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The Irresistible Force of Market Competition

by Israel M. Kirzner

The systematic character of the market process derives, in the Austrian view, from the interplay of the actions of entrepreneurial human beings. Entrepreneurs act imaginatively and creatively, seeking to identify and to grasp market profit opportunities (generated by earlier entrepreneurial limitations of vision). As a result of the interplay of such entrepreneurial acts of vision, product prices and quantities of product offered for sale tend to be nudged systematically in the direction of the market-clearing price/quantity configuration.

In the present article we draw attention to the essentially *competitive* character of this entrepreneurial process and draw out some critical implications for any assessment of governmental antitrust policies. We must begin by pointing out certain crucial ambiguities that have long plagued economists' use of the adjective "competitive." The problem was identified over half a century ago by F. A. Hayek; despite the valiant efforts of Hayek and others, the problem continues to confuse both economists and the public.

The Meaning of Competition

For the mainstream of economic theory the notion of competition has come to be associated with the *absence of market power* (to effect change in price or product quality). A competitive market is one in which no firm possesses market power. There is a certain reasonableness to this use of the term. Competition is seen as the antithesis of monopoly. Monopoly is identified with possession of the power to name one's price without having to worry whether this will encourage one's potential customers to seek more favorable terms elsewhere.

Competition is therefore reasonably understood to mean the situation in markets where such monopoly power is absent. "Perfect" competition therefore came to mean the situation in markets where each and every participant lacks *any* power whatever directly to influence product price or product quality. The conditions needed to define such a perfect situation are, as we would expect, completely unrealistic, including (as we saw in the first in this series of articles) universal perfect information concerning all current market events and potential events. But this is not necessarily a damning weakness; the notion of the state of perfect competition is, after all, seen in mainstream economics not as a description of reality, but as a model able to serve (a) as a theoretical framework helpful for understanding real-world markets, and (b) as a yardstick of perfection against which to assess the seriousness with which real-world situations (of less-than-"perfect" competition) fall short, in terms of the resulting pattern of resource allocation, as compared

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with the perfectly competitive efficiency ideal. It is this model of perfect competition which is, in mainstream economics, seen as the heart of the law of supply and demand, and which has, in the history of modern antitrust policy, driven governmental efforts to "maintain competition"—that is, to secure a structure of industry reasonably close to the perfectly competitive ideal.

For Austrians, however, the term competition has a *completely different meaning,* both for understanding how markets work and for formulating public policy in regard to the structure of industry. Austrians find the mainstream meaning of "competition" not only unhelpful, but in fact grossly misleading in terms of economic understanding. For Austrians it is clear that to seek to emulate an "ideal" state in which no single entrepreneur can have impact on market price or output quality is in effect to seek to paralyze the competitive market process.

Following a long tradition in economics going back at least to Adam Smith, Austrians define a competitive market not as a situation where no participant or potential participant has the power to make any difference, but as a *market where no potential participant faces nonmarket obstacles to entry.* (The adjective "nonmarket" refers, primarily, to government obstacles to entry; it is used to differentiate such obstacles from, for example, high production costs that might discourage entry. These latter do not constitute noncompetitive elements in a market; to be able to enter means to be able to enter a market if one judges such entry to be economically promising—it does not mean to be able to enter without having to bear the relevant costs of production.) That is, a situation is competitive if no incumbent participant possesses privileges that protect him against the possible entry of new competitors.

The achievements that free markets are able to attain depend, in the Austrian view, *on freedom of entry, that is, on the absence of privilege.* It is because the law of supply and demand (as understood by Austrians) depends crucially on freedom of entry that this meaning of the term "competition" is so important. As we shall see, it is because of this importance that so much twentieth-century antitrust policy can be seen as positively harmful, as seriously obstructing the competitive-entrepreneurial market process.

Semantics and Substance

Certainly the dispute concerning the meaning of "competition" is a semantic one. But, together with, and underlying, the semantic squabble (which, admittedly, should not overly concern us as economists; after all, new terms can be coined that are not subject to misunderstanding), there is a profound substantive disagreement concerning the way in which markets work. The mainstream notion of competition sees it as a *state of affairs*: the notion of competition has nothing to do with the *process* through which the market achieves its results. For Austrians, on the other hand, it is the market process that is important. And that market process cannot be imagined at all without *necessarily* departing from that state of complete powerlessness which mainstream economics sees as perfectly competitive. For Austrians the adjective "competitive" captures the essential feature of the market *process*.

In other words, entrepreneurial actions that are, in the Austrian sense of the term,* seen as essentially and emphatically *competitive*, as critical steps in the market process, are, in the mainstream view, seen as *anti*competitive, as monopolistic, as aberrations to be eliminated for the sake of the efficient-market ideal. As a result of this confusion of thought in twentieth-century economics, governments ostensibly intent on maintaining the competitiveness of markets have been seen as having the obligation to outlaw and zealously stamp out the very actions through which ordinary competitive strategies are effected. A brief glance at typical tools in the antitrust kit can help illustrate this Austrian critique.

Some Tools of Antitrust

Obstructing mergers. Antitrust policy has traditionally frowned upon (and often prohib-

*This is also the sense universally adopted by business people, and the sense once universally followed by economists as well.

ited) mergers between hitherto competing firms. The rationale is, given the mainstream perspective, obvious and plausible. Replacing two competing firms by one larger firm cannot but constitute a reduction in the degree of market competition (in the mainstream definition of the term). Two less powerful firms have been replaced by one more powerful firm.

But the Austrian view must be that such a merger, provided the potential entry of others has not been and is not being artificially blocked, is itself an entrepreneurial act, a *competitive* act; *the blockage obstructs the way in which market competition is able to discover the best size of firms and thus the lowest cost at which production can be maintained.* (Even if a single firm supplies an entire industry, the industry is still competitive, in Austrian terminology, so long as the firm is kept on its toes by the potential threat of new entrants into *this* industry, as well as by the threat and/or reality of competition from industries producing substitute commodities.)

Outlawing price collusion. A group of powerful firms may collude to keep prices high; their motives may be to cartelize the industry, to eliminate interfirm competition and thus to force the consumer to pay more. For this reason antitrust policy has of course been directed toward preventing such price collusion. But the Austrian perspective sees matters quite differently. Even where the *motive* is indeed to paralyze interfirm competition, such collusion is itself a competitive step—since, *in the absence of artificial blockage against entry*, such collusion can be taken only in the face of the threat of competition from new entrants (who may in fact be able to profit by offering to sell at lower prices). No one knows when a price is "too high"; only the competitive process of entry (or of the threat of potential entry) can reveal the lowest level of price that can be sustained. So long as entry is open, the colluding firms may, in seeking to maintain their higher prices, be unwittingly attracting new entrants to reveal the truth that lower prices are sustainable. Or they may, if no such new entry occurs, be demonstrating that the cost structure indeed dictates these higher prices, as being the lowest ones sustainable in a competitive world.

Preventing predatory price-cutting. What seems, from the mainstream perspective, a clear strategy of eliminating competition occurs where a large firm temporarily keeps prices very low, thus forcing smaller competing firms out of the industry, and is then able to raise prices drastically with impunity. Careful theoretical and historical analysis has cast serious doubt on even the possibility that such a strategy could be successful and on the validity of the classic claims that such strategies were indeed employed around the turn of the century in U.S. industry. But the Austrian objection to government attempts to limit so-called predatory price cuts does not rest on this analysis. Rather the Austrian objection is that, *so long as entry is not artificially blocked*, even where "monopoly" positions have indeed been acquired through "predatory" price-cutting, these positions have been acquired as part of the competitive process, and can only be maintained in the teeth of new potential competition.

No one can know when a price cut that eliminates a competitor is intended to establish a "monopoly"; more to the point, even an attempt to establish a "monopoly," *taken in the face of freedom of entry*, is itself a competitive step. No one denies that economic muscle may be used to confront consumers with higher prices. But if competition can indeed conceivably serve the consumers better, then these higher prices are themselves the way—the *competitive* way—through which it becomes profitable for new entrants to discover how better to serve consumers.

Inexorable Market Competition

Our desperately brief glance at antitrust attitudes should perhaps suffice to confirm our central Austrian thesis: What is needed to stimulate that all-powerful entrepreneurial-competitive process upon which the free market depends is nothing more than freedom of entry to anyone with an idea of how to profit by serving consumers more faithfully than they are being currently served. It is important to remember that no claim is made that freedom of entry entails that competitors refrain from attempts to monopolize markets. They *may* attempt to do so; and certainly their efforts may possibly place the consumer in a worse position (than he might be under a system reflecting perfect knowledge). The Austrian claim is that since no such perfect knowledge can exist, we must rely on the competitive-entrepreneurial process to reveal how the consumer may be better served. To *obstruct* this process in the name of competition (!) is to undermine the only way through which the tendency toward social efficiency is possible. By obstructing or preventing entrepreneurial steps taken that do not fit the "perfectly competitive" model of universal utter powerlessness—even if such obstruction or prevention stems from the best of intentions on behalf of consumers—government is necessarily tending, to a greater or lesser extent, to paralyze what is truly the competitive process. □