Monopoly is a bureaucrat’s friend but a democrat’s foe
By Tim Harford

The challenges from smaller competitors spur the innovations that matter

“It takes a heap of Harberger triangles to fill an Okun gap,” wrote James Tobin in 1977, four years before winning the Nobel Prize in economics. He meant that the big issue in economics was not battling against monopolists but preventing recessions and promoting recovery.

After the misery of recent years, nobody can doubt that preventing recessions and promoting recovery would have been a very good idea. But economists should be able to think about more than one thing at once. What if monopoly matters, too?

The Harberger triangle is the loss to society as monopolists raise their prices, and it is named after Arnold Harberger, who 60 years ago discovered that the costs of monopoly were about 0.1 per cent of US gross domestic product – a few billion dollars these days, much less than expected and much less than a recession.

Professor Harberger’s discovery helped build a consensus that competition authorities could relax about the power of big business. But have we relaxed too much?

Large companies are all around us. We buy our mid-morning coffee from global brands such as Starbucks, use petrol from Exxon or Shell, listen to music purchased from a conglomerate such as Sony (via Apple’s iTunes), boot up a computer that runs Microsoft on an Intel processor. Crucial utilities – water, power, heating, internet and telephone – are supplied by a few dominant groups, with baffling contracts damping any competition.

Of course, not all large businesses have monopoly power. Tesco, the monarch of British food retailing, has found discount competitors chopping up its throne to use as kindling. Apple and Google are supplanting Microsoft. And even where market power is real, Prof Harberger’s point was that it may matter less than we think. But his influential analysis focused on monopoly pricing. We now know there are many other ways in which dominant businesses can harm us.

In 1989 the Beer Orders shook up a British pub industry controlled by six brewers. The hope was that more competition would lead to more and cheaper beer. It did not. The price of beer rose. Yet so did the quality of pubs. Where once every pub had offered rubbery sandwiches and stinking urinals, suddenly there were sports bars, candlelit gastropubs and other options. There is more to competition than lower prices.

Monopolists can sometimes use their scale and cash flow to produce real innovations – the glory years of Bell Labs come to mind. But
the ferocious cut and thrust of smaller competitors seems a more reliable way to produce many of the everyday innovations that matter.

That cut and thrust is no longer so cutting or thrusting as once it was. “The business sector of the US economy is ageing,” says a Brookings research paper. It is a trend found across regions and industries, as incumbent players enjoy entrenched advantages. “The rate of business start-ups and the pace of employment dynamism in the US economy has fallen over recent decades . . . This downward trend accelerated after 2000,” adds a survey in the Journal of Economic Perspectives.

That means higher prices and less innovation, but perhaps the game is broader still. The continuing debate in the US over “net neutrality” is really an argument about the least damaging way to regulate the conduct of cable companies that hold local monopolies. If customers had real choice over their internet service provider, net neutrality rules would be needed only as a backstop.

As the debate reminds us, large companies enjoy power as lobbyists. When they are monopolists, the incentive to lobby increases because the gains from convenient new rules and laws accrue solely to them. Monopolies are no friend of a healthy democracy.

They are, alas, often the friend of government bureaucracies. This is not just a case of corruption but also about what is convenient and comprehensible to a politician or civil servant. If they want something done about climate change, they have a chat with the oil companies. Obesity is a problem to be discussed with the likes of McDonald’s. If anything on the internet makes a politician feel sad, from alleged copyright infringement to “the right to be forgotten”, there is now a one-stop shop to sort it all out: Google.

Politicians feel this is a sensible, almost convivial, way to do business – but neither the problems in question nor the goal of vigorous competition are resolved as a result.

One has only to consider the way the financial crisis has played out. The emergency response involved propping up big institutions and ramming through mergers; hardly a long-term solution to the problem of “too big to fail”. Even if smaller banks do not guarantee a more stable financial system, entrepreneurs and consumers would profit from more pluralistic competition for their business.

No policy can guarantee innovation, financial stability, sharper focus on social problems, healthier democracies, higher quality and lower prices. But assertive competition policy would improve our odds, whether through helping consumers to make empowered choices, splitting up large corporations or blocking megamergers. Such structural approaches are more effective than looking over the shoulders of giant corporations and nagging them; they should be a trusted tool of government rather than a last resort.

As human freedoms go, the freedom to take your custom elsewhere is not a grand or noble one – but neither is it one that we should abandon without a fight.

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