



Stop Stopping Price Cutting

by Donald J. Boudreaux

“There’s nothing new under the sun.” This aphorism speaks volumes about Uncle Sam’s antitrust suit against Microsoft. One of the government’s principal accusations in this suit is that Microsoft is a predator — meaning that the attractive deals that Microsoft today offers to consumers cannot be matched by its rivals. When the hapless rivals eventually are bankrupted by Microsoft’s pestiferous artifice, Bill Gates and his lieutenants will use the monopoly power they’ve acquired to raise prices, restrict output, and slow the pace of innovation. The benefits that consumers get from Microsoft’s good deals today will be swamped by the costs that consumers endure tomorrow when Microsoft is a monopolist.

This predation theory was endorsed by MIT’s Franklin Fisher, the government’s chief expert economist in the Microsoft lawsuit. When asked on the witness stand to explain why Microsoft currently charges so little for its Web browser, Fisher testified that “while the [predatory pricing] campaign is going on, consumers are getting a better deal.” But beware the future! Fisher affirmed Judge Thomas Penfield Jackson’s suspicion that Microsoft is pursuing a strategy of “delayed gratification” — increasing its prospects for future profits by purposely earning unnecessarily lower profits today. (As an aside, I find it curious that many people who insist that Microsoft purposely sacrifices profits today in hopes of earning higher, monopoly profits tomorrow also allege that modern American capitalism compels business leaders to maximize short-run profits at the expense of long-term growth.)

Microsoft isn’t the only firm accused today of predatory pricing. The U.S. Department of Transportation accuses major airlines of lowering their fares whenever their markets are entered by upstart carriers. The sole purpose of these fare cuts, the department alleges, is to run the upstarts out of the market so that the major carriers face less competition.

And so it has been for all of antitrust’s history. From accusations in the 1880s that Chicago meatpackers charged too little for their beef and pork, through accusations in the 1930s that A&P’s low prices unfairly hurt mom-and-pop grocers, to accusations in the 1990s that Wal-Mart predatorily prices downtown retailers into bankruptcy, antitrust has commonly been used to prevent entrepreneurial firms from improving the lot of consumers. Sadly, the current harassment of Microsoft is simply the latest episode in 110 years of this anti-entrepreneur, anti-consumer campaign.

What Is Predation?

Is predation real? Yes — but not in the way that government and many economists believe. In my view, predation occurs only when a firm relies on force or fraud to harm its rivals. For example, if Microsoft dynamites Sun Microsystem’s production facilities, that’s predation. If Delta Airlines advertises vicious lies about Southwest Airlines’ safety record, that’s predation. If Barnes & Noble successfully lobbies Congress to ban on-line book selling — thereby bankrupting Amazon.com — that’s predation. But it’s not predation for a firm to offer consumers better deals. A firm is not a predator if the advantage it wins over its rivals results from voluntary consumer choices.

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None of this denies that each firm wants to be a monopolist. But desiring monopoly power is not akin to acquiring monopoly power. A chief justification for free-market competition is that by seeking maximum profit, firms yield benefits — as if by an invisible hand — not only to their owners, but also to their suppliers and consumers. Competition is supposed to encourage firms to compete for consumers. It is supposed to encourage firms to try to “harm” their rivals by offering consumers better deals and, therefore, attracting consumers away from rivals. That’s how competition works; that’s the only way that competition can work.

It is theoretically possible that Acme Corporation today offers deals so attractive to consumers that its rivals soon are bankrupted and, as a result, Acme tomorrow charges monopoly prices. But this possibility hardly justifies government policing against low prices.

First, this possibility is too remote. Not only does the historical record contain scant evidence of predatory pricing, but even successful predators cannot count on their monopoly power lasting. The reason is that any market monopolized by a predatory pricer is one in which the “monopolist” today enjoys excessively high profits only because it earlier charged prices that were below its costs. That firm has no special cost or quality advantages. (If the firm did enjoy such advantages, it could have bankrupted its rivals without charging below-cost prices.) Entrepreneurs will surely sweep in rapidly to challenge that firm. Profits in such an industry are low-lying fruit.

Second, there’s nothing special about low prices to distinguish them from a million and one other strategies that firms use to attract more business. Anything a firm does to attract more business — cutting prices, improving quality, or more intensely advertising its services — “harms” its rivals. (Again, that’s what competition is about!) There’s no justification for singling out a firm’s low prices as a source of potentially fatal harm to rivals.

Suppose, for example, that Delta Airlines seeks more business not by lowering its fares but instead by investing in safer aircraft (and advertising the improved safety of its fleet). Won’t consumers then be more likely than before to fly on Delta? Of course — and a consequence is that United, USAir, AirTran, and other airlines will suffer. If they can’t turn to government, Delta’s rivals can avoid losing customers only by following its lead by making their airlines more attractive to consumers. These other airlines might cut their fares, or they might also invest in a safer fleet, or they might improve the quality of their in-flight service. They can compete with Delta in countless ways, all of which are to be expected — and applauded — in a market economy. Any airline that doesn’t adequately respond to Delta’s competitive move to increase the safety of its fleet might well go bankrupt. Indeed, it’s remotely possible that Delta’s investment in a safer fleet will bankrupt every last one of its rivals, leaving Delta with a monopoly. Surely, though, no one would seriously argue that government regulators ought to have the authority to stop Delta from increasing the safety of its fleet.

When firms cut prices (rather than use other methods) to compete, it is because in those cases price cutting is deemed to be the most effective way to satisfy consumers. In other cases, firms deem other methods to be best. Trusting bureaucrats and judges to second-guess entrepreneurs on how best to please consumers unleashes the possibility of a genuine (and dangerous) form of predation — namely, disgruntled rivals filing predatory pricing suits against entrepreneurial price cutters.

All price cutting should be legal.

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