

THE COST OF COMPETITION UNDER NATURAL MONOPOLY CONDITIONS

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ONE OF THE MOST INTERESTING and difficult applications of the theory of monopolies is to the question whether the public interest is best served by the allotment of a distinct basin to each great railway, and excluding competition there. For the proposal it is urged that a railway can afford to carry two million passengers, or tons of goods, cheaper than one million : and that a division of the public demand between two lines will prevent either of them from offering a cheap service (Alfred Marshall, *Principles of Economics*, 8th Edition, 1920, BK. V, Ch. XIV, p. 485).

Introduction

Since, at least, the inception of the Cambridge theories of Robinson¹ and Chamberlin² in the 1930's, economists have stressed the "welfare" loss produced by monopolistic misallocation of resources : given the income distribution, society would be better off if resources were shifted from competitive to monopolistic industries, because firms in the latter restrict production below the optimum level in order to maximize profits. In short, there is under-production and over-pricing in monopolistic vis-a-vis more competitive industries.

Of course, it is recognized that there may be situations where monopoly may not be undesirable. For instance, in those cases where the economies of scale result in so few optimum-sized firms as to preclude pure competition, there is a conflict of objectives between the social objectives of combining productive resources in a given use in the most economical manner, and of allocating resources among alterna-

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¹ ROBINSON, JOAN, *The Economics of Imperfect Competition*, (London: Macmillan and Co., 1933).

² CHAMBERLIN, EDWARD H., *Theory of Monopolistic Competition*, (Cambridge, Mass.: Harvard University Press, 1931).