

Glossary entry: Monopoly

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I was writing a 'View On' article on markets yesterday morning and discovered there was no glossary entry for monopoly, although there was for oligopoly. This entry remedies the deficit. It took a lot longer to write than I expected.

Monopoly

A monopoly exists when a single business, organisation or provider has sufficient control over the supply of a good or service that meaningful competition in its delivery is absent or severely restricted.

In elementary economics, monopoly is often presented as the exceptional opposite of competitive markets. In reality, the tendency towards monopoly and concentrated market power is inherent within capitalism. This tendency arises from the dynamics of capital accumulation: competitive success generates resources and advantages that compound over time, and successful businesses frequently have stronger incentives to eliminate competition than to sustain it. They do so by acquiring competitors, controlling essential technologies, creating barriers to entry, and establishing market positions from which they can extract economic rents. Monopoly should therefore be understood primarily as an issue of economic power, from which a number of consequences flow.

First, monopoly gives the supplier power over price.

A business operating in a genuinely competitive market has limited ability to determine the price at which it sells.

A monopolist has considerably greater freedom to do so because customers have few, or sometimes no, realistic alternatives.

The result can be prices substantially above the cost required to supply the product or

service, with the difference generating economic rents for the monopolist.

Second, monopoly can restrict supply.

A monopolist does not necessarily maximise its return by supplying as much as possible. Restricting supply can increase scarcity and permit higher prices. This is one reason why the interests of a monopolist and those of society can conflict. What maximises the financial return to the owner of a scarce resource does not necessarily maximise its availability to those who need it.

Third, monopoly creates economic rent.

Monopoly profits should be distinguished from the return required to encourage genuine investment and entrepreneurship. Where a company can charge more simply because competitors cannot enter its market, part of its return represents economic rent. That income results from control over scarcity rather than the creation of additional value.

Fourth, monopolies depend upon barriers to entry.

Monopoly power can arise because competitors face obstacles that prevent them from entering a market. Those barriers can include;

- * ownership of scarce natural resources,
- * patents and other intellectual property rights,
- * control of infrastructure,
- * network effects,
- * access to large quantities of capital,
- * economies of scale,
- * ownership of data,
- * regulatory advantages,
- * control of distribution systems,
- * established brands, and
- * the acquisition or destruction of potential competitors.

Some barriers arise naturally from the characteristics of an industry. Others are deliberately constructed.

Fifth, monopoly power can be created by the state.

Some monopolies exist because the law deliberately gives a person or company an exclusive right to do something. Patents and copyrights are obvious examples. A patent gives its owner the legal right, for a limited period, to prevent others from making use of an invention without permission. Copyright does something similar for creative work. Licences can also restrict who is permitted to provide particular goods or services.

There can be good reasons for granting these rights. A patent, for example, is intended to reward innovation by allowing an inventor a period in which they can benefit from what they have created. The monopoly is therefore not an accidental failure of the market. It is deliberately created by law in pursuit of another objective.

The problem arises when these temporary or limited privileges become a means of extracting excessive profits, or when companies find ways to extend their monopoly power beyond what was originally intended. This is particularly significant when monopoly rights restrict access to essential goods, such as medicines, because the owner of the legal right may then be able to charge prices far above the cost of supplying them.

There is a wider point. It is misleading to imagine that monopoly results simply from governments interfering in otherwise free markets. Markets do not exist independently of the state. Property rights have to be defined. Companies exist because company law creates them. Contracts depend upon legal enforcement. Intellectual property rights exist only because legislation establishes them.

The question is therefore not whether the state should intervene in a supposedly natural free market. The state already creates the legal framework within which every market operates. The real question is whether the rights it creates promote competition and public benefit, or whether they allow economic power to become concentrated and monopoly rents to be extracted. That legal framework is not neutral: it embodies choices about whose interests to protect, and those choices can be made differently.

Sixth, some industries are natural monopolies.

There are activities where competition can be economically wasteful or impractical. Water distribution is an obvious example. It would make little sense for several competing companies to install parallel networks of water pipes beneath every street so that households could choose between them. Similar issues arise with electricity networks, rail infrastructure and some other essential utilities.

In such cases, the question is not necessarily how competition can be created. The more important question is who should own the monopoly, how it should be governed and whose interests it should serve. This creates a strong argument for public ownership of natural monopolies. If monopoly rents are unavoidable, there is no obvious reason why they should accrue to private owners rather than being retained for public benefit.

Seventh, monopoly can undermine innovation rather than promote it.

It is sometimes claimed that large monopoly profits encourage innovation. In some circumstances, substantial expected returns might indeed encourage investment. But once monopoly power has been established, the opposite incentive can arise.

A dominant company may have little reason to improve its product, reduce prices or develop alternatives. It may instead devote resources to protecting its existing market position through lobbying, litigation, acquisitions and control of intellectual property. Buying potential competitors can be easier than competing with them. As a result, monopoly power can actively prevent innovation.

Eighth, monopoly power extends beyond prices.

A monopolist can influence wages, working conditions, suppliers, governments and even the information available to consumers. A company dominating a supply chain can dictate terms to smaller suppliers, while a dominant employer can exercise considerable power over workers. A technology platform controlling access to a market can determine which businesses succeed within it. Economic concentration therefore creates political as well as commercial power.

Ninth, monopoly and financialisation can reinforce each other.

Large companies with secure market positions generate predictable cash flows. Those cash flows can be particularly attractive to financial investors because monopoly rents can support borrowing, dividends, share buybacks and other forms of financial extraction. Private equity and other financial interests may consequently have strong incentives to acquire businesses with monopoly or near-monopoly characteristics. The objective can then cease to be the provision of the best possible service and become the extraction of the largest possible financial return from a captive customer base.

This dynamic is not confined within national borders. Large multinational corporations can use international corporate structures, including intellectual property holding companies, intercompany financing arrangements and transfer pricing, to extract monopoly rents generated in one country while minimising the taxation of those rents in the jurisdiction where value is created. The analysis of monopoly and the analysis of international tax avoidance are therefore closely related.

Tenth, monopoly is not always absolute.

A company does not need to be literally the only supplier in a market to exercise monopoly power. An economy can contain several businesses and still suffer from extreme concentration. When a handful of companies dominate a market, the situation is usually described as an oligopoly. In practice, oligopoly is the dominant form of market power in most advanced economies, including in technology, banking, food

retail, pharmaceuticals and media.

The distinction matters technically, but perhaps less economically than textbooks sometimes suggest. What matters is whether consumers, workers and suppliers have meaningful alternatives and whether businesses possess sufficient market power to extract rents.

The Funding the Future perspective

From a Funding the Future perspective, monopoly demonstrates one of the fundamental contradictions within the idea of the free market. Competition is supposedly at the heart of capitalism, but successful capitalist businesses have powerful incentives to escape competition. Monopoly, market dominance, intellectual property, network effects, mergers and acquisitions can all provide ways to achieve that goal.

A business that succeeds in escaping competition can extract economic rents precisely because the market is no longer functioning in the way that conventional economic theory assumes. The resulting concentration of economic power can also become a concentration of political power, giving large businesses considerable influence over regulation, taxation and government policy.

The appropriate response depends upon the activity concerned. Some monopolies should be broken up, some require strong regulation, some monopoly rents should be taxed, and some intellectual property rights should be restricted. Natural monopolies providing essential public services may be best placed in public ownership.

The essential point is that monopoly is about power. The question is not simply how many companies appear to operate in a market, but whether anyone has sufficient control over an essential resource, technology, infrastructure or service to dictate terms to everyone else.

When they do, the resulting economic rents, inequality and concentration of political influence become matters of legitimate public concern. Markets do not automatically correct monopoly power. Addressing it requires deliberate choices about the legal framework markets depend on, and whose interests that framework is designed to serve.