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## **CHAMBERLIN, EDWARD HASTINGS (1899 – 1967)**

*Rodolfo Signorino*

Edward Hastings Chamberlin was an American economist. He was born in La Conner, Washington, on 18 May 1899 and died in Cambridge, Mass., on 16 July 1967. His book, *The Theory of Monopolistic Competition*, and Joan Robinson's *The Theory of Imperfect Competition*, both published in 1933, are unanimously acknowledged as the two path-breaking contributions which paved the way to the (so-called) imperfect/monopolistic competition revolution, whose basic aim was enfranchising economic analysis from the straightjacket of perfect competition theory. Insomuch as it was presented as a revolution in microeconomic theory –on a par with the almost contemporaneous Keynesian revolution in macroeconomic theory– the monopolistic competition literature of the 1930s – 1950s was a revolution that failed to dethrone perfect competition from its privileged status within economics (Tsoulfidis 2009). Yet, taking the clue from Dixit and Stiglitz (1977), a second wave of monopolistic competition literature has blossomed with much more profound impact on various quarters of economic analysis such as international trade, macroeconomics, growth theory and economic geography (Brakman and Hijdra 2004).

While Joan Robinson soon lost any interest in the subject, Chamberlin devoted his entire intellectual life to *i*) report and rectify (what he considered to be) ‘misconceptions’ of his own theory and *ii*) differentiate his own contribution from that of his Cambridge (UK) counterpart. At least on this latter point, his efforts were largely ineffective: Kaldor's scathing remark –“Professor Chamberlin has fallen a victim to the general tendency among producers in an imperfectly competitive market –a tendency he so convincingly describes– and is trying to differentiate his product too far” (Kaldor 1938, p. 525)– epitomizes the mainstream view that Chamberlin's and Robinson's analyses are but an instance of a multiple discovery of the same set of ideas, a phenomenon not uncommon in economics. (On Chamberlin's multivariate tactics to gain precedence over Joan Robinson see Aslanbeigui and Oakes 2011.)

As we know from Chamberlin's personal recollections, his interest in value theory, in general, and on the relationship between perfect competition and monopoly, in particular, dates back 1921 when, as a graduate student at the University of Michigan, he “took a course in Railway Transportation under Professor I. L. Sharfman, and wrote a course paper on the Taussig-Pigou controversy over railway rates” (Chamberlin 1961, p. 517). He then moved to Harvard where he devoted the years 1924 – 1926 to write his PhD dissertation, successfully defended in 1927, under the guidance of

Allyn Young. Reading Chamberlin's acknowledgement of his intellectual debt to Young in the Preface to the first edition of his 1933 book one may speculate that the latter was deeply involved into the project, more than as a simple supervisor. (On Young's influence on Chamberlin see Reinwald 1977 and 1985 and Blich 1985.)

Till retirement in 1966, Chamberlin spent almost all of his academic carrier at Harvard (where he became full professor in 1937) also serving as editor of the *Quarterly Journal of Economics* from 1948 to 1958. Together with Wassily Leontief, Gottfried Haberler, Alvin Hansen and, of course, Joseph Alois Schumpeter, he was one of the leading figures who contributed to establish the Harvard Department of Economics in the 1930s. A balanced assessment of Chamberlin's scholarship is provided by two of his Harvard colleagues:

As a scholar Chamberlin was a "lone wolf" whose work owed remarkably little to the extensive literature of the 1920s on increasing returns. He was not much interested in developments in areas of economics other than his own. Macroeconomic analysis in particular left him cold, and the fact the Keynes and other macroeconomists, in general, assumed that markets were competitive was enough to turn him off. But his influence on the study of the structure and functioning of markets and on the theory of the firm was profound. (Mason and Lamont 1982, p. 423)

Right in the Introduction to his 1933 book Joan Robinson pointed to Sraffa's intimation to "abandon the path of free competition and turn in the opposite direction, namely, towards monopoly" (Sraffa 1926, p. 542) as her primary source of inspiration. By contrast, as the opportunity arose, Chamberlin minimized or even denied his intellectual debt to the literature concerning the increasing returns – perfect competition debate of the late 1920s. Conversely, he was cryptic on the "ultimate origins and influences contributing to the development of *The Theory of Monopolistic Competition*", as he plainly admitted in his 1961 *QJE* paper, where he tried to make good such lacuna. There, besides 'classic' references to perfect competition and duopoly literature (from Cournot to Marshall and J.M. Clark), he focused on the " "Competing Monopolists" and the Literature of Business" (pp. 524 ff) and stressed the abysmal chasm between the view of market competition proposed by pure economic theorists, on the one hand, and by the applied scholars working on goodwill, patents, trade-marks, advertisement, selling costs etc, on the other hand. For Chamberlin, received economic theory, based on the perfect competition/pure monopoly dichotomy, presented a basically false representation of actual competition in real-world markets: its two polar models rigidly separated the forces which tend towards monopoly (the tireless effort by individual undertakers to create their own 'special markets' –as Marshall would say– by means of product differentiation) and those which tend towards competition (the invasion of someone else 'special market' through product imitation). For Chamberlin, these two forces are deeply

interwoven, though in varying degrees in different markets, to the effect that a rigid taxonomy of market structures turns out to be definitely misleading:

“Monopolistic competition” is a challenge to the traditional viewpoint of economics that competition and monopoly are alternatives and that individual prices are to be explained in terms of either the one or the other. By contrast, it is held that most economic situations are composites of both competition and monopoly, and that, wherever this is the case, a false view is given by neglecting either one of the two forces and regarding the situation as made up entirely of the other [...] To say that each producer in an industry has a monopoly of his own variety of product is not to say that the industry is monopolized. On the contrary, there may be a very intense competition within the industry, not of the sort described by the theories of pure competition to be sure, but different by virtue of the fact that each producer has a monopoly of his own variety of product. (Chamberlin 1937, pp. 570 – 571. See also Chamberlin 1951, pp. 352 – 353)

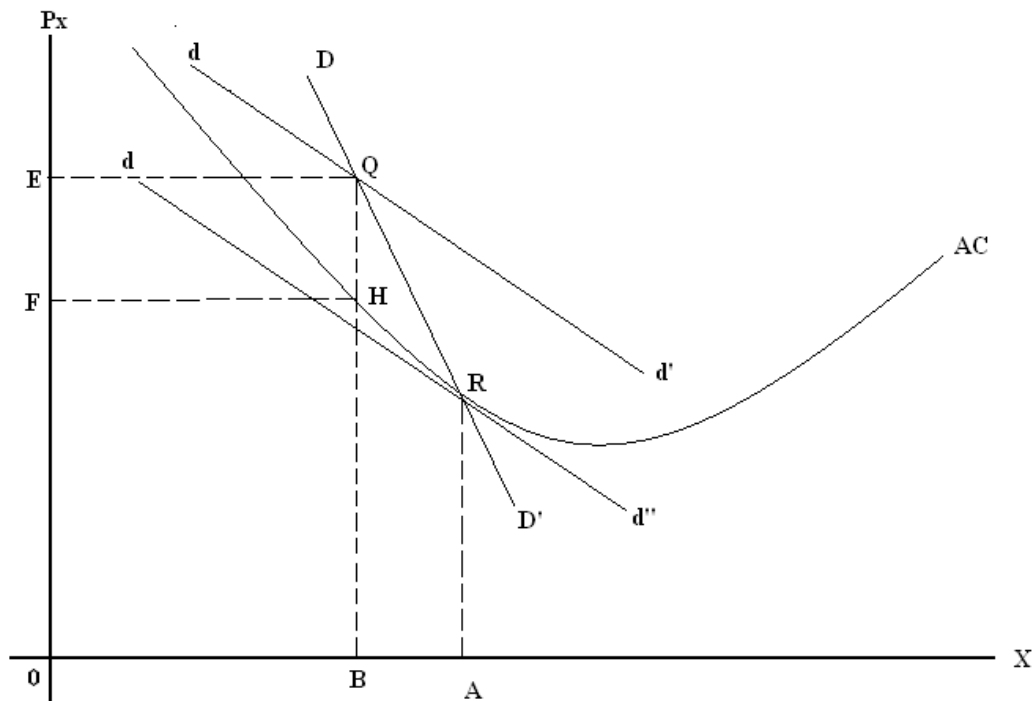
According to Chamberlin’s (implicit) methodology, the predictive content of a theory depends on the realism of its assumptions. That is the reason why he thought that perfect competition, based on an utterly unrealistic description of the firm, ought to be banished from the realm of economics:

if we are to have any respect as scientists for the economic system which it is our duty to explain, the correct procedure would seem to be not to assume pure competition and then to bring the firm into line by Procrustean methods, but rather to build up the system from the firms which compose it, *discovering from the facts what assumptions are appropriate as to competition and monopoly*, and therefore as to structure. (Chamberlin 1951, p. 349, emphasis added)

(It hardly needs to be stressed that such a methodological standpoint dramatically flies in the face of a positive economist *à la* Friedman and played a non-negligible role in provoking Chicagoans to react vehemently against the monopolistic competition literature. Keppler (1998) provides a methodological assessment of the ‘Chamberlin vs Chicago’ controversy.)

Once consumers perceive goods as differentiated and brand loyalty is created, competing firms may control and optimally choose price(s), product quality, design and packaging, store location, retail contracts, advertisement expenditure, after-sales services etc. In short, competition becomes a multi-dimensional activity, far removed from the passive quantity-adjustment envisaged by the perfect competition model. While any realistic description of how competition actually works cannot dispense with the notion of “product as a variable” (Chamberlin 1953), it is fair to say that Chamberlin was not able to achieve definite analytical results beyond the narrow field of price-competition. In what follows we concentrate on Chamberlin’s analysis of firm’s equilibrium in the large-group case, that is, when producers “whose goods are fairly close substitutes” (Chamberlin 1933 [1962], p. 81) are so numerous that “any adjustment of price...by a single producer spreads its influence over so many of his competitors that the impact felt by any one is negligible and does not lead him to any readjustment of his own situation” (*idem*, p. 83). Moreover, Chamberlin’s analysis of the large-group case is carried “under the heroic assumption that both demand and cost curves for all the “products” are uniform throughout the group” (*idem*, p. 82) and that “conditions of constant

cost obtained for the group as a whole” (*idem*, p. 85). (The debate following the publication of *The Theory of Monopolistic Competition* focused on the large-group case as Chamberlin’s main analytical innovation. Chamberlin did not ignore the small-group case, both with homogeneous and differentiated products; but his analysis of oligopolistic competition was not equal to the task: see Kuenne 2008.)



The graph above reproduces with only slight modifications Figure 14 on page 91 of *The Theory of Monopolistic Competition* (8<sup>th</sup> ed). AC is the long-run, U-shaped, average cost curve of firm *i*, *dd'* is its (perceived) demand curve. Since products are differentiated, the *dd'* curve is downward-sloping and not horizontal, as in the perfect competition model. For Chamberlin, “the divergence of the demand curve for his product from the horizontal imposes upon the seller a price problem, absent under pure competition, which is the same as that ordinarily associated with the monopolist” (Chamberlin 1933 [1962], p. 71). Yet, unlike the pure monopoly case where the monopolist faces no close substitutes, in Chamberlin’s large-group case the position of firm *i*’s demand curve depends, *inter alia*, on the prices of its substitutes. How to tackle analytically such interdependence problem? Chamberlin’s solution is a very Marshallian one: “[within] any group of closely related products...the demand and cost conditions (and hence the price) of any one are defined only if the demand and cost conditions with respect to the others are taken as given” (*idem*, p. 69). Accordingly, the *dd'* curve is drawn on the assumption that firm *i* believes that all its competitors

will keep their prices constant, irrespective of its price policy. In particular, firm  $i$  believes that if it reduces its price, its competitors will not retaliate by cutting their prices. (By contrast,  $DD'$  is firm  $i$ 's demand curve when all its competitors follow its same price cutting policy so to keep their market shares unaltered.)  $BQ$  is firm  $i$ 's initial price and  $EQHF$  its initial profit.

(Note that, unlike Joan Robinson and her emphasis on the marginal revenue curve, Chamberlin wittingly did not make use of marginal analysis to determine firm's equilibrium price  $BQ$  and quantity  $OB$ . He disparagingly defined the marginal revenue curve as "a piece of pure technique unrelated to the central problem". For Chamberlin the major drawback of the marginal revenue curve is that "it does not by itself reveal the price" while price is "the category with reference to which business decisions are most usually taken" (Chamberlin 1952, pp. 321 – 322). The (alleged) irrelevance of marginalism in *The Theory of Monopolistic Competition* is the basic foundation of Chamberlin's claim that his analysis, unlike Joan Robinson's, is wholly compatible with full-cost pricing theories *à la* Hall and Hitch.)

$BQ$  is not an equilibrium price for firm  $i$ : the latter may increase its profit by cutting its price, that is, moving to the right of  $BQ$  along  $dd'$ . For Chamberlin "any individual seller [has no fear] of ultimately reducing his gain [by a price cut] through forcing others to follow him because his competitors are so numerous that the market of each of them is inappreciably affected by his move" (Chamberlin 1933 [1962], p. 91). Thus, since all firms within the group are assumed to have the same demand and cost conditions and the same belief on their rivals' reaction, all firms have an incentive to, and actually will, cut their prices. As a consequence, firm  $i$ 's demand curve will shift downwards (from  $dd'$  to  $dd''$ ) till it becomes tangent to  $AC$ . At this tangency point the price cutting policy ceases to be profitable and the equilibrium price  $AR$  is finally determined. Though its profit is annihilated, firm  $i$  is producing in the downward-sloping region of its average cost curve. Hence, firm's equilibrium is characterized by unexploited scale economies (excess capacity).

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