Monopolies only work if they're not contestable [1]

Written by **Tim Worstall** [2] | Saturday 15 December 2012

A little story from the annals of my corner of the weird metals industry. You'll recall all those stories of how the Chinese had cornered the market in rare earth metals. Then the wily Orientals rather scrutably decided to, once they were 97% of the supply, restrict exports, reduce production and rub their hands with glee as they collected monopoly profits. All in all an example of how they had got it right through industrial planning and we in our free market foolishness had got it wrong.

So let me bring you up to date with what's happening [3]:

> The shares and rare earth prices plunged in 2011 as buyers pursued alternative raw materials and used stockpiles. Lanthanum oxide, a rare earth used to refine gasoline, has dropped 53 percent this year, according to Shanghai Steelhome Information data. Cerium oxide, used in glass polishing, has declined 56 percent and neodymium oxide, used in magnets, has fallen 46 percent, the data show.

Prices have indeed done that. But not particularly for the reasons mentioned, although they play a part. The real reason is this [4]:

> Molycorp and Australia's Lynas Corp (LYC.AX), some of the few rare earth producers outside of China, are ramping up production even as prices have dropped sharply since early 2011, dragging shares of other producers as well. "We remain very concerned about what will happen as new supplies from Molycorp and Lynas totaling 57k tonnes hit up against a ROW (rest of the world) demand estimated at 40k tonnes in 2011 ..." J.P. Morgan analyst Michael Gambardella said in a note to clients.

Here's what really happened. China did indeed end up with a production monopoly on rare earths. For they were willing to sell as much as anyone wanted at a price they were willing to pay. (A small personal note, the one rare earth that I really deal with I used to import *into* China, as it was the only one they didn't in fact produce in quantity.) Oooh! A monopoly, that's bad!

But as soon as they tried to exploit that monopoly then, given that rare earths aren't rare (nor earths), people started to contest that exercise of monopoly power. To the point that prices are falling, we're looking at over supply at current price levels. In fact, Bayan Obo, the largest Chinese mine (and the world's) was closed for November in a bid to keep prices up. There's even more. Another of the Chinese producers, Jiangxi, is largely owned by the family of the incoming Chinese President, Ji Xinping. And there's been quite a lot of rules and regulations trying to put some of the smaller operations out of business: on purely environmental grounds you understand.

And yet global prices continue to fall as global supply rises.

Which brings us to an interesting observation. Monopoly, purely and simply as monopoly, is neither a bad nor a good thing. If someone's the lowest cost producer and can supply total demand then why the heck

not leave it as a monopoly? The difficulty comes if someone attempts to exercise those monopoly powers, to gouge consumers in some manner. And for many to most monopolies the exercise of such power leads to competition and the breaking of that monopoly power.

This isn't always true: and we should most certainly take action when that competition cannot, for whatever reason, arise. But as long as a monopoly is contestable then there's usually pretty much nothing wrong with the existence of said monopoly. As the Great Rare Earths Scare of the last few years shows us. As soon as anyone tried to rook consumers by exercising that monopoly the monopoly disappeared.

Free markets beat central planners once again. Oh Dear, such a shame, eh?

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