Monopoly and General Welfare

In a free society, the idea of a large bureaucracy deciding when a company needs to be busted is a frightening notion. In a free economy, the market takes care of any problems, and although self-defining, if the market cannot take care of a problem, the economy isn't free.

The majority of economists get monopoly completely wrong. In this module, the benefits of monopoly to the general welfare are examined along with the highly destructive power of competition.

In the next module, two powerful government protections of monopoly are shown to be primarily responsible for both any negative externalities from present day monopolies and the failure of many businesses to adapt to the highly beneficial form of competition called "creative destruction".

In the final module in this set, it is shown how all monopolies in land-based capitalism are location monopolies, how this maximizes voluntary ground rent revenue without limiting production, and how land-based capitalism virtually eliminates the harm from creative destruction.

Economists are not all together in their dislike of monopolies. There is a considerable literature on monopoly advantages, including the ability to fund high-cost research and survive the common high percentage of research failures.

Monopolies provide a market for innovations from small firms and individuals that could not be developed otherwise. Conversely, small firms desiring to become monopolies use innovation to "creatively destroy" existing monopolies.

Other advantages are long-term planning in a dynamic economy; economies of scale; cost saving on advertising and retailer interactions; and subsidizing loss-making services, which in totality improve everyone's quality of life.

Regarding negative externalities, monopolies have the pricing power to clean their pollution and produce less of it to begin with, eliminating redundant factories and vehicles. The negative externalities of consumption itself (wasted space, opportunity cost, landfill usage) are reduced for low-demand purchases that do not occur under monopoly pricing.

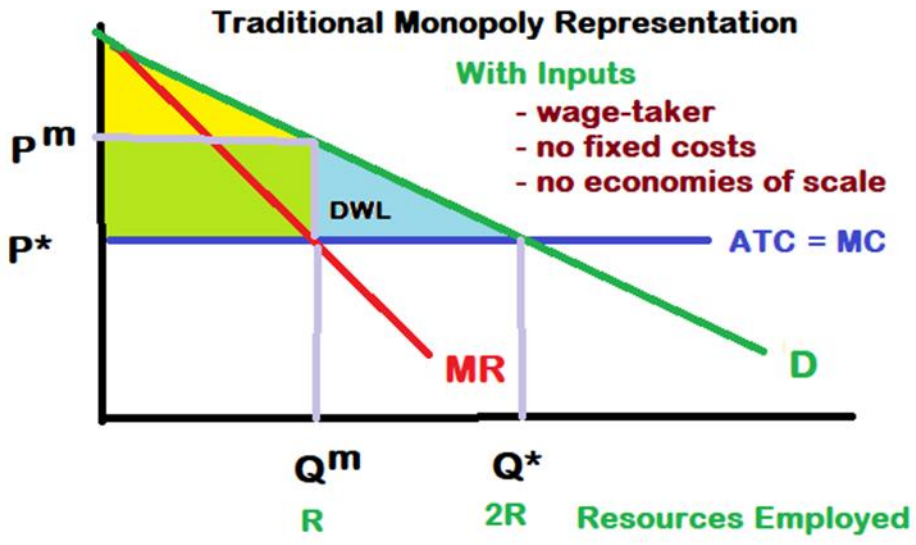
David Wells has shown that monopolies provide the only real protection against overproduction, and thus serve to counter the boom-bust cycle.

A key argument on improvements to the general welfare found in monopolies is their ability to pay efficiency wages. This has included good healthcare and educational benefits. Tech monopolies of the last few decades have offered game rooms, free meals, rest areas, and field trips.

Consistent with these arguments are those showing flaws with the perfect competition model, including assertions of zero transaction cost entry, perfect information, and failure to explain how a market develops over time, including the introduction of a new product without the profit motive.

While Schumpeter argues that the general welfare is improved by monopolies when the dynamical nature of economies is considered, the only somewhat trivial relationship between monopoly and the general welfare is a negative one, displayed as the Harberger triangle on the Marshallian cross diagram and labeled "deadweight loss".

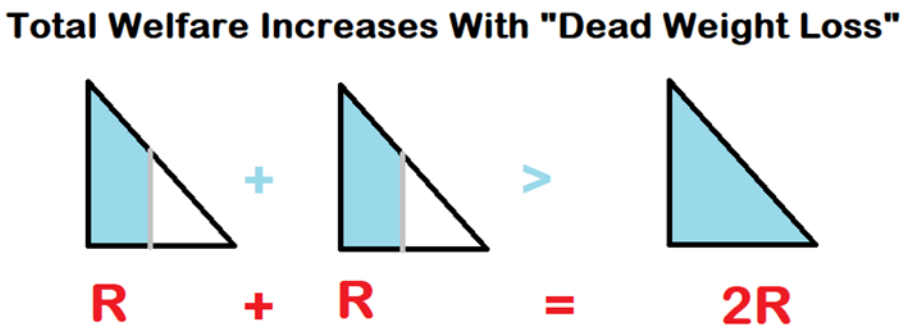
Concerning monopolies, is deadweight loss an illusion?



In the traditional monopoly representation, it is rarely noted that additional resources are required to produce Q*. In this diagram, production to Q^M requires R resources, while production to Q* employs 2R resources.

It is trivially obvious that the marginal efficiency of resources at producing total welfare is a rapidly decreasing function. The first resource produces welfare shown by the yellow triangle and green square, the second only the smaller blue triangle labeled DWL.

If the second resource R were alternatively employed in a different monopoly, the total welfare would be higher. This can be seen simply and diagrammatically.



This is demonstrated with two examples of market-clearing economies. In the first, 12 workers are divided into 6 firms of 3 competitive industries. In the second, those 12 workers are divided into 6 firms of 6 monopoly industries. The total welfare is higher with the monopolies.

Computing Social Benefit in a Competitive Economy with 3 products A, B, and C

The total population of this economy is 12, all of whom are employed. They are named W1 through W12. All workers are interchangeable and each can produce 2 units of A, 2 units of B, or 2 units of C.

Ignoring all fixed costs and managerial costs, each worker in a fully competitive economy of full employment produces 2 units and is paid 2 units.

With 3 products, 12 workers, competition, and full employment, there would be 6 firms, 2 competing firms for each product. Each firm hires 2 workers and produces 4 units. A total of 24 units of A, B, and C are produced. Each worker has a budget constraint of 2 units for a total budget amongst all workers of 24 units.

Each firm is a price taker and the price of each unit of A, B, and C is 1 unit. With 24 units of income and 24 units of product, the market clears.

As seen in the table of individual demand, workers do not place the same value on the first instance of a product (assume that the value placed on the 2nd instance of the same product is miniscule and never figures into the optimal solution).

Individual Demand – Optimal Solution						
	Product A		**Product B**		**Product C**	
	Subj. value	Units sold	Subj. value	Units sold	Subj. value	Units sold
W1 – W4	2	4	1	2	1	2
W5 – W8	1	2	2	4	1	2
W9 – W12	1	2	1	2	2	4
Total Value	8 + 2 + 2 = 12		2 + 8 + 2 = 12		2 + 2 + 8 = 12	

Total value of all products = 36. Value to each worker as a consumer = 3.

Optimally, each worker first buys the product that is worth 2 units to them personally. There are 8 of each product and 4 of them are in especially high demand. I will assume the workers are successful, although there is no guarantee of this, particularly if one product is generally infinitesimally preferred on average over another. But assuming success, each worker has an income of 2, but ends up with a total value of 3. For instance, W3 will purchase 1 of Product A (valued by W3 at 2) and 1 of either B or C (valued by W3 at 1) for a total value of 3.

Innovation Creates 3 New Products or Services, D, E, and F with Fixed Population

With the population fixed at 12, three new products or services, D, E, and F are introduced. Like A, B, and C, a worker can produce 2 units of D, E, or F. To keep things simple, the subjective valuations for D, E, and F look exactly like the valuations for A, B, and C.

With 6 products, each of the 6 firms now becomes a monopoly. As before, each firm hires two workers producing a total of 4 units of each product. However, there is sufficient demand to sell these 4 units for 2 units each, for a total revenue of 8 units. Cost is only 4 units, leading to monopoly profit of 4 units as well.

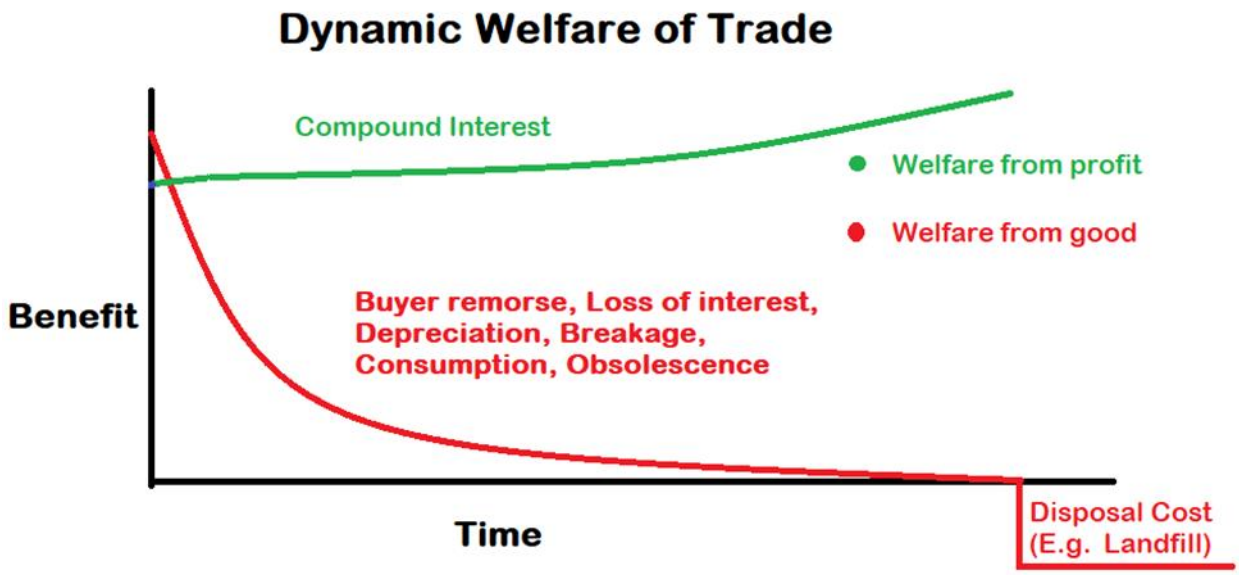
But does the market clear? To answer the question, assume the 4 units of profit are divided between the 2 workers (there is no fixed cost or management). Each worker has a total income of 4 units (2 units of base salary and 2 units of profit).

Individual Demand – Market Clearing Solution						
	Product A		**Product B**		**Product C**	
	Subj. value	Units sold	Subj. value	Units sold	Subj. value	Units sold
W1 – W4	2	4	1	0	1	0
W5 – W8	1	0	2	4	1	0
W9 – W12	1	0	1	0	2	4
Total Value	8 + 0 + 0 = 8		0 + 8 + 0 = 8		0 + 0 + 8 = 8	
Individual Demand – Market Clearing Solution						
	Product D		**Product E**		**Product F**	
	Subj. value	Units sold	Subj. value	Units sold	Subj. value	Units sold
W1 – W4	2	4	1	0	1	0
W5 – W8	1	0	2	4	1	0
W9 – W12	1	0	1	0	2	4
Total Value	8 + 0 + 0 = 8		0 + 8 + 0 = 8		0 + 0 + 8 = 8	

Total value of all products = 48. Value per worker/consumer = 4.

Using identical resources, monopolies have produced 12 more units of social value (48 – 36) or 1 more unit of value per consumer.

A different objection to deadweight loss is found in the time component of welfare. The diagram below challenges economist's claims about the equivalence between currency and goods, showing that an instantaneous benefit to the buyer is a long-run benefit for the seller. The total welfare of monopoly profits over time will always exceed the welfare provided by any good or service.



It does not serve the interest of an economy built on consumerism to show these dynamic benefits of trade over time. The motto of our future world might be, "We consume in order to pursue our interests," while the current philosophy of many consumerist economists is, "We pursue our interests in order to consume."

A monopoly limits the supply of product in order to produce profits. Thus, a monopoly increases demand faster than it increases supply. This increase in demand causes other firms to innovate, so that they might increase their supply and profits. It is a virtuous cycle of ever-increasing demand leading to great prosperity (particularly in a land-based economy that can handle great prosperity without booms and busts).

In an ideal economy, every person, family, or collective would be a monopolist; a world producing the greatest possible variety of goods and services. Or perhaps, they would serve as the sole and most efficient purveyor of some goods or services in their community. Cutthroat competition ends, as the treble adds an entire new dimension to the concept of competition.