

There's Nothing Natural About "Natural" Monopolies

Gary S. Becker. *Business Week*. (Industrial/technology edition). New York: October 6, 1997. Iss. 3547; pg. 26.

The old concept in economics of "natural" monopoly refers to an industry where the technological advantages of large-scale production preclude efficient competition among smaller companies. The alleged superiority of bigness has been used in most countries to justify government ownership of many industries, since state monopolies are supposed to do a better job than private ones looking out for the public interest. Although claims about natural monopoly continue to influence public policies and academic discussions, this concept has become largely irrelevant to modern dynamic economies.

The growth of global competition implies that even when large-scale production is most efficient, companies in small nations are no longer restricted to the inefficiently small scale of their limited domestic market. They can increase production enormously by operating in several nations. Chilean electric power companies, for example, have raised their profits and expanded production out of their small domestic market by operating in other Latin American countries.

A more important defect of the natural monopoly argument is its failure to recognize that new technologies often evolve over time that are efficient at much lower levels of output than older methods of production. Small natural-gas turbine plants can now generate electricity at lower cost than more traditional and considerably larger coal plants. Cellular phones, unencumbered by a wired grid, are competing effectively with traditional wired telephone systems, especially in places where government-owned companies are grossly inefficient.

SPECIAL CLIENTS. A crucial defect of government enterprises is that they slow down the introduction of better technologies. They are insulated from competition, and they are exposed to political pressures to cater to unions, favored customers, and other groups. Moreover, despite their mandate to serve the public interest, they have often provided abysmal service to the average customer.

These problems with public enterprises stimulated the revolutionary privatization movement of the past couple of decades. Many nations have at least partially privatized telecommunications, banks, insurance, natural gas, airlines, steel, oil, and other industries that were once considered natural monopolies. Newly privatized companies and entrants into formerly closed industries have frequently improved technologies and service while making good profits.

However, much remains to be done to allow greater competition into industries such as telecom and electric power production that had been government-owned or closely regulated. Long-distance phone service has been opened to vigorous competition in many nations, and quality has greatly improved. However, local telephone companies are still protected from open competition.

CABLE CONTENDER. Competitors should be allowed to access this local grid by paying a license fee for its use, the way long-distance companies already do. They could then offer local telephone services at unregulated and competitive prices. Even without compulsory licensing, the telephone grid would not be a barrier for long to pricing by competition rather than by government bureaucrats. Cable companies would convert their wires to offer two-way phone service as well as TV programming if they could make profits from local telephone service. They already do this in Britain and are beginning to do so in the U.S.

Companies providing cellular and more advanced digital-wireless phone service would expand more rapidly to offer vigorous competition to the local phone monopolies. Some experts estimate that digital wireless could have well over half the phone market within the next 5 to 10 years, and that they would provide convenient fax, E-mail, Internet, and other services.

The production and transmission of electricity in practically all countries remains under the management of local or national governments. Yet the development of efficient high-voltage transmission lines means that the market for the generation of electric power could transcend local and even national boundaries with free entry and unregulated pricing. An open market for electricity would end the sizable regional disparities in the cost of power found in the U.S. and other nations and would lower the cost to industry and consumers.

Old concepts in economics die slowly, but the concept of natural monopoly is no longer of much relevance to economic policy. The sooner we get rid of this dated idea, the better off the average consumer and producer will be.