Is Market Power Destructive? An Undergraduate Assignment Using Adam Smith’s Criticisms of Monopolies

Sara Gundersen, Valparaiso University
Is Market Power Destructive? An Undergraduate Assignment Using Adam Smith’s Criticisms of Monopolies

Sara Bothun
Valparaiso University


DOI: http://dx.doi.org/10.1504/IJPEE.2012.052678

This work is licensed under a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License.
Abstract: This paper describes an assignment where students evaluate a current industry using Adam Smith’s arguments against monopoly power. Using Smith’s arguments, students write a paper describing whether they believe a current industry, such as the US cellular phone carrier industry, suffers from the problems Smith described in *The Wealth of Nations*. This assignment invites students to take ownership over a current issue while developing a deep understanding of monopolies. By using Smith’s criticisms of monopolies, students will also see that economic “truths” are complicated, even in the classic “laissez-faire” text.

Keywords: teaching methods, pedagogy, undergraduate economics, Adam Smith, monopolies

Acknowledgements: I would like to thank Amy Atchinson, Daniel Saros, and Cynthia Rutz for helpful comments.
Section 1: Introduction

Adam Smith is “generally regarded as the patron saint of laissez-faire economics and an opponent of government” (Pressman 2006, p. 37). In reality, economists generally view Smith’s writings as displaying, “a subtlety and complexity that is at odds with the received image of Smith as the spokesman of modernity” (Brown 1997, p. 281). In fact, a massive literature continues to grow where scholars speculate about the true meanings and motivations behind Smith’s works (Brown 1997, Wight 2002). This complex view isn’t always translated into undergraduate teaching, where Smith is often covered in a very general way. This article proposes an assignment where students use Smith’s arguments against monopolies to evaluate the current economic climate. Students speculate whether Smith would see current industries with market power as a hindrance or aid to economic prosperity. In doing so, students will take ownership over a current issue, develop a deep understanding of monopolies, and recognize that economics is rarely black and white.

This paper proceeds as follows. The next section describes the need for the assignment. Section three describes specifics of the assignment, including examples from an assignment given at Valparaiso University. Suggestions are given for instructions, preparation, and grading. Section four concludes.

Section 2: Motivation

It is easy for students in undergraduate economics courses to cling to overgeneralizations such as: economic growth is caused by increases in capital; monetary stimulus always leads to prosperity; and markets lead to efficient outcomes. A seasoned economist will identify the caveats that come in the above statements, but an economics student may leave a course with a simplified view of the field. This is not beneficial to the student and is certainly not beneficial to society. The student who clings to overgeneralizations will at best view economics as mere memorization and at will at worst spread incorrect notions as truths.

Instructors must make efforts to teach students the nuances of economics, even at the introductory level. Instead of glossing over difficult or controversial topics, a good instructor can acknowledge the
complexity in economic arguments and use it as a goal: an undergraduate student in economics should leave her studies feeling able to navigate some of the complexities and, ideally, able to participate in some of the larger discussions.

Unfortunately, economics courses are largely still “chalk and talk,” with professors lecturing more than those in other disciplines (Allgood et al. 2004, Watts and Becker 2008). While it is certainly possible to lecture effectively, some have argued that active methods, such as cooperative learning (Bartlett 1998) classroom experiments (Noussair and Walker 1998) or writing (Hansen 1998) improve student outcomes and enjoyment in economics courses. If students are active participants in a course, they will likely leave with a better grasp of the material and a more favorable view of the course. The assignment described here revolves around the use of opinion essays to force students to become active participants.

**Use of opinion based assignments**

Whether or not an instructor calls for it, a number of undergraduate students will form opinions about economic issues in class, particularly if they are controversial. The formation of these opinions may be motivated by prior experiences (for example, if a student’s parents voice a particular political stance); by one’s peers; or by simply paying attention during lectures. If an instructor ignores these opinions, she is missing a great opportunity to teach students to be critical thinkers. If, on the other hand, she creates assignments around them, she is giving students an opportunity to practice articulating arguments. Furthermore, by encouraging opinions, an instructor gives students a signal of confidence; the instructor trusts the students to have something interesting to say and that they understand the material well enough to say it.

Opinion-based assignments force students to become active learners. An instructor who calls for opinions is asking students to take personal ownership over the material. A student who completes an opinion based assignment such as the one described here will leave the class being able to talk about a topic from a variety of angles. An open-minded student will mull over which angle to take, crafting a
more considered argument than she might otherwise have made. A student with strong political or economic viewpoints will also benefit, as she will be able to refine her arguments under a trained eye.

When creating an opinion-based assignment, it is best to choose a topic in which there is at least one feasible answer. For example, an instructor would not want to ask students to write about whether increases in gas prices hurt American families. While a student could feasibly argue either way, most would argue that they do. However, an essay about whether a Pigouvian gas tax should be implemented could be argued either way. Even if a student wants people to drive less, she might argue that there are better ways to reduce the negative externality (perhaps with a carbon tax). The best topic is one where even the instructor would be challenged to respond.

**Adam Smith’s Criticisms of Monopolies**

Teaching Adam Smith provides the instructor with a great opportunity to discuss some of the complexities of seemingly straightforward economic arguments. While it is tempting to classify Smith as a free-market “caricature” (Recktenwald 1978, p. 66), his arguments are more intricate than is often perceived. In his work, Smith discussed issues of morality, justice, and social order (Brown 1997, Recktenwald 1978). Perhaps one of the most counter-intuitive contributions Smith has made has been in his criticisms of monopolies. In *The Wealth of Nations*, Smith repeatedly expresses skepticism of monopolies, calling them “a great enemy to good management” (1776, p. 147) and criticizing their effect on competition (1776, pp. 461, 595). He states,

“The monopolists, by keeping the market constantly under-stocked, by never fully supplying the effectual demand, sell their commodities much above the natural price, and raise their emoluments, whether they consist in wage or profit, greatly above their natural rate” (p. 61)

By focusing on these criticisms, an instructor can teach students a powerful lesson. A student excited about the power of the “invisible hand” might seem confused, or even disturbed, by the welfare
losses present in an unregulated monopolistic market, while a student skeptical of the power of the market may suddenly become engaged by learning about Smith’s criticisms\(^1\). Either way, breaking Smith of his free-market “caricature” will invite students to think about economics in a deeper way.

**Section 3: The Assignment**

This article describes an opinion-based assignment where students consider Adam Smith’s viewpoints on monopolies. Specifically, students will argue whether Adam Smith would say a current firm/industry helps or hinders economic well-being. This assignment is designed to do the following:

1. Familiarize students with the writings of Adam Smith
2. Allow students to apply a relatively straightforward economic concept to a complex world problem
3. Challenge students’ notions of whether free markets are always good or bad
4. Allow students to practice using economic theory to make sophisticated arguments.

The assignment will work in any microeconomic, macroeconomic, history of economic thought, or comparative economic systems classes. It will work just as well in introductory and intermediate courses with a few modifications. This assignment has been used in two sections of a Comparative Economics Systems course at Valparaiso University\(^2\). Parts of these assignments will be highlighted to demonstrate possible applications.

**Instructions**

In the Comparative Economics Systems courses at Valparaiso University, students were asked to write an essay answering the following question:

---

\(^1\) It is important to note that opponents of government regulation argue that an unregulated market actually reduces the power of monopolies, and that monopoly power is caused by government intervention (Hetzel 1984). Bringing up this controversy may also engage students.

\(^2\) The assignments were given during the Fall 2011 and 2012 semesters.
“For this opinion essay, you will speculate as to what Adam Smith would say about an industry/store with market power in the US. Would Smith think the store/industry is a hindrance to capitalism, or would Smith argue that the store/industry is NOT a hindrance to capitalism? While none of these are technical monopolies, each has a significant amount of market power, so Smith’s criticisms of monopolies could apply.”

The students were asked to choose one of three firms/industries: British Petroleum, the cellular phone carriers in the US, or Wal-Mart. These can certainly be altered based upon the interests of the instructor or class. In the example described here, students chose each of the three options, although the majority chose Wal-Mart. This could likely be changed by spending some in class time discussing the other industries.

To facilitate grading and help students stay on task, the assignment required students to make arguments based on three of Adam Smith’s four criticisms of monopolies based on the summary by Pressman (2006, pp. 32-41). While Pressman provides a nice summary of Smith’s arguments, other sources and classifications may certainly be used. Another useful source might be Hetzel (1984), which also discusses inequality (page 6).

The Pressman arguments were described via a reading, group work, and a lecture. The criticisms are:

1. Monopolies produce too few goods and charge prices that are too high, making consumers worse off (Pressman 2006, p. 36, Smith 1776, p. 61, 342-343, 461, Hertzel 1984, p. 5-6)

2. Monopolies are a “great enemy to good management” (Pressman 2006, p. 36, Smith 1776, p. 147, Hertzel 1984, p. 6)

3. Monopolies are more likely to pressure the government into passing “bad and oppressive laws” (Pressman 2006, p. 36-37, Smith 1776, p. 612)
4. High profits in monopolistic industries will distort the market mechanism. High profits, instead of consumer preference or efficiency will dictate what is produced (Pressman 2006, p. 37, Smith 1776, p. 595)

Students were given clarification of how they might use one of these arguments. For example, “would Smith think that the government is treating this industry effectively, or have there been ‘bad and oppressive laws’ passed? Is the industry producing what people want or is it producing inefficient goods just because there is market power?”

The length of this assignment may vary: if the instructor wants to see three or more sources, the paper could be over five pages; however, the instructor might simply want to see well-developed arguments with fewer sources, perhaps in an introductory course, in which case a three or four page paper might suffice. Either way, it might be more helpful to grade based on arguments rather than length. (For example, did the student make three arguments, each citing a different source?) This will likely speed up grading and prevent students from going on unnecessary tangents.

**Preparation/Classroom Activities**

In order to prepare students for this assignment, the instructor must do two things. First, the instructor must ensure that students have knowledge of how monopolistic markets work. Second, the instructor should give an appropriate reading assignment. Specific suggestions are outlined below.

**Discussion of monopoly**

In an introductory course, the essay should be assigned when monopolies are taught, usually with a lecture. After the lecture is completed, it will be helpful to give students some practice connecting Smith’s arguments to economic theory. This may be done in a homework assignment, discussion, or group activity such as that described below. If the essay is assigned in an upper level class, most of the students will have some experience with monopolies. In this case, the instructor may want to jump directly to the practice activities. This will ensure that any “refresher” lecture is done efficiently; if
students remember the theory they won’t need a long lecture and if they do not, the refresher exercise will serve as a signal that they should pay close attention.

Readings

In addition to the classroom discussion of monopolies, background readings will give students a starting point for the assignment. In an introductory course, a summary article may suffice, such as the Pressman (2006) and Hertz (1984) articles cited above. The instructor might also include a broader biographical reading, such as that in Blaug (1997) or may simply assign a reading in the course textbook. In an upper level course, the instructor may also want to include excerpts from The Wealth of Nations. Useful passages about monopolies can be found on pages 61, 342-343, 147, 461, 612, and 595 (each described above), but the instructor may also wish to include more general passages, such as those about the invisible hand in Book IV Chapter II.

Either way, class time should be spent ensuring the students are able to connect the readings to the theory taught in class. Again, this can be accomplished via in-class discussion, homework, or a group activity. Group work was used in the Valparaiso University courses due to small class sizes (13 and 16 students). If a class size allows it, group work or homework may be preferable so that the quiet students are able to be active participants. In any case, the following types of questions can be helpful:

<table>
<thead>
<tr>
<th>Table 1: Sample Refresher/Leading Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Question</strong></td>
</tr>
<tr>
<td>1. What does it mean for a firm to be a monopoly? What does it mean for a firm to have market power, even if it is not a monopoly?</td>
</tr>
<tr>
<td>2. Can you think of a firm/industry in the US (or other country) where one or a few firms has a lot of market power?</td>
</tr>
<tr>
<td>3. What does Adam Smith think about the quality of management at a monopolistic firm?</td>
</tr>
<tr>
<td>4. Why would a manager of a monopoly be able to do a worse job than a manager for a firm facing competition? Do you see</td>
</tr>
</tbody>
</table>
evidence of this in real life?  This is fine, as it may still generate a useful discussion

5. Does a monopolist necessarily have the freedom to do what he/she wants?  The students should realize the answer is no. A monopolist still faces a downward sloping demand curve and must have customers to buy its products. This question will allow students to see that a monopoly today may still have an incentive to provide customers with high quality products or services.

6. (The instructor will draw a demand/marginal revenue/marginal cost graph without labeling anything.) Where is the demand curve on the graph? Why is it shaped the way it is? Where is the marginal revenue curve? What does this show?  This is simply to serve as a practice question based on the typical model used in undergraduate textbooks. Also, by thinking about the meaning of the demand curve, students will ideally see that the monopolist is constrained by consumer preferences.

7. According to Adam Smith, what sort of prices do monopolists charge?  Students should locate/recall that Smith says that monopolists charge higher prices than firms in a competitive market.

8. Can you label the equilibrium price and quantity on the graph? According to this, is Smith correct?  Some students will be able to identify this quickly. For those that cannot, question number 7 will ideally help them find a relevant range of prices. The instructor may wish to point out the competitive equilibrium.

These, of course, are all sample questions and can be changed to suit the instructor’s needs.

Regardless of the specifics, however, an activity such as this provides the instructor with a great opportunity to create an atmosphere of mutual inquiry. The discussion should contain questions starting with, “Do you think…” or “Would Adam Smith agree with…?” By inviting student opinions and experiences early on, students will feel more comfortable creating and defending an argument in their assignment.

*Grading and Expectations*

---

3 While Smith didn’t discuss the specific neoclassical model described above, he did reference the constraints imposed by a town’s demand (p. 342) and argue that monopolists will charge a higher price and produce a lower quantity than a market with competition (p. 61). An instructor not using this model may simply wish to focus on the price and quantity effects.
Expectations will vary by course. In an introductory course, the instructor may simply expect to see evidence that the student has read the relevant materials and showed some thought. In an upper level course, the instructor may wish to see a polished paper with very well-developed arguments. In either case, it’s extremely important that expectations are made clear. Students should never feel hesitant to formulate an argument because of grading uncertainty. In the courses described above, a grading rubric was used and is reported in Appendix A. Rubrics are useful to students writing the paper, to instructors in grading, and to both parties in the case of a complaint.

It is also helpful to provide clear instructions about sources. Students will always find highly politicized sources in discussions of monopolies and the instructor should be very clear about if and how to use them. In the application described above, an information literacy instruction session was provided by a University librarian. The librarian was able to clearly show students how to find high quality sources using the library website. If this resource is not available, the instructor should provide students with examples of acceptable and unacceptable sources. Instructor tastes will likely vary in determining what’s acceptable, but some typical sources would be magazines (such as The Economist or Time), newspapers (such as the Wall Street Journal or New York Times), or peer-reviewed journals. A potentially unacceptable source might be an article released by a left- or right-wing think tank (such as the Center for American Progress or the Heritage Foundation).

Response

Students at Valparaiso University were very receptive to the assignment. They took it very seriously, submitting well-argued essays. After the essays were completed, students also seemed to feel more comfortable expressing their opinions inside and outside of the classroom. Several students even included positive comments about being able express their opinions on their course teaching evaluations. Perhaps the most rewarding result of the assignment, however, has been in the conversations with students during the writing process. Most students appear to treat the assignment with care, weighing
each side before taking a stance. This activity, more than any other in the class, seems to open the door for genuine conversations about the importance of economic thought.

**Section 4: Conclusion**

While it is tempting to teach undergraduate students basic theory, it is vital that instructors make efforts to introduce the nuances of economic arguments, even at the introductory level. Students who leave classes thinking there are “correct” answers miss out on learning about the true, complex world of economics. An instructor who introduces some of the complexities will not only teach richer material, but will also be able to engage students.

Adam Smith provides an ideal way to do this. By teaching Smith’s criticisms of monopolies, an instructor will be able to break Smith of his free-market “caricature” (Recktenwald 1978, p. 66), and introduce some of the welfare losses that may occur in an unregulated market. In the assignment described above, students use Smith’s criticisms of monopolies to evaluate the current economic climate. In particular, students speculate as to whether Smith would think a specific firm, such as Wal-Mart, or industry, such as the US cellular phone industry, is helpful or harmful to capitalism. Students completing the assignment will take ownership over a current issue, will develop a deep understanding of monopolies, and will practice applying a relatively straightforward economic concept to complex world problem.

**Works Cited**


1937


http://ecedweb.unomaha.edu/roas.pdf

(Accessed 20 July 2012)


Economy, Vol. 34 No. 1, pp. 55-82
Appendix:

Example Grading Rubric from a Fall 2011 Comparative Economic Systems course at Valparaiso University

1. Did the student demonstrate knowledge of three of Smith’s four criticisms of monopoly?
   highly competent  competent  emerging  not competent

2. Did the student demonstrate the ability to find effective sources outside of the sources used in class? Did the student use the sources appropriately?
   highly competent  competent  emerging  not competent

3. Did the student demonstrate the ability to support his/her argument with supporting evidence?
   highly competent  competent  emerging  not competent

4. Did the student’s evidence provide a clear logical connection to the conclusions that he/she drew?
   highly competent  competent  emerging  not competent

5. Did the essay proceed in a clear and logical manner?
   highly competent  competent  emerging  not competent

6. Did the student use proper spelling/punctuation?
   highly competent  competent  emerging  not competent