Capitalism Does Not Exist In the U.S.

Warren Buffett, arguably the best investor of all time, has been known to study an industry or a company for decades before investing. That was exactly the case with railroads; for decades, each year Buffett would read the annual reports of all the public railroad companies. And each year, he passed on investing in them. He did not invest a single dollar, because he saw a capital-intensive industry with intense competition. Then, something changed. In 2007, Buffett pulled the trigger and bought shares in three railroad companies. A couple of years later he bought one of those railroads—Burlington Northern Santa Fe—in its entirety.

The Oracle of Omaha did something similar recently. For years he demurred to the idea of investing in the airline industry, refusing to invest because of its high fixed costs, high dependence on volatile fuel prices, and unionized workforce. He often remarked that the airline industry, from its birth until recently, had produced an aggregate, cumulative *loss*. His running joke was that if a capitalist had been present at Kitty Hawk, he would have done a great service to his descendants by shooting down the Wright brothers. But then, in 2016, he invested billions of dollars buying up shares in American Airlines, United, Delta, and Southwest.

What gives? What prompted Buffett to suddenly change his mind and buy into two industries that he decried for decades? One word: oligopoly.

Competition Is Dead

What Buffett realized was that these two industries had significantly been transformed to the point where only a few companies controlled all traffic. Railroads and airlines went from many players competing on price to an oligopoly where the few survivors could command huge pricing power. Another frequent Buffett quote regarding the types of investments he prefers pithily encapsulates this idea:

> “The single most important decision in evaluating a business is pricing power. If you've got the power to raise prices without losing business to a competitor, you've got a very good business. And if you have to have a prayer session before raising prices, then you've got a terrible business.”

In the case of railroads, after 1980 the number of Class I railroads shrank from over 30 to just 4: Burlington Northern Santa Fe, CSX, Norfolk Southern, and Union Pacific. These four companies effectively control the industry in this country. Airlines have followed a similar pattern, with major consolidation taking place after Congress deregulated the industry in 1978. Currently, the four airlines that Buffett owns control the vast majority of domestic travel in the U.S.

But more than that, these industries are not just oligopolies. On a local and regional basis, they are almost monopolies. Think about the last time you flew through the Atlanta or D/FW airport. You could almost count on one hand the number of non-Delta or non-American planes you spot there, respectively.

Buffett patiently waited for these industries to consolidate to the point where the oligopolistic nature of the industry would produce satisfactory returns. That is smart investing: invest in companies that have pricing power and have a "moat" around their business, given by the fact that no new entrants would come and compete.

But is that good for society?

Competition Is Dead

A new book by Jonathan Tepper and Denise Hearn, *The Myth of Capitalism: Monopolies and the Death of Competition*, argues that too many industries are becoming highly concentrated in a few dominant players, which is harming our society.

Before we get into the arguments proposed by the authors, let's look at a small sample of other industries that are dominated by just a few companies.

- *Cable/High-Speed Internet:* Three companies control 65% of the nation's cable market. But at the local level it is usually even more concentrated—pretty much a local monopoly.

- *Computer operating systems:* Microsoft controls over 90% of computer operating systems.

- *Social networks:* Facebook has over 75% market share in all social media.

- *Online search:* Google has an almost 90% market share in search advertising.

- *Seeds:* Monsanto has 80% market share of U.S. corn seed and more than 90% of U.S. soybeans.

- *Beer:* Two firms control over 90% of the U.S. beer market: AB Inbev and MillerCoors.

- *Phone operating systems:* Almost 99% of all phones run on either Apple's iOS or Google's Android.

- *Credit reporting bureaus:* Three companies—Experian, Equifax, and Transunion—control the entire credit reporting market.

- *Glasses:* Luxottica controls 80% of the major brands in the global eyeglasses industry. They own LensCrafters, Sunglass Hut, Ray-Ban, Oakley, as well as the optical departments at Sears, Target, JC Penney, and Macy's.

- *Banks:* While there are close to 5,000 banks in the U.S., only five—JPMorgan Chase, Wells Fargo, Bank of America, Citigroup, and US Bank—control 44% of the $15.3 trillion in assets held by U.S. banks.

- *Drug wholesalers:* The triumvirate of AmerisourceBergen, McKesson, and Cardinal Health handle more than 90% of the pharmaceuticals in the U.S.

- *Title insurance:* Four underwriters—Fidelity, First American, Stewart, and Old Republic—have around 87% market share in title insurance. (And don't get us started on what an antiquated and usually unnecessary, though legally obligatory, thing title insurance is.)

The authors' main argument in the book is that all of this oligopolistic behavior has killed competition, which has in turn created unjust inequality of wealth and income:

> "If there is no competition, consumers and workers have less freedom to choose. Competition creates clear price signals in markets, driving supply and demand. It promotes efficiency. Competition creates more choices, more innovation, economic development and growth, and a stronger democracy by dispersing economic power. It promotes individual initiative and freedom. Competition is the essence of capitalism, yet it is dying."

The authors argue, rather convincingly, that less competition has resulted in fewer jobs, fewer startups, less economic growth, and lower wages. They cite a recent study by Credit Suisse that we found especially mind-blowing: in the 20 years between 1996 and 2016, roughly half of all U.S. public firms had disappeared. There are now less publicly-listed U.S. firms today than there were in the 1970s, when real GDP was about a third of what it is today.

Tepper and Hearn end the book with some suggestions on what to do about this decline in competition. They are highly critical of the Department of Justice and the FTC in how they approve mergers in the country. They are proponents of tougher antitrust laws and advocate that previous mergers which have reduced competition should be reversed. They also propose some ideas which would lead to more and better regulation to avoid monopolistic behavior and promote competition.

Conclusion

The Myth of Capitalism is a fascinating and an eye-opening book. While different audiences will have different take-aways—investors might look at potential investments to make, while policymakers might get ideas on what areas to regulate—it should be read by a wide audience to at least gain a better understanding of the current state of our economic society.

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