conditions:

a. Each participant (buyer or seller) has perfect knowledge of all aspects of the market.
b. No participant has the power of significantly affecting the price of goods and/or services.
c. Participants can enter and leave the market at any time.
d. Goods and services are similar.
e. Participants all seek to maximize their utility.
f. The market balances itself so that the cost of production is absorbed by the selling price of goods and services.
g. There is no intervention in the marketplace from any external institution.

This so-called perfect competition is often referred to as a free market, and is attributed to the work of Adam Smith in his text, Wealth of the Nations, published in 1776 (Glahe, 1993). Carrying on from this, a monopoly is defined as a market that is dominated by a firm, or a group of firms acting as a cartel; and an oligopoly is defined as a market that is dominated by a few firms.

The debate about the efficacy of the Adam Smith free market model (Adam Smith Institute, 2008) has dominated the fields of economics and politics for most of the previous century, and indications are that it will continue to be featured in discussions to come. This discussion has also dominated political discussions in the United States of America (USA) over the past three decades, and intensifies every time there is a general election. Extremists in the Republican party (referred to as the far right) seem to expose the argument that the market should be free of regulations; extremists in the Democratic party (referred to as the far left) seem to argue in favor of regulation and intervention in a number of issues including the economy, education and health care. It appears the two groups will never fully agree.

This paper takes a pragmatic approach by attempting to answer the question, what is in the best interest of the public? It proceeds as follows: Section 2 identifies what appears to be a problem in economies that implement or attempt to implement the free market model. Section 3 provides brief clarifications on various theories of ethics, and applies them to the problem. Section 4 observes that a number of problems tend to exist in unregulated markets. Finally, section 5 proposes appropriate public policy guidelines to deal with the stated problem, followed by a summary in the final section.

2. The Problem with Free Markets

Contrary to common economic thought, perfect competitions, as defined in the literature (Henderson, 1991, pp. 278 - 283; Velasquez, 2006, p. 167) apparently do not readily occur on their own, and when they do, they require external intervention to preserve them. Conversely, monopolies and oligopolies are rampant because a business left on its own, will seek to maximize its profits by increasing its market share, in keeping with the utilitarian principle (Bentham 1781).

There is a term that is widely used to refer to the implementation of the free market model with negligible regulation and monitoring. It is called *unfettered capitalism* (Darr, 1996; Heutis, 2004; Palaema, 2008). Over the past three years, CNN's Lou Dobbs (2006) has launched a campaign to arouse public awareness of what he calls the "war on the middle class," caused by unfettered capitalism. Over the past decade, we have also witnessed a noticeable increase in corporate scandals, and attempts by companies to monopolize the marketplace. Companies such as Enron and Microsoft readily come to mind (Culpan and Trussel, 2005; Economides, 2001).

It seems that in many cases, when economies attempt to implement a free market system with negligible or no regulation, the end result is severe economic hardship. Several countries have tried this with disastrous results from which they are still trying to recover. Jamaica and Russia are useful cases in point. Some of the problems that have been observed to arise from wanton implementation of free markets are collusion by corporations to monopolize the market, price-fixing, supply manipulation, tying arrangements, exclusive dealing arrangements, price discrimination, unfair advantages, and bribery (Velasquez, 2006, pp.176 – 190).

3. Applying Theories of Ethics to Monopolies and Oligopolies

Business ethics has become a very topical issue in businesses, government, and institutions of higher learning over the past two decades. There are nine related schools of thought that will be applied in this discussion: the utilitarian principle, the categorical imperative principle, the stakeholder theory, the theories of justice, the theory of the ethics of care, the theory of virtue ethics, the theory of ecological ethics, the contract theory, and the theory of due care. This section provides a brief clarification of each, and applies the theory to monopolistic and oligopolistic markets.

3.1 The Utilitarian Principle

The utilitarian principle was first introduced by Jeremy Bentham (1781), and has since fascinated numerous philosophers and academics. The essence of the principle is that an action is right if its overall net effect on society is to diminish social costs and increase social benefits.

A situation that would easily warrant the application of the utilitarian principle is a company trying to maximize its profits in a legal and ethical way. A situation that renders the principle inadequate is an organization seeking to maximize profits in a manner that may be legal, but

causes injury to one or more individuals in the society. While this act could be justified from a utilitarian perspective, it would be in violation of other ethical principles such as the categorical imperative principle, the stakeholder theory, various theories of justice, the contract theory, and the theory of due care (these are all clarified below). If we apply this scenario to monopolies and oligopolies, it easy to see how an organization may choose to disseminate misleading or incomprehensive information about a product or service in order to maximize its sale of such product or service. This would violate condition (a) for perfect competition, since buyers would not be obtaining perfect knowledge of all products/services in the market.

3.2 The Categorical Imperative Principle

The categorical imperative principle was first introduced by Immanuel Kant in 1785. The essence of the principle is that one should always act in a manner that he/she would be comfortable if everyone else acted, and the reason for the action is a reason that he/she would be comfortable with if everyone else used it in acting in a similar manner (Sullivan, 1989). This principle is similar to that articulated by Jesus Christ in (Matt. 7:12, New King James Version), which states, "whatever you want men to do to you, do also to them…" — a principle that has become known as the Golden Rule.

Acts such as price-fixing, tying arrangements, coercion, or exclusive dealing arrangements that are common in monopolies and oligopolies are in violation of the Kantian categorical imperative principle. Moreover, these actions serve to disrupt the stated conditions for perfect competition, violating at least one (but in many instances, each) of the first three conditions. To appreciate this, try calling six to ten mortgage companies and pose as someone interested in refinancing a property. You are likely to waste a considerable amount of time in this exercise, and if you are keen, you will also observe some rather creative ways that some of these companies withhold information in order to suck the consumer into buying their service.

3.3 Stakeholder Theory

In an apparent attempt to unite the merits of both the utilitarian principle and the categorical imperative principle, R. Edward Freeman (1994) draws from the shareholder theory (Quinn and Jones, 1995) to propose a revised stakeholder theory that places on the shoulders of the management of a corporation, the dual responsibility of acting in the best interest of shareholders and investors on one hand, and employees and the community on the other. He argues in favor of expanding the Shareholder Theory (Quinn and Jones, 1995) to a multi-fiduciary interpretation of the Stakeholder Theory, to include stockholders and stakeholders. Freeman then proposes three principles that should drive the operation of managers in corporations (Freeman 1994, 417):

- **Stakeholder Enabling Principle:** "Corporations shall be managed in the interests of stakeholders, defined as employees, financiers, customers, and communities."
- **Principle of Director Responsibility:** "Directors of the corporation shall have a duty to care to use reasonable judgment to define and direct the affairs of the corporation in accordance with the Stakeholder Enabling Principle."
- **Principle of Stakeholder Recourse:** "Stakeholders may bring an action against the directors for failure to perform the required duty to care."

Based on Freeman's contribution, any act by an organization to exploit the consumers that it serves would qualify as being unethical, and could potentially undermine any (or each) of the first three conditions for perfect competition. Additionally, any act by the organization's employees to undermine the corporate mission of the organization would also qualify as being unethical, and could undermine the organization's ability to maximize it profits (condition e). Freeman's contribution should therefore serve as a useful resource for organizations in the marketplace.

3.4 Theories of Justice

There are various definitions of justice, but the one by BrainyQuote.com (n.d.) is rather useful: Justice is defined as "the quality of being just; conformity to the principles of righteousness and rectitude in all things; strict performance of moral obligations; practical conformity to human or divine law; integrity in the dealings of men with each other; rectitude; equity; uprightness." This definition contains a number of significant terms: righteousness, rectitude, moral obligations, conformity to … law, integrity, equity, and uprightness. The definition therefore suggests that justice is more than mere law observance; it is about being right. As Velasquez (2006) explains, there are three categories of justice: distributive, restrictive, and compensatory (p.88). He also describes various perspectives for the application of distributive justice: egalitarianism, capitalism, socialism, libertarianism, and Rawls' theory of justice as fairness (Velasquez, 2006, pp. 89 – 99; Rawls, 1999).

Applying this understanding of justice to monopolies and oligopolies, it is clear that justice is not served on society when individuals are exploited, manipulated, or deceived for the financial gains of one or a few corporations. Price-fixing, supply manipulation, tying arrangements, exclusive dealing arrangements, price discrimination, unfair advantages, and bribery are all contrary to societal justice. Moreover, as in the previous subsection, they could potentially undermine any (or each) of the first three conditions for perfect competition.

3.5 Theories of Care and Virtue

The theory of the ethics of care owes its advancement to Nel Noddings (1984), but has caught the attention of several authors, including Mark Smith (2004), and Velasquez (2006, pp. 100 – 105). The ethics of care theory may be summarized in two points: Firstly, we should nurture and preserve concrete relationships that we have with specific individuals. Secondly, we should specially care for members of our web of close relationships, by attending to their needs, values, desires and well-being. When companies are given a free reign to pursue strategies that are injurious to members of the society, this violates the ethics of care principle.

This brings us to the theory of virtue ethics. This theory traces back to the work or ancient philosophers Plato and Aristotle (Stanford Encyclopedia of Philosophy, 2007). The theory submits that human action is driven by character. Virtuous character yields virtuous actions; bad character yields bad actions. In explaining the theory of virtue ethics, Velasquez (2006, p. 113) explains how actions may be judged: An action is morally right if it exhibits or promotes a morally virtuous character; an action is morally wrong if it exhibits or promotes a morally vicious character. Applying this theory to monopolistic or oligopolistic markets,

there is nothing virtuous about allowing companies to morph into monopolies and then exploit society through price-fixing, supply manipulation, tying arrangements, exclusive dealing arrangements, price discrimination, or nurturing of unfair advantages against other participants in the market.

3.6 Theories Relating to the Production and Marketing of Goods and Services

The theory of ecological ethics argues that individuals and organizations have a responsibility to preserve the ecological system in which they operate. A corollary of this theory is that all human beings have a right to a livable environment (Velasquez, 2006, pp. 226 – 231). The argument has also been eloquently and forcefully made that pollution violates principles of distributive and compensatory justice (pp. 235 – 236). Consequently, proponents of the ecological theory are usually strong supporters that human beings are responsible for taking the steps necessary to protect the environment. Other issues include protecting wildlife and endangered species, and curbing pollution.

Pollution violates and undermines the principle of a free competitive market as defined in the literature (Henderson and Poole, 1991, 277 - 304) in a two ways: it imposes external costs on market participants (Velasquez, 2006, pp. 231 – 234) — costs they do not choose, and in many cases, did not know about (conditions a and b); it threatens the very tenet of civilization and competition by contaminating the very resources needed to live and actively participate in the market (condition g).

The contract theory (Velasquez, 2006, pp. 265 - 272) purports that a manufacturer/vendor has certain obligations to its customers, and that a sale is actually the implementation of this contract. The company agrees to provide a product/service with certain characteristics and features; the consumer agrees to pay for the product/service. The manufacturer/vendor agrees to the duties of compliance, disclosure, provision of accurate information to consumers, and non-coercion of consumers. Companies that fail to meet any of these benchmarks are considered to be in violation of the contract theory.

The final theory to be noted is the theory of due care (pp. 272 – 278). This theory argues that the manufacturer/vendor is in a privileged position of having information about a product/service that consumers may not have. The manufacture/vendor therefore has the obligation to exercise due care for the consumer in areas of design, production, and information dissemination. Any act of deliberate exploitation of the consumer, dissemination of false or misleading information about a product or service, or failure to disclose pertinent information about a product or service, would qualify as a violation of the theory of due care. Such acts could also undermine any or each of the first three conditions for perfect competition.

4. Observations

From the foregoing discussion, it is evident that unfettered capitalism, or unregulated monopolies or oligopolies (or whatever alternate term that is used) is an undesirable phenomenon. Susan Ariel Aaronson (2005) articulates quite eloquently that the United States (US) government needs to play a more active role in providing unambiguous guidelines for multinational corporations operating in developing countries where the temptations for

human exploitation and other unethical conducts are very great. She argues that the government has an ethical obligation to provide leadership and example in corporate social responsibility (CSR) — a term used for ethics. She makes the case that other developed countries are leading the US in this area, and suggests that the US government could address this in four specific ways: have clearly defined social and environmental responsibilities, and benchmarks for multinational corporations; reexamine and revise existing policies that appear to undermine global corporate social responsibility (CSR); make the US government a model of CSR; require pension funds of these corporations to report on social and environmental consequences. I would argue that these principles need to be applied by government to the local economy as well.

Research conducted by David Heinze (1999) suggests that CSR, financial soundness (FS), and investment value (IV) are related in the following ways: There is a direct proportional relationship between CSR, FS, and IV. The relationship between CSR and FS is stronger than the relationship between CSR and IV. This observation is consistent with conventional wisdom for prudent business, as was displayed by Roy Vagelos of Merck Corporation, who led his company to volunteer over 500 million dollars in finding a cure for a disease called river blindness (Velasquez, 2006, pp. 4 – 7). In view of this, government should be held accountable to the responsibility of ensuring that organizations are encouraged to conduct business in an ethical way, and discouraged from doing otherwise.

The argument for limited regulation of the marketplace is really a call for pragmatism. Life experiences have taught us a number of valuable lessons, some of which are stated below:

- Businesses when left unregulated, in an effort to maximize profits, often pursue strategies that inflict much pain and financial strain on members of the society, thus violating the very utilitarian principle that they often use in their defense. The Enron debacle is an apt case in point (Culpan and Trussel, 2005).
- In pursuit of the self-interest of maximized profits, businesses often violate the Kantian categorical imperative principle by violating the rights of others. Pollution is an example of this. Because of water pollution, land pollution, and air pollution, millions of people today are homeless; millions are famished, with no prospect of obtaining clean water; and our planet is endangered from global warming, and depletion of the ozone layer.
- As mentioned in the previous section, pollution violates principles of distributive and compensatory justice. People are entitled to clean air, water, and privately owned property. When due to pollution, these essentials are denied, or the value of any is compromised, this is a form of injustice. Regulation to protect these rights is therefore essential.
- Pollution violates the principle of care for the environment and for those who benefit from it. Unregulated businesses have not done a good job of exercising this care, hence the need for regulation in the form of pollution laws.
- Pollution destroys the fabric of the ecological system that is necessary for life. Since unregulated businesses have failed to exercise due diligence in protecting the ecological systems in which they operate, pollution laws have become necessary.
- There is nothing virtuous about wantonly destroying the ecological system in order to maximize profits. Pollution threatens not only plant and animal life, but human beings as well. Regulation has therefore become an absolute imperative.

- Companies often disseminate misleading and/or incomprehensive information about the products/services they market, in order to gain unfair competitive advantage in the marketplace. This violates ethical principles of due care, and the contract theory.
- Acts such as price fixing, collusion, supply manipulation, tying arrangements, exclusive dealing arrangements, price discrimination, unfair advantages, and bribery are all contrary to societal justice. Moreover, they disrupt the free market by providing unfair advantages for some, and extreme disadvantages for others.

Despite what the pundits say, the fact is, unfettered capitalism has never worked anywhere, and offers no guarantee that it ever will. Alexander Hamilton, the first United States (US) Secretary of the Treasury, understood this quite well. That was why he founded the US Mint, and took steps to encourage the efforts of the manufacturing and agricultural sectors. More recently, former Federal Reserve Bank head, Alan Greenspan recanted from the doctrine of unregulated free market, and conceded to the US Congress that he was wrong in his former beliefs (MacNeil/Lehrer Productions, 2008). Unfortunately, it took a catastrophic recession caused by greed, selfishness, and indiscipline, to extract this admission.

Regulation is necessary, not to interfere with the market, but to ensure and protect it from unscrupulous acts driven by human greed and selfishness. The only dominant democratic government in the modern free world that has not yet come to full realization of this appears to be the US government. While there is still much ground to cover, market indications suggest that slowly, painfully, reflectively but surely, we'll get there.

5. Proposed Public Policies to Regulate Monopolies and Oligopolies

Consistent with Aaronson's call for policy guidelines for multinational corporations (Aaronson 2005), and Velasquez's proposal for dealing with disparities in ethics due to national differences (Velasquez, 2006, pp. 116 – 117), I would recommend the following ethics policy guidelines for corporations in a free market (be it a free market, monopoly or an oligopoly):

- All human rights clarified by the United Nations must be upheld.
- Companies and individuals must be protected against blatant deceit and exploitation by other companies or individuals.
- No company or individual should be allowed to exact coercion or exclusion on participants in the marketplace by pursuing strategies of collusion, supply manipulation, tying arrangements, price discrimination, or other strategies deemed to be unfavorable or harmful to participants in the marketplace.
- Organizations should be required to act in an environmentally responsible manner. This includes observance of non-pollution guidelines, as well as guidelines relating to the protection of endangered species and wildlife.
- Corporations must always act in accordance with the law.
- Violation of any established law or ethics policy should be met with severe punitive and retributive charges against the corporation, as well as possible criminal charges against individuals responsible.

In addition to these guidelines, the following guidelines should apply to multinational corporations:

- All human rights clarified by the United Nations must be upheld, irrespective of the cultural norms within the country in which business is conducted.
- If due to national differences, there are disparities in ethical standards, the multinational corporation has a responsibility of observing the broader, more far-reaching standards, in the interest of human dignity.
- Where there are significant differences that are not easily resolved, the multinational corporation should engage in dialogue with the host country as well as its home country to obtain clarification.
- Multinational corporations must always act in accordance with local and international laws.

Government has an important role to play in promoting and preserving ethical conduct in the marketplace. Most countries have the equivalent of a bureau of standards (BOS). The role of the bureau of standards is to work closely with corporations operating in various industries of the economy to establish manufacturing standards. These standards are then documented and communicated to the wider community. The BOS also monitors the various industries to ensure that corporations conform to the established industry standards.

The role of the BOS in any country or state can be extended to include ethical standards for the various industries of the economy. As in the case of manufacturing standards, these benchmarks should not be unilaterally set by the BOS, but should be deliberated and determined by industry players, with facilitation and direction coming from the BOS. BOSs in various countries and states have traditionally done an excellent job of articulating and enforcing manufacturing standards; it is therefore reasonable to expect that they should also succeed in including ethical standards to complement the manufacturing standards. In the United States of America (USA), these services are provided by multiple institutions including the American National Standards Institute (ANSI), the Environmental Protection Agency (EPA, and the Food and Drug Administration (FDA). Coordination and collaboration among these institutions tend to be challenging, and sometimes nonexistent. The point to be noted here is that even limited regulation of a market (monopoly or oligopoly) is by no means a trivial task; its complexity often increases with the complexity of the marketplace. Nonetheless, failure to provide this service often results in significant harm to members of the society.

6. Summary and Concluding Remarks

In summary, this paper began by clarifying what is meant by a free market. The paper noted that perfect competitions rarely exist on their own, as opposed to monopolies and oligopolies. Next, various theories of ethics were applied to monopolistic and oligopolistic markets. The paper then noted the occurrence of various ways in which ethical principles are violated in monopolistic and oligopolistic markets. Against this background, the paper argued in favor of limited regulation of monopolistic and oligopolistic markets.

In conclusion, it should be noted that most economies that claim to operate a free market do so successfully by having regulations. The notion of a successful unregulated free market or oligopoly therefore appears at best to be wishful thinking. Successful markets tend to have some form of limited regulation.

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