CAPITAL, COMPETITION AND CAPITALISM

by

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Nothing, surely, is more fundamental about capitalism than that competition is its very lifeblood. It is the interaction of consumers, resource owners, and entrepreneur-producers in freely competitive markets, which achieves the allocative efficiency and the affluence we take for granted in capitalist societies. At the same time, again, nothing can be more integral to the definition of capitalism than the private ownership of the tools of production. It is, therefore, with puzzled surprise that one confronts the circumstance that it is precisely the private ownership of capital resources which has been held to be either unnecessary to, or even incompatible with operation of the competitive market.

On the one hand Professor Lancaster has recently asserted that a competitive market system does not <u>require</u> private ownership of capital. All the virtues of the system, he claims, could be achieved equally well in a system in which the state was the sole source of capital, providing it at a market-clearing price to all comers[1]. On the other hand it is even more frequently asserted that private ownership of capital, especially in the context of the capital requirements of modern industry, operates as a barrier

against the entry of new competition, and is thus, in effect, incompatible with the allocative efficiency associated with the competitive market economy. It is with the critical examination of this second assertion that we shall be primarily concerned in this paper, but our discussion will, as we shall see, at the same time reveal certain weaknesses in the first assertion as well. The thrust of our analysis will tend to reaffirm the vital role which the private ownership of capital plays in the competitive market process, by elucidating the way in which this supports the efficiency, the flexibility and the resourcefulness of the capitalist system.

Competition and Efficiency

The theory of the competitive market process teaches that where the existing deployment of resources within a society leaves unexploited opportunities for improvement (via exchange, or production, or some combination of both), these will offer themselves in the form of opportunities for entrepreneurial profit. The lure of profit will lead entrepreneurs to discern these opportunities, pursuing them until, through the competitive entrepreneurial process, resources have, in equilibrium, become reallocated in a manner that has eliminated both the profit opportunities and the misallocation which was their source. Freedom of entry is crucial to this process. The process depends heavily on the likelihood that, whenever anyone is in a position to perceive an opportunity for improvement, he

will be motivated by the lure of profit to move to exploit that opportunity. For this to be in fact the case, it is required that no one who has perceived (or who might perceive) such an opportunity, be barred from exploiting it. Efficiency in resource allocation might fail to be achieved as a result of monopolistic ownership of a resource. Where access to a necessary resource is blocked by its monopolized ownership, the monopolist-owner may find it to be in his own interest to limit its utilization in production even where the opportunities for its socially useful utilization are fully percieved by other would-be producers. It is the claim of the critics that the institution of private ownership of capital serves as an obstacle to the competitive market process. Capitalism, it is in effect argued, is incompatible with competition. Let us state these criticisms more fully.

Capitalism and Competition: The Criticisms

Lack of capital, it is argued, may prevent the entrepreneur with the better idea from following it through. Resources will continue to be applied to produce less urgently needed products, they will continue to be combined in less efficient techniques of production, not because superior modes of utilization cannot be perceived (at least by some potential entrepreneurs), but because these visionary pioneers lack the capital resources needed to implement their projects[2]. (As a special case of this criticism, it is frequently

argued that even where a poor youth shows unmistakable signs of exceptional native ability, he may, not being able to afford an education, never come to take advantage of his talents, and thus society may never be able to enjoy their fruits. Absence of access to capital has meant that a perceived valuable resource is left unexploited[3].) If entrepreneurs who lack capital are unable to compete, then the ideas which do become implemented in production need not at all be those whose superiority in serving consumers has been proven in the crucible of competition.

Incumbent firms, it is argued, are, by virtue of their ownership of capital--a resource not accessible to many potential competitors, --able to enjoy a monopolistic or oligopolistic position in their respective industries. Capital requirements, serving as a barrier to entry, operate to confer imperfectly competitive market structures upon industries, generating significant deviations from the pattern of desirable allocation of resources associated with competitive markets. Inefficiency is seen as inevitable because, given the imperfectly competitive structure of an industry, firms will find it in their self-interest to produce less than the competitive ideal. "The capital resources necessary to establish a new firm in an effective competitive position may be so large as to eliminate potential competition as a practical consideration."[4]

This line of criticism is, especially when advanced by laymen,

often unhelpfully jumbled with other arguments based on the size of incumbent firms. Thus a frequently cited source of monopoly power is the large size for a firm needed if it is to take advantages of the economies of scale. With a market limited in total size by demand conditions, economies of scale thus tend to keep down the number of firms in the market, a circumstance which, in the common view, at once defines the industry as imperfectly competitive. But this version of the criticism is based on confusion. While the argument that capital requirements constitute a barrier to entry is indeed strengthened by the existence of scale economies,[5] (since these will increase the amount of capital needed to compete effectively), the argument does not depend on the superficial identification of large size with monopoly power (an identification which derives its plausibility, as we have noted, from considerations of limited size of markets). It depends, in its clearest form, strictly on the contention that capital requirements serve to bar entry into industries. It will be in this form that we shall appraise it.

On Ownership, Entrepreneurship and Profits

Critical discussion of the capital-as-barrier-against-entry thesis requires that we first clarify several widely misunderstood basic theoretical concepts relating to entrepreneurial profits. The common view appears to perceive profits as ordinarily accruing to the owner of an enterprise[6]. The entrepreneur is seen as capturing profits through his successful deployment of the resources of his

firm. In fact it is this identification of the owner as the recipient of entrepreneurial profit which has been responsible for the difficulties which economists purport to have discovered for themselves in the modern corporation. The modern large corporation is owned by stockholders who exercise virtually no day-to-day control over the deployment of the corporate resources. Ownership has, apparently, come to be divorced from control over firm assets. In the Berle-Galbraith view of things, this circumstance shatters the traditional perception of the role which profits play in shaping the pattern of production. In the traditional view, the lure of profits spurs producers to serve consumers; in the corporation the production decisions are made, not by owners, to whom accrue profits, but by a new class of corporate managers for whom the prospect of corporate profits for stockholders provides little personal incentive. It is not our purpose at this point to expose the fallacies in this Berle-Galbraith doctrine concerning the corporation. We merely note that it rests on an uncritical acceptance of the common view that entrepreneurial profits go to the owners of business firms, in their capacity of owners. It is only because profits are seen as accruing strictly to owners that powerlessness of stockholders is perceived as contradicting the assumption that corporate production decisions are actuated by the profit motive. We will, later on, revert critically to this aspect of the Berle-Galbraith view of the modern corporation.

In contrast to this widespread position associating profit with

the ownership of assets, there flows from the Misesian analysis of the market process, an entirely different perception of entrepreneurial profits. Entrepreneurial profits, in this view, are not captured by owners, in their capacity of owners, at all. They are captured, instead, by those exercising pure entrepreneurship--for which asset ownership is never a condition. This assertion deserves some elaboration.

The Misesian theory of entrepreneurial profit can be described as an "arbitrage" theory of profit[7]. "What makes profit emerge is the fact that the entrepreneur who judges the future prices of the products more correctly than other people do buys some or all of the factors of production at prices which, seen from the point of view of the future state of the market, are too low."[8] Profits arise, then, from the absence of adjustment between the prices on different markets. Entrepreneurship does not consist in the exchanging (or the physically converting) of owned assets of low value, into assets of higher value. It consists in exploiting the difference between two sets of prices for the same goods. It consists in buying at the low price and selling at the higher price. Where the opportunities to buy and to sell are, as in pure arbitrage, truly simultaneous, no initial resources are, in principle, needed at all. The higher price obtained from the sale is more than sufficient to pay the low price that must be paid simultaneously for the purchase. Where, as in the more general case of entrepreneurship exercised across time, purchase must precede sale; the capture of profit requires the investment of capital.

"But it is still correct to insist that the entrepreneur qua entrepreneur requires no investment of any kind. If the surplus (representing the difference between selling price and buying price) is sufficient to enable the entrepreneur to offer an interest payment attractive enough to persuade someone to advance the necessary funds, it is still true that the entrepreneur has discovered a way of obtaining pure profit, without the need to invest anything at all."[9]

Recognition that entrepreneurship, in the pure sense, does not require any prior ownership, should not prevent us from seeing how an entrepreneur <u>may</u>, at the same time, be an owner. An owner of a resource may, instead of employing it in a standard, routine use, (for which its productivity at the margin is widely known, and is already precisely reflected in its own market price), deploy it in a new, imaginative fashion yielding a sales revenue far in excess of its own current market price. But clearly precisely the same entrepreneurial success might have been obtained by a non-owner purchasing the same resource in the market (at its low price) and deploying it in the novel way. Where the resource owner himself acted entrepreneurially in production, we should see him as having "purchased" the resource from himself (at the current market price.) Again, when an entrepreneur has purchased a good for subsequent resale, he has, of course, now become the owner of the good. When he does subsequently sell the good at a profit-yielding price, it might appear that it is as an owner that he

has captured that profit. But reflection will confirm that the successful decision to which the entrepreneur must attribute his profit was taken at a time when he was not yet the owner of the good which he has now sold. The entrepreneurial decision is that which inspired him to buy the good in the first place for the sake of its expected sale at a later date. Clearly, then, while we see profits captured by owners, we must perceive that this ownership has, analytically, nothing to do with these profits, and by the same token, nothing essentially to do with the exercise of entrepreneurship.

Capitalists and Entrepreneurs

From the foregoing discussion there emerges with clarity the very important distinction separating the role of the entrepreneur from that of the capitalist. The capitalist role in the production process derives wholly from his ownership of resources. The capitalist is the resource owner who is willing, in return for the promise of interest payments, to permit his resources to be used in economic processes extending over time. The entrepreneur is he who perceives (in a way in which the capitalist himself does not) how these resources can be deployed in a way able to justify, at the very least, the contractual interest payments which must be offered to prospective investors. It is the entrepreneur who acquires these resources from the capitalist (at the "low" price including interest) in order to yield an even higher sales revenue at a later date.

In order to fulfil the capitalist role in production, it is necessary to own resources that can be offered in the market to producers, and to be prepared, for sufficient prospective remuneration, to wait for payment until these resources will have generated revenue in relatively time-consuming processes of production. Without prior ownership of productive resources, (or, of course, funds able to command resources), it is as impossible to be a capitalist as to be a laborer without possessing the capacity to work. But in order to fulfil the entrepreneurial role, as we have seen, no prior ownership of any resources is needed. It is necessary for the prospective entrepreneur "merely" to become alerted to the possibility of securing from capitalists and other resource owners, the means of production able to produce a final sales revenue greater than the sum of the amounts he must offer them in return.

It is of course true that, in the complexity of the real world, we must not expect to discover pure analytical categories. Those exercising entrepreneurship in the real world are likely to be resource owners at the same time. A laborer may borrow capital and produce a product which, after full payment of the costs of capital, leaves a surplus higher than the market value of his labor. (And we have already noticed that the exercise of entrepreneurship will render the entrepreneur an owner of that which he has purchased, for the period between its purchase and its later sale. So that

we are likely to see those who have exercised entrepreneurship as being currently owners of assets.) But this does not in any way diminish the power of our conclusion that the exercise of entrepreneurship as an analytical category does not call, as a prerequisite, for the prior ownership of anything.

Again, acceptance of this important conclusion may be hampered by the circumstance that, if we are unlikely to discover a pure entrepreneur, we will certainly be unable to discover a pure capitalist. As Mises has pointed out, "every action is embedded in the flux of time and therefore involves a speculation"; the decision to lend capital is itself partly an entrepreneurial one, because it involves the possibility of the borrower being unable to carry out his side of the contract. "A capitalist is always also virtually an entrepreneur and speculator."[11]

But the fact that every capitalist must be an entrepreneur does not in any way logically entail that to become an entrepreneur one must be a capitalist. And, moreover, even where an entrepreneur happens in fact to be a resource owner, we have seen that the entrepreneurship which he has exercised, has not depended, in any essential way, upon the accident of his being an owner of resources.

We emphasize here the sharpness of the distinction between the capitalist and the entrepreneurial roles not only for the sake of the economic insight which the distinction confers. (A fascinating

chapter in the history of economic thought concerns the gradual emergence of this insight.) Our emphasis has also the purpose of illuminating the question with which this paper is directly concerned, i.e. the possibility that the capital requirements of modern industry operate as a barrier to competition. Let us see how this is the case.

On Barriers to Entry

For competition to be eliminated from any branch of production, it is necessary that prospective competitors be somehow prevented from entering that branch of production. In the absence of institutional barriers erected by governmental authority, one can imagine prospective competitors being unable to enter an otherwise profitable line of activity only as a result of barred access to needed resources. Only, that is, if the needed resources for a particular line of production are monopolistically owned and barred to newcomers, can it be possible for the producers to feel secure from new competition. Obstacles to competition in production must have their source in monopolized resource ownership. It is important to perceive the implications of this way of looking at things.

If the resources needed for production are not monopolized, no one can be said to be barred from competing by virtue of his lack of resources. If oranges are widely available for purchase, no prospective producer of orange juice is barred from entering the industry (if it promises profits) merely because he lacks oranges.

Nor does any one owner of oranges, in such circumstances, possess any kind of entrepreneurial advantage over non-owners: "if the supply of an important factor is not controlled monopolistically, ownership conveys no economic power."[12] No prior ownership of oranges is needed in order to capture, by the exercise of entrepreneurial imagination, the profits waiting to be won through the production of orange juice. Entrepreneurial entry into the orange juice industry can be barred only through monopolistically barred access to oranges.

The case is not one whit different with respect to the possibility of one being said to be barred from competing by virtue of his lack of capital. Unless access to capital is monopolistically restricted, lack of capital can in no way be seen as barring competition; nor can ownership of non-monopolized capital resources, be seen as conferring any special economic power. Capital resources, where they are not monopolized, are available to entrepreneurs who perceive how they can be turned to a profit. It is because entrepreneurship requires no prior ownership, because the entrepreneurial role is sharply distinguished from that of the capitalist, that entrepreneurial competition can never be said to be barred by lack of capital. Some further qualifying observations on the matter are, however, in order.

Capital and Entry

Despite our conclusion,on strictly theoretical grounds, that the

lack of capital resources cannot, unless these are monopolized, be perceived as a barrier to entrepreneurial competition, it will be objected that casual business experience supports the contrary position. In everyday business experience, it will be argued, it is a commonplace that potential entrepreneurs find themselves unable to assemble the capital needed to finance promising projects. Apparently capital requirements do hamper competition.

We shall see, however, that the facts presented by casual empiricism can be reconciled with our theoretical conclusion in a number of ways. In fact such reconciliation will be useful in further clarifying the insights embodied in that conclusion, as well as in guarding us against applying it in inappropriate contexts.

(a) We need not tarry long to observe that what may deter a would-be entrepreneur from implementing what he believes to be a good idea may be, not the inaccessibility of capital, but merely its high cost. Clearly, where an idea which seems profitable with capital available at zero cost, turns out to be unprofitable under actual capital market conditions, the idea is in fact not a very competitive idea. "The necessity of having to raise large amounts of capital, . . . cannot be said to prevent entry, since if sufficient profits were anticipated the capital would be forthcoming . . . ."[13]

(b) Of greater relevance are those circumstances in which an entrepreneur is fully prepared to offer market rates of interest for capital and yet finds it impossible to finance his project. The late Professor Knight observed years ago that "demonstrated ability can always get funds for business operations."[14] But what if funds are available only at above market rates of interest which render proposed operations no longer profitable? And what if the prospective competitor is an entrepreneur who happens not to have had the opportunity to demonstrate his ability?

Economists have fallen into the habit of recognizing these kinds of possibilities by reference to "capital market imperfections." Put in this way, these possibilities seem to support the charge which we are here rebutting. Even without monopoly in the ownership of capital, it is being implied, distortions in resource allocation may be generated by the absence of perfect markets in capital. And, moreover, in specific cases imperfection in the capital market may itself be ascribed to monopoly. In a valuable but neglected paper Professor Stigler has carefully collected examples of statements by economists alleging imperfections in the capital market, and has demonstrated that all too frequently such allegations reflect nothing but careless thinking[15]. We will, in what follows, briefly report Stigler's

criticisms, and will subsequently point out, in addition, an aspect of capital markets to which Stigler has not drawn attention.

Market perfection, (permitting "all exchange which the traders prefer to non-exchange"), Stigler explains, requires a single price throughout the market for a given good. The existence of more than one price implies that "one seller is receiving less than some other buyer is paying, and both would prefer to trade with one another than with whomever they are trading." Thus economists who discover cases where capital can be obtained only at rates higher than those obtainable elsewhere, describe these as cases of market imperfection. But, Stigler points out, ". . . this is surely not sufficient evidence to allow us to conclude that capital is being allocated inefficiently--any more than the fact that some people walk is proof of an imperfection in the automobile market."[16] The existence of trading costs (such as costs of transportation, of acquiring information on products and other traders, inspecting quality, collecting funds) may make the absence of a single price fully consistent with market perfection. "There is no 'imperfection' in a market possessing incomplete knowledge if it would not be remunerative to acquire (produce) complete knowledge."[17]

In other words, if capital can be obtained for a project only at rates higher than those available elsewhere, this is not necessarily evidence of market imperfection, and does not, it

follows, justify the claim that capital requirements somehow operate to hamper competition. Thus, to use one of Stigler's examples, if an investment in college education is likely to yield a 12 per cent return, no necessary "imperfection" in the capital market is demonstrated by the fact that a would-be student cannot borrow funds at "the" interest rate of 6 per cent. It is, after all, possible that the likely default rate--clearly a very significant transaction cost!--on student loans is such as to make even a 12 per cent interest rate possibly unprofitable to lenders. So that the difficulty which would-be students find in competing in the market for those with college degrees could, under such circumstances, not be attributed to lack of access to capital. Instead, it should be clear, capital fails to flow into investment in education simply because, when costs of transactions are appropriately taken into account, such investment turns out not to be the most profitable use of funds.

To pursue the point a little further. Suppose an unknown, penniless would-be entrepreneur has a genuinely good idea, but cannot put it into operation because capitalists do not wish to risk their capital on a venture concerning which they must rely both on his unproven judgement and undemonstrated integrity. We have here a good idea which, if the entrepreneur had been independently wealthy, he would have plunged into himself with enthusiasm; it

will now fail to be implemented solely because he is in fact penniless. We have seen that it would be an error to describe this as necessarily implying an obstacle in the competitive process. What we may be seeing, in such a situation, may merely be the efficient translation of very real transactions costs (viz. the cost of securing recognition for one's entrepreneurial judgement and personal integrity) into the appropriate allocation of resources.[18] These costs of securing recognition of one's competence and trustworthiness are, surely, truly social costs. They would exist under any system of economic organization; (thus under socialism, too, planners would face the problem of determining the competence and integrity of those to whom to entrust social capital.) It is true, of course, that were the penniless entrepreneur in fact a wealthy man, these costs would be absent. So that it may be argued that <u>given the existing pattern of resource ownership</u> capital requirements operate to restrict entrepreneurial entry. But such an objection would be quite without force. It would be similar to an objection charging inefficiency on the grounds that there exist on the West Coast unexploited opportunities for the utilization of skilled laborers who reside on the East Coast (whose transportation the opportunities do not in fact justify.) Were the initial pattern of the geographical distribution of labor supply different, these transportation costs would indeed not have been needed. Given the existing state of the world, they <u>are</u> needed; to ignore them is to fall into mis-

calculation. Quite similarly, given the asset ownership pattern at any date, a true social cost must be incurred in order to entrust scarce valuable capital to penniless unknown entrepreneurs. This hardly qualifies as an obstacle against entrepreneurial entry.

(c) The considerations of the preceding paragraphs, based substantially on the work of Stigler, go far to demonstrate the error of interpreting the difficulty which may be encountered in practice, in assembling capital for specific projects, as negating our conclusion, on theoretical grounds, that lack of capital resources cannot (unless these are monopolized) constitute a barrier to entrepreneurial competition. But still further considerations, not mentioned in Stigler's treatment, require to be adduced, lending additional support to our position in this paper.

Let us suppose, again, that a bright, unknown, penniless entrepreneur finds it difficult to finance his good idea. Let us suppose that his idea is in fact so good that it justifies incurring all the transactions costs mentioned on previous pages; that it is profitable even after making ample allowance for the costs of making the entrepreneur's competence and integrity known to potential investors. But that, despite all this, he still finds it impossible to raise the necessary capital. Our treatment so far would merely suggest, with Stigler, that such cases have yet to be proven to exist. But, as we shall see, we do not need to be satisfied with this stance. What can be shown is that, even

if such cases do exist (and, in fact, despite the expectation that they will indeed exist) the case arguing the existence of a barrier to competition is not one whit the stronger. The clue to the matter lies in the circumstance that, as cited earlier from Mises, a "capitalist is always also virtually an entrepreneur and speculator."

If a new idea holds forth promise (even after all trading costs have been taken into account) of a yield to capitalists higher than they can obtain elsewhere, their failure to exploit it constitutes an entrepreneurial error on their part. To describe such a situation (as Stigler, by implication, seems forced to do) as the manifestation of imperfection in the capital market, is to assume, quite erroneously, that absence of entry barriers assures instantaneous attainment of equilibrium; or it is, at any rate, to use the term "imperfection" in a way misleading to laymen. In fact, whenever there exist (without entry barriers) two prices for the same good, this represents (rather than some sinister market "imperfection") nothing but a disequilibrium situation created by entrepreneurial errors, which the competitive entrepreneurial process can be relied upon to tend to correct. Two prices for the same good, for which transaction costs are unable to account, are the result of imperfect information on the part of market participants. It is the essence of the entrepreneurial process that a two-price situation provides the incentives for entrepreneurial arbitrage, tending to eliminate the discrepancy.

Such processes are the essence of markets; they can be relied upon wherever entrepreneurial entry is not blocked. Errors by capitalists constitute no exception to these general market laws.

If capitalists have, every one of them, failed to assess correctly the profitability of an idea advanced by a penniless entrepreneur, because they have underestimated the competence or the integrity of its promoter, this creates, for capitalist-entrepreneurs an opportunity for profit. Unless, again, capital is monopolistically owned, capitalists will tend to compete among themselves with respect to the true measure of the competence and integrity of penniless, unknown would-be entrepreneurs. We have no reason to doubt that capitalists do, in fact, frequently misjudge the ability of entrepreneurs vying for their capital. We have no reason to doubt, either, that entrepreneurial competition among capitalists operates, as always, to generate a tendency towards equilibrium; that is, for present purposes, towards a state of affairs where the competence and integrity of prospective men of ideas, are correctly assessed.

Corporations, Entrepreneurs, and the Berle-Galbraith Thesis

Our discussion permits us to return to consider again the problem of fitting the modern corporation into our theoretical framework. We have seen that the Berle-Galbraith thesis perceives the modern corporation as destroying the traditional paramouncy of the profit motive in allocating resources. With the ownership of the cor-

porate capital separated from its control, the argument runs, the profit motives of the owners can hardly be seen as controlling the way in which corporate resources are allocated. In fact, in Galbraith's view, the modern corporation marks a highly significant shift of economic power away from the owners of capital, who dominated in earlier periods, to the "organized intelligence" which constitutes Galbraith's "technostructure" in the economy of today[19].

The perspective developed in this paper enables us to see things with greater clarity. For our present purposes we do not need to engage the Berle-Galbraith thesis on its principal premise, viz. the validity of a separation between corporate ownership and control. Shorey Peterson and others[20] have shown how fuzzy such an alleged separation must be judged to be. For present purposes it is sufficient to differ drastically with Galbraith in what the significance of any such separation must be held to be.

Our position, is briefly, that where the corporate form of business organization permits a measure of independence and discretion to corporate managers, this is to be interpreted as an ingenious, unplanned device having the merit of easing the access of entrepreneurial talent to sources of large scale financing. Instead of the entrepreneur having to borrow capital--with all the transactions costs we have seen this to involve--the corporate form of organization permits would-be entrepreneurs to hire

themselves out to owners of capital as corporate executives. The capitalists retain formal ownership, permitting them, if they choose, to divest themselves easily of their shares in badly managed firms, and permitting them, in the last resort to oust incompetent management. Yet the executives, to the limited extent that they do possess discretionary freedom of action, are able to act as entrepreneurs and implement their ideas without themselves becoming owners at all.

Space does not permit an elaboration of this way of seeing the modern corporation. But this brief glimpse of it should reveal, at the same time, the remarkable institutional flexibility of capitalism. With no entry into markets blocked by institutional intervention, the market is incredibly ingenious in the success with which it encourages new forms of entrepreneurial competition in the deployment of social capital resources to their most valuable uses. So far from the modern corporation reflecting any weakening of the role of entrepreneurial profits, it exemplifies the subtle ways in which the lure of profits permeates markets in the highly capitalized industrial forms of our time[21].

Capitalists and Competition

The main purpose of this paper has been achieved. We have seen how the capitalist role in modern market economies cannot in any way be described as in itself incompatible with the competitive process. But our discussion also permits us to dissent vigorously

from a related critical assertion. We saw at the outset of our paper that it has been argued that, in order to enjoy the well recognized advantages of a competitive market economy, it is not at all necessary to adopt the institution of private ownership of capital. All the virtues of a competitive market can be achieved equally well, it is claimed, in a system in which the State is the sole source of capital, providing it at a market clearing price to all comers. There are a number of difficulties with this line of argument, (as there are with all similar proposals for "market" systems under socialism); we will deal here only with one of them.

We have seen how important a role, in the market for capital, is played by the special trading costs associated with the entrusting of capital into entrepreneurial hands. In the assessment of the extent of these costs, we saw, a new scope for the exercise of entrepreneurship comes into view. The Misesian insight that every capitalist must at the same time be an entrepreneur permitted us to see how entrepreneurial competition among capitalists plays a vital role in the selection of which would-be entrepreneurs shall be entrusted with society's scarce and valuable capital resources. Were the state to be the sole source of capital, this level of entrepreneurial competition would have been eliminated. We need not stress the potential abuses lurking in such a state monopoly of capital ownership. We may, that is,

assume for the sake of argument, that such a monopoly would not create those very barriers to entrepreneurial entry which critics of capitalism erroneously claim to perceive in the capital needs of modern industry. But certainly state control of capital resources would mean that private capitalists no longer exercise, in competition with one another, entrepreneurship in the identification of would-be entrepreneurs possessing the competence and integrity needed to put massive quantities of capital to work in implementing their ideas. With the profit motive absent from the function of entrusting capital to men selected for their potential for action, initiative, and leadership--even if the profit motive is retained for the level at which men of action, initiative, and leadership themselves operate--we will have abandoned one crucial segment of the market process which tends to allocate capital to the entrepreneurs most likely to succeed[22].

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We conclude, then, not only that private ownership of capital is not at all inconsistent with the competitive market process--we conclude also that it is in fact essential to the efficiency of the competitive market process.

FOOTNOTES

[1] K. Lancaster, "The Dynamic Inefficiency of Capitalism," Journal of Political Economy, Sept./Oct. 1973, p. 1092.

[2] ". . . absolute capital requirements may be so large that relatively few individuals or groups could secure the needed capital, or that entrants could secure it only at interest rates and other terms which placed them at a net cost disadvantage to established sellers." J. S. Bain, Barriers to New Competition (Harvard University Press, 1956), p. 55.

[3] For references to the literature on this see G. J. Stigler, "Imperfections in the Capital Market," Journal of Political Economy (June, 1967), pp. 287-88.

[4] E. S. Mason, Economic Concentration and the Monopoly Problem (Harvard University Press, 1967), p. 348.

[5] See J. S. Bain, op. cit., chapter 3.

[6] See e. g. A. A. Alchian, "Corporate Management and Property Rights," in Economic Policy and the Regulation of Corporate Securities, ed. H. G. Manne (Washington, D. C.: American Enterprise Institute, 1969), pp. 342-43.

[7] On this see my Competition and Entrepreneurship (University of Chicago Press, 1973), pp. 85f.

[8] L. Mises, "Profit and Loss," in Planning for Freedom, 2nd Edition, (South Holland, Ill.: Libertarian Press, 1962), p. 109.

[9] I. M. Kirzner, Competition and Entrepreneurship, p. 49.

[10] L. Mises, Human Action, (Yale University Press, 1949), p. 254.

[11] Ibid.

[12] H. Demsetz, "The Technostructure, Forty-Six Years Later," Yale Law Journal (Vol. 77), 1968, p. 805.

13
S. R. Shenoy, "The Sources of Monopoly," New Individualist Review, (Spring, 1966), p. 42.

14
F. H. Knight, Risk, Uncertainty and Profit (1921), p. 274, ftn. 1; see also D. M. Lamberton, The Theory of Profit, (A. M. Kelley, New York, 1965), p. 50.

15
G. J. Stigler, "Imperfections in the Capital Market," Journal of Political Economy, (June, 1967).

16
Op. cit., p. 288.

17
Op. cit., p. 291.

18
See Stigler's remarks on Keynes' distinction between borrower's and lender's risk (op. cit., p. 291.)

19
J. K. Galbraith, The New Industrial State (Houghton Mifflin, 1967), chapters V, VI.

20
Shorey Peterson, "Corporate Control and Capitalism," Quarterly Journal of Economics (February, 1965); A. A. Alchian, op. cit.

21
See H. G. Manne, Insider Trading and the Stock Market (New York: Free Press, 1966), for a discussion of how corporate executives may be in a position to win pure entrepreneurial profits for themselves.

22
For critical discussion of earlier proposals concerning the allocation of capital in non-capitalist "competitive" systems, see F. A. Hayek, Individualism and Economic Order (London: Routledge and Kegan Paul, 1949), pp. 172-176; 200f.