

THE PROGRESS REPORT

Natural Monopolies

By Fred E. Foldvary

The great evil in economics is not communism, not socialism, not capitalism, not landlords or bosses, not unions, not feudalism or industrialization or automation, not progress or lack of it, and not any scarcity of natural resources. No, the great evil in economics is COERCIVE MONOPOLY.

But what is "monopoly"? "Mono" means single, and people usually think of a monopoly as a single seller. That is what economists call an "absolute" monopoly. But that is only one type of monopoly. The basic meaning of monopoly is that there is no entry into the industry to expand the supply. Therefore the existing firms, whether one or several, are the single source of that product. To enter the industry, one cannot obtain some input resources and expand the output. Instead, one must buy out one of the existing firms. There is an "entry monopoly" in which entry into the industry is impossible unless one transfers a title from one of the existing firms.

Some monopolies are legal monopolies, it being illegal to enter the industry to compete. For example, the delivery of first class mail in the United States is an absolute monopoly of the United States Postal Service. In other cases, the government requires a permit to operate in the industry, and limits the number of permits. The firms then have monopoly power, since they can limit production and raise the price above what would be the competitive price. In other cases, monopolies are legally protected by copyrights and patents which presumably encourage inventions and creative work.

Landownership is inherently a monopoly, since it is impossible to manufacture or import space, or to create more material natural resources such as oil and minerals. If you want to be a landowner, you must either obtain land from someone who already has title or discover land that nobody has claimed yet. Since the solid surface of the earth is now all discovered and under the jurisdiction of countries, the landowners and governments together now have a monopoly on the usable land on earth. This monopoly is coercively imposed on those who don't have a share of land, unless the natural benefits, manifested as rent, are equally shared.

A "natural monopoly" is defined in economics as an industry where the fixed cost of the capital goods is so high that it is not profitable for a second firm to enter and compete. There is a "natural" reason for this industry being a monopoly, namely that the economies of scale require one, rather than several, firms. Small-scale ownership would be less efficient.

Natural monopolies are typically utilities such as water, electricity, and natural gas. It would be very costly to build a second set of water and sewerage pipes in a city. Water and gas delivery service has a high fixed cost and a low variable cost. Electricity is now being deregulated, so the generators of electric power can now compete. But the infrastructure, the wires that carry the electricity, usually remain a natural monopoly, and the various companies send their electricity through the same grid.

To prevent utilities from exploiting their monopolies with high prices, they are regulated by government. Typically, they are allowed a fixed percentage of profit above cost. But this type of regulation can lead to inefficient high costs, since the monopoly is guaranteed a profit. Economists call this a "lazy monopoly." To get around this problem, some municipalities and government districts own the local utility and provide the service at cost. Another way to handle the natural monopoly is to periodically put the delivery service up for bidding, with the lowest cost firm getting the contract.

Local natural monopolies are less monopolistic when communities themselves compete with one another. In a county or metropolitan area, folks can then "vote with their feet" and choose communities with efficient utility and transportation services. Local governments have a coercive monopoly when they do not allow residents to create new independent communities. Secession from existing large cities is legally very difficult. If residents could secede at will and create new local governments, then natural monopolies would be much less coercive, since there would be much more local geographic competition among communities.

Natural monopolies would also be less coercive if the land rent were shared by the members of the community. The infrastructure of a community, including utilities, streets, transit, parks, and security, all generate land rent. The better the services, the higher the rent. If this rent is collected by the title holders, this is a coercive transfer of wealth from the residents to the landowners. The beneficiaries of coercive natural monopolies are the owners of the monopoly and the owners of the land rent. If the members of the community share the rent, then the benefits of the infrastructure are no longer transferred away from the public.

The ideal way to deal with natural monopolies is therefore a legal structure where people can voluntarily choose their governance by being able to create new community governments whenever they wish. The land rent generated by the local infrastructure is owned and shared by the community members or by contract. The local natural monopoly utilities are either owned by the community governance or contracted for with competitive bidding. With many independent communities rather than one huge coercive metropolitan government, folks can vote with their feet to provide geographic competition.

It is not economically feasible to eliminate territorial and natural monopolies, but it is not necessary for these monopolies to be coercive. Voluntary governance and share rents are the keys to having both efficient and just natural monopolies.