Monopoly and Government: Enemies of the Free Market **March 2018**

Richard (Chip) Peterson, (Economics, PhD)
Professor Emeritus (Finance) and former holder of the Briscoe Chair of Bank Management
Texas Tech University

Free markets work to allocate resources and people efficiently to areas where they can be most productive and achieve their highest benefits. However, free markets do not only depend upon individual liberty, property rights, and the rule of law to have their beneficial effects. They also require that there be multiple competing providers and buyers of goods and services so people can make choices that will enhance their individual welfare. Multiple competitive providers will continually compete to offer consumers, workers, and suppliers a better deal so they will agree to do business with them rather with another vendor or producer.

Free markets do not work as well if a monopoly (only one producer) or a monopsony (only one buyer) exists in a market. They also do not work as well if a colluding oligopoly (limited number of producers) exists in a market and establishes a common price rather than competing for business or workers.

In the absence of price competition, individuals will not be able to choose between multiple options to obtain greater benefits, welfare, or profits. Thus, monopoly, monopsony, and colluding oligopolies hinder the beneficial operations of free markets. They do so by eliminating potential options that would allow people and producers to make choices that might increase their welfare.

Monopolists can often charge the highest price that a market will bear—at least in the short run. In totally free markets, profitable monopolists will typically attract the free entry of competitors who compete to obtain a share of the market and its exceptional profits. If something impedes the entry of direct competitors, such as legal restrictions like patents, licensing requirements, etc., competing products may be developed that will allow others to substitute products that can replace or compete with the monopolist's goods or services. It may take some time, but free markets are very good at developing substitute products that can compete with those offered by a producer with monopoly powers. For instance, I am typing this on a program called "Open-Office" which is offered by Adobe as a competitor to Microsoft's relatively expensive "Office" set of programs. Also, because Microsoft originally made great profits with its DOS operating system, other operating systems were developed such as Lynix, Java, etc. that competed with Microsoft's products. Thus, over time, left to themselves, free markets will tend to erode the excess profits earned by a monopolistic entity—unless that entity is protected by some external force, such as government.

Governments can enhance the beneficial operations of free markets by preventing the development of colluding oligopolies (which is the goal of government "antitrust" policies that would prevent mergers or consolidated operations that result in a "restraint of trade") and by encouraging market competition. However, more malevolently, they can use their monopoly power on the use of domestic force, to establish and protect

private or governmental monopolies.

A major problem is that governments may cater to entities who would gain excess profits by establishing or maintaining a profitable monopoly position—especially since such entities may come bearing "gifts." Such gifts may take the form of campaign contributions, provisions of "free" goods or services, or direct payments or promises. Such "gifts" are, in fact, a form of "monopoly rent" payments that a would-be monopolist must pay the governmental entity or regulator in order to establish and maintain a potentially profitable monopoly position. In the limit, these "rent" payments may exhaust all of the potential excess profits that monopolists hope to earn by having monopoly powers that protect them from potential competition.

Governments can use their monopoly control of the legitimate use of domestic force to establish or enhance monopoly positions. Some governments may choose to own and control entire industries or functions in their domestic economies while prohibiting internal private competition or external imported competition for their enterprises. Unfortunately, without the goad of free market competition, government monopolies often operate inefficiently, waste resources, and provide products that would otherwise be too expensive to produce, or too poor quality to sell, or too obsolete or inappropriate to be able to compete effectively against free market alternatives.

Governments can also seek to gather monopoly rents by, in essence, franchising private entities and people by granting them monopoly privileges (for a price, or "gift"), and by limiting their potential competition. Occupational licensing requirements, or exclusive utility operating areas, etc. are a few examples, of such an approach. Many might questions why licensing restrictions need apply to hairdressers and various other professions, etc. However, the explanation may involve the potential payment of monopoly rents made in the form of "licensing fees" or political contributions to eliminate unrestricted competition. Those payments may weigh more heavily upon governmental minds than the off-stated "public safety" considerations.

Many other examples of governmental restrictions upon market entry and competition exist. The FDA may restrict the ability of various companies to produce and market various pharmaceutical drugs and products—such as competitors to the "Epipen" or natural herbs or foods that that may have ("unproven") therapeutic potential. It also can prevent the importation of various products without its approval.

Governments can also anoint private businesses to be exclusive suppliers of valuable goods or services. In addition to having favored vendors for supplying government products—who find that purchase specifications are often exactly to their liking, governments may grant exclusive operating franchises. For instance, Lady Bird Johnson, President Johnson's wife, for a long time had the only license to operate a (highly profitable) television station in Austin Texas—since such licenses had to be approved by the Federal Communications Commission, which Lyndon Johnson oversaw.

If one looks closely, one can find other examples of situations where governmental influence can provide special benefits or monopoly powers that will enhance the welfare or profits of a politically favored group. Tailor made purchase specifications, local source purchasing requirements (such as the Jones Act for domestic shipping), and quota and tariff restrictions, along with non-tariff restraints upon import competition, are but a few of the additional ways in which governmental entities can earn "monopoly rents" by granting or potentially establishing limits upon competition that allow private entities to earn "monopoly" profits which they, in turn, share with the governmental entity or person that facilitated the privileged economic position for the favored entity.

In the absence of governmental intervention, history shows that free market competition will tend to facilitate economic growth and provide a plethora of affordable products that consumers desire. This is demonstrated by Hong Kong and Singapore, both of which were desperately poor after WWII, but adopted free market principles, low taxes, and low or non-existent tariffs. As a result, both countries are now among the most prosperous in the world as judged by per capita income measures. Conversely, governments with the most heavy handed government controls have stagnated and produced products that their population does not desire. The Soviet Union fell for that reason, while, Venezuela, North Korea, and Cuba have all stagnated. Even many European Union countries have grown relatively slowly when the government has restricted the operation of free markets in their economies. Britain, prior to Margaret Thatcher, was a primary example of that process.