INFOCUS

MACRO COMMENT

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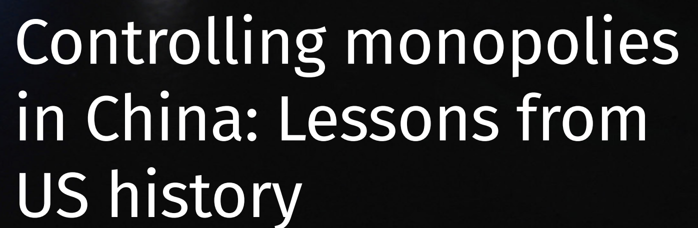

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HIGHLIGHTED IN THIS PUBLICATION:

In recent months, the Chinese government has taken a series of policy measures to enhance competition by barring monopolistic behaviour by domestic firms. Much of its attention has focused on the tech sector. In this issue of *Infocus*, EFG Chief Economist Stefan Gerlach takes a historical perspective of such policies and looks at the US policy measures before 1913.

The Chinese government has recently taken a series of steps to combat monopolistic behaviour by domestic firms and boost competition, particularly in the tech sector. To make its views clear, earlier in the year the *People's Daily* published the Chinese Communist Party's (CCP) position on anti-competitive behaviour: [1]

> *"Monopoly is the great enemy of the market economy. There is no contradiction between regulating under the law and supporting development. Rather, they complement each other and are mutually reinforcing."*

It is not surprising that Chinese regulators have focused on the digital sector, as information offers a huge competitive advantage in modern economies. Collecting massive quantities of data is a key tool used by companies in both the US and China to gain dominant positions in their markets.

There is an element of 'winner-takes-all' in that access to data boosts market share and therefore leads to even more data being collected, further improving a firm's competitive position. Big data businesses therefore often achieve monopoly-like market share.[2] The lack of competition leads to more inequality, reduced productivity and less economic growth at a time when China is moving away from investment-led growth.[3]

While the owners of the Chinese firms exposed to tighter regulation might not recognise it, there is little doubt that the CCP's view that monopolistic behaviour is harmful, is sound economics. In fact, regulations to boost competition are commonplace in western economies, no more so than in the US, where they were introduced towards the end of the 19th century.

Monopolies in US history

After the end of the US civil war in 1865, the US entered the 'Gilded Age' which ended in the 1890s. During this time the US economy experienced a massive transformation. It was an era of rapid economic growth. Wages grew rapidly in real terms and came to exceed those in Europe by a wide margin. This was one factor that led to rapid immigration from the poorer parts of Europe.

The main engine of growth was the railroad, which in those days connected the country in much the same way as the internet does now. With the completion of the transcontinental railroad in 1869, the US became a large and integrated market without internal barriers, supported by a common language and legal system. While heavy industries, in particular mining and steel, grew rapidly in this period, so did finance.

This was the age of the so called 'robber barons' (or 'captains of industry', as others would call them). Their names and the industries they were active in are familiar: John D. Rockefeller in oil; Andrew W. Mellon in finance, oil and steel; Andrew Carnegie in steel; J. P. Morgan in finance; and Cornelius Vanderbilt in railroads, to mention some of the most well-known.

Trusts became common. The Merriam-Webster Dictionary defines these as *"a combination of firms or corporations formed by a legal agreement, especially one that reduces or threatens to reduce competition."*[4] The US economy rapidly became concentrated through mergers and acquisitions of small companies into bigger ones. Many big companies colluded to raise prices by restricting supply and regularly forced smaller competitors into bankruptcy through predatory pricing. The result was that many markets became practically monopolies. The two most well-known examples are the markets for oil and tobacco.

Standard Oil was a corporate trust established by John D. Rockefeller that, from 1870 to 1911, controlled almost all oil production, processing, marketing and transportation in the United States.[5] Through the elimination of competitors, mergers and the use of favourable railroad rebates, it controlled 90 to 95 percent of all oil produced in the United States by 1880.

The American Tobacco Company was established in 1890 and followed a similar strategy. Using mergers and acquisitions, it

[1] As quoted by Tom Wheeler, 'The Chinese government embraces tech industry competition,' *Brookings Institution Tech Blog*, 16 April 2021.
[2] See Andy Xie, 'Politics trumps money in Chinese Markets', *Financial Times*, 22 September 2021.
[3] See Tom Hancock, "*China Should Curb Tech Monopolies to Ensure Growth", Says PBOC Advisor*, Bloomberg Markets, 13 September 2021.
[4] https://www.merriam-webster.com/dictionary/trust
[5] This draws from the entry on Standard Oil in the Encyclopaedia Britannica at https://www.britannica.com/topic/Standard-Oil

came to control practically the entire US tobacco industry by the late 1880s.[6]

The tide turns

The growing concentration of industry did not go unnoticed among the public and politicians. Monopolistic practices raise prices and while they may be good for the profitability of the firms that adopt them, they are bad for their customers, who may be other firms. Overall, monopolies are bad for the broader economy. During the 'progressive era' that started towards the end of the 19th century, strong pressures developed for political reforms to limit the power of corporations and raise competition. In response, Congress adopted several laws to ban monopolistic behaviour. The Interstate Commerce Act, the Sherman Act and the Clayton Act are among the most well-known of these.

The Interstate Commerce Act of 1887 was designed to regulate monopolistic practices in the railroad industry which was of critical importance. Railroads sought to restrict competition to raise prices and engaged in anti-competitive practices to the detriment of their clients which led to wide public outcry. This legislation was the result of widespread and longstanding anti-railroad agitation. These included the pervasive practice of giving free travel to elected officials, newspaper editors and others to limit public protests against the railroads. The act also created the Interstate Commerce Commission with the task of ensuring compliance with the Act.

The Sherman Antitrust Act of 1890 followed. The act bans anticompetitive agreements and practices that seek to monopolise markets. Importantly, having a large market share is not illegal. Monopolies raise prices and attract other firms to enter the industry. To prevent them from doing so, monopolies rely on anticompetitive behaviour, which is prohibited.

The government sued Standard Oil under the Sherman Act in 1906 and the company was broken up by the courts in 1911. Similarly, a court held that the American Tobacco Company violated the Sherman Antitrust Act and ordered it to be dissolved in 1911.

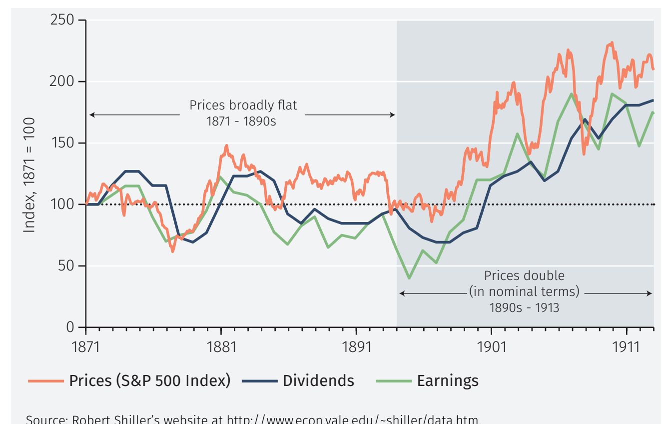
The Clayton Antitrust Act of 1914 followed. The Act sought to ban specific anticompetitive practices such as price discrimination, excusive dealing agreements and mergers of firms with the intention to stifle competition.

Several other steps were taken by Congress to promote competition. These included the establishment of the Federal Reserve in 1913, which limited the power of large banks, and the establishment of the Federal Trade Commission in 1914 and which was tasked to enforce the bans introduced by the Clayton Act.

The behaviour of stock prices

The reason for taking strong political action against monopolistic practices was that by reducing competition and raising prices for consumers and other firms, they constituted a burden on the economy. While it is difficult after more than a century to judge why asset prices changed, the behaviour of US stock prices in this period is striking.

1. US stock market, 1871-1913



Source: Robert Shiller's website at http://www.econ.yale.edu/~shiller/data.htm.

Figure 1 shows that US stock prices were broadly flat between 1871 and the early 1890s before anti-competition practices were prohibited. From the 1890s to 1913 as Congress took measures to ban them, stock prices doubled (in nominal terms).

Conclusions

Reviewing the experiences of the US before World War One, it is easy to understand why the Chinese government would like to limit restrictive practises in business. Monopolistic behaviour pushes up prices for consumers and firms alike and slows innovation and economic growth. As suggested by the behaviour of US stock prices in the 19th century, they are not good for economic wellbeing.

[6] See the entry on the American Tobacco Company in the Encyclopaedia Britannica at https://www.britannica.com/topic/American-Tobacco-Company

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