

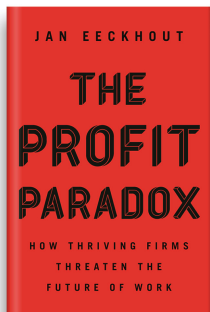
DOMINANT FIRMS IN THE DIGITAL AGE

JAN EECKHOUT

UPF Barcelona

Bojos per l'Economia

27 January, 2024



THE PROFIT PARADOX

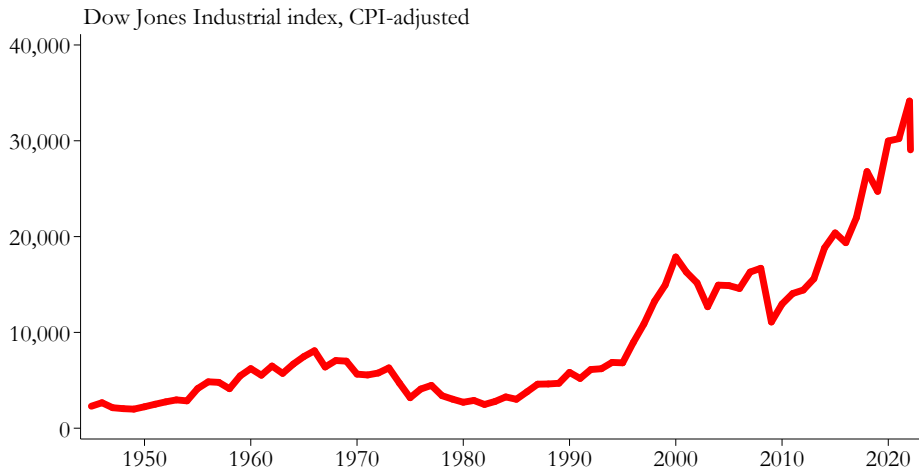
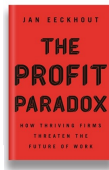
How Thriving Firms
Threaten the Future
of Work

BY JAN EECKHOUT

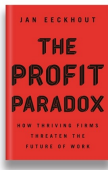
X @jan_eeckhout

TheProfitParadox.com

Dow Jones



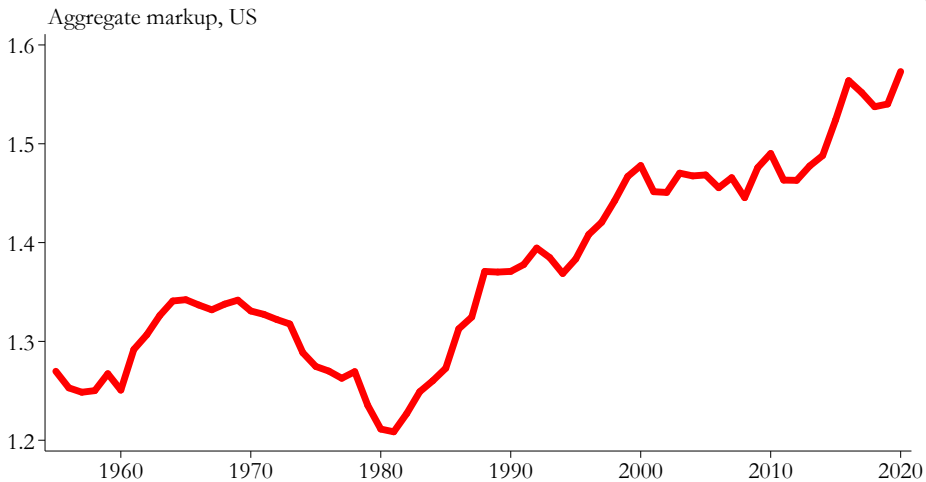
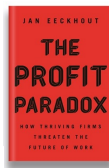
RISE IN ECONOMY-WIDE MARKET POWER



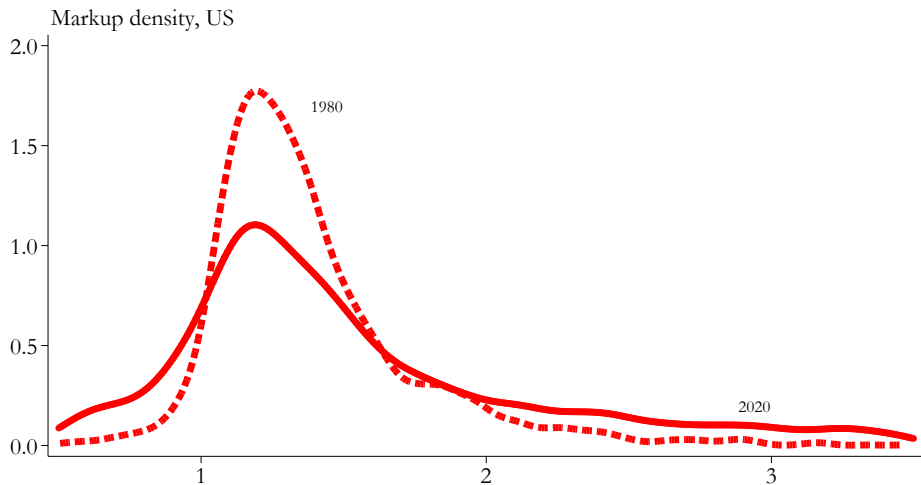
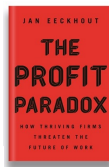
Economy-wide market power...

- Stock market valuations: p.a. growth $< 1\% \rightarrow 7\%$
 - Markups: $1.2 \rightarrow 1.6$
 - Profit rates: $1\% \rightarrow 8\%$
- For a few dominant firms: distribution and reallocation

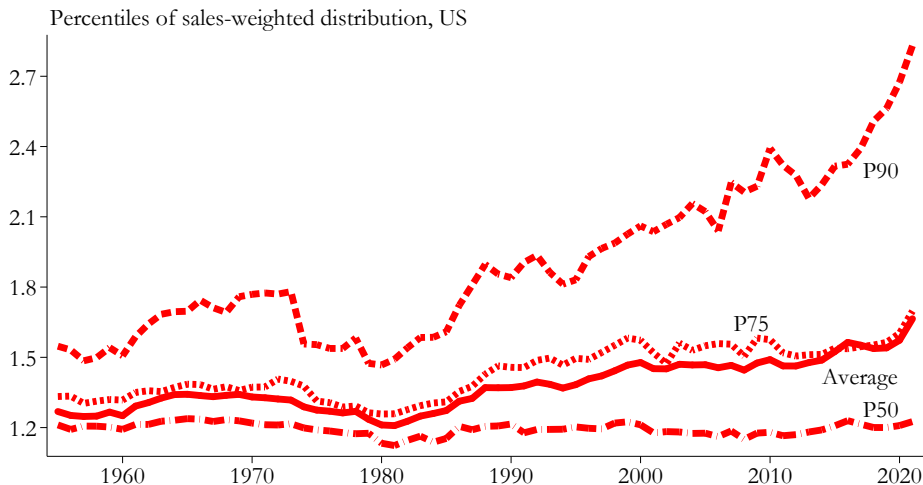
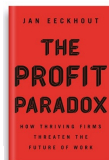
Aggregate Markup



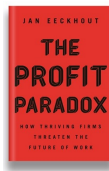
Markup Distribution



Markup Distribution: weighted percentiles

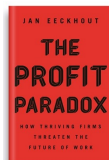


Markup Distribution

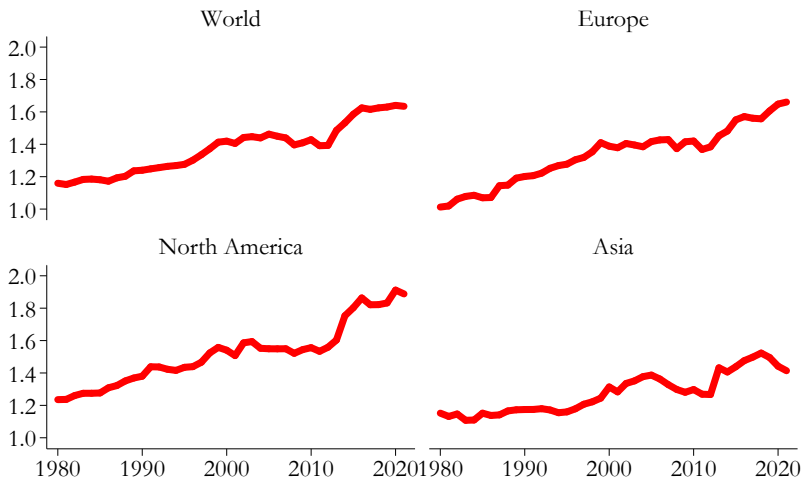


- Decomposition: within-sector, not between sectors
- Large reallocation to productive firms: Autor-Dorn-Katz-Patterson-Van Reenen (2020)
- In all sectors, from Tech to Textiles
- But, tech plays a role, Teulings-Van 't Klooster (2021)

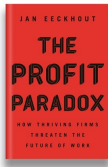
A Global Phenomenon



Aggregate markups

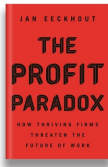


History



- Market Power has always been part of economics:
 - Ancient Greece: Monopoly power granted by sovereign
 - British East India Company: built on monopoly power (origin of US independence)
 - First formal models economics: Cournot oligopoly in 1838
 - Any business person knows: gain and exploit market power to make money
 - Schumpeter: (temporary) market power is necessary for growth (creative destruction)
- Has its own discipline, Industrial Organization (IO)
- Macro: Monetary policy; Input-output connections and aggregate fluctuations
- Antitrust Policy: Herfindahl-Hirschman Index (HHI)

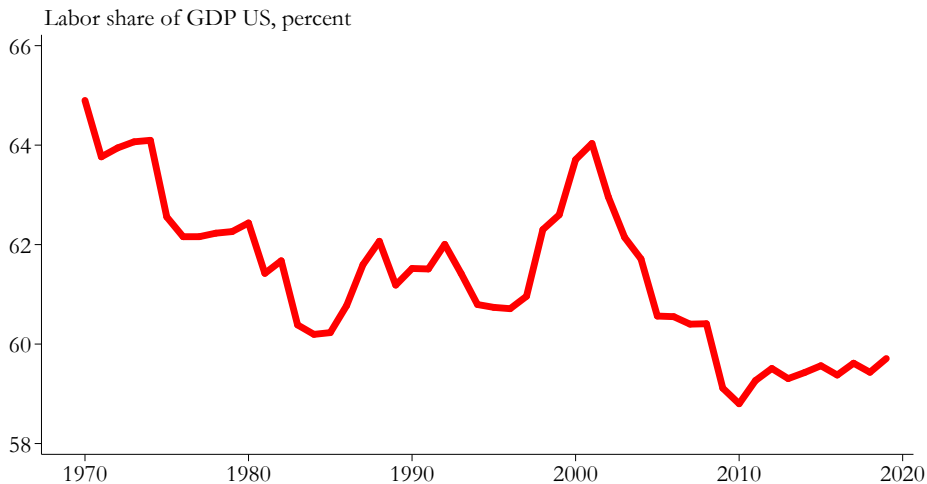
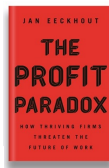
MACROECONOMIC IMPLICATIONS



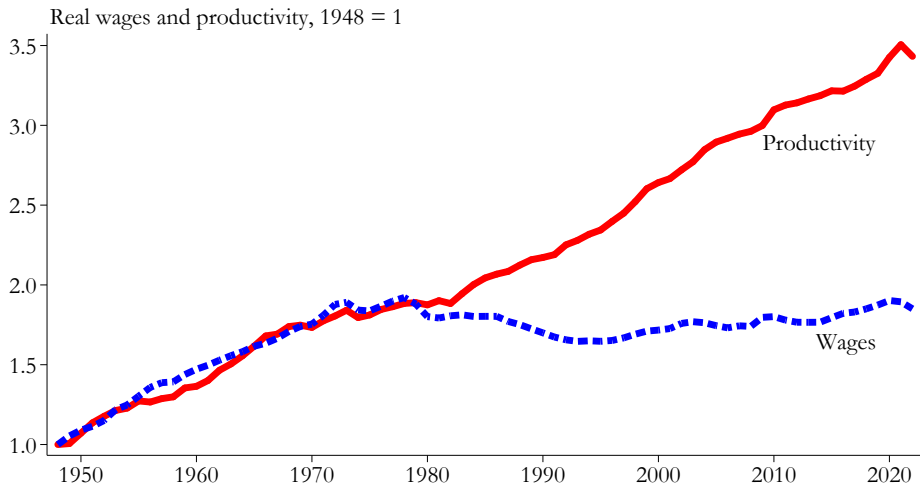
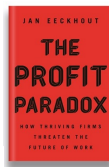
Economy-wide market power ... has an **economy-wide** impact

- Declining labor share
 - Wage stagnation (wedge productivity–wages)
 - Falling labor force participation
- Declining business dynamism
 - Labor reallocation
 - Startup rate
- Rising Wage Inequality

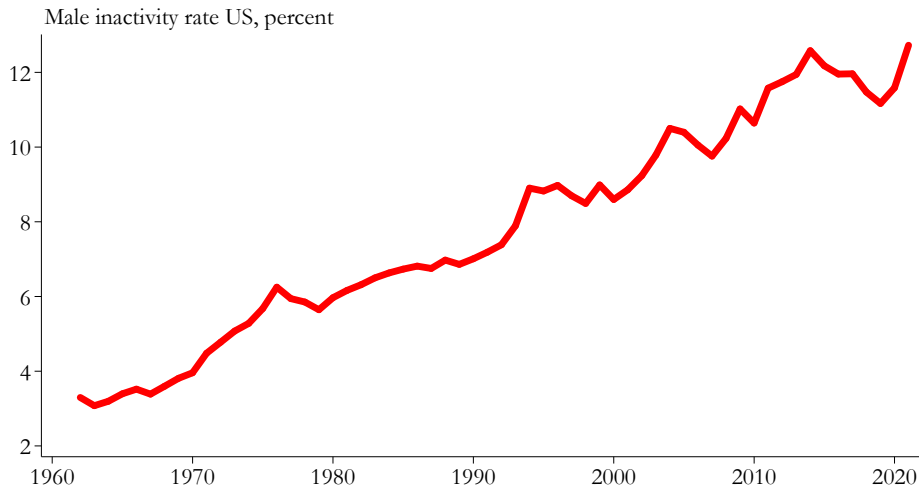
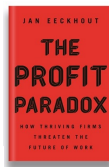
Labor Share



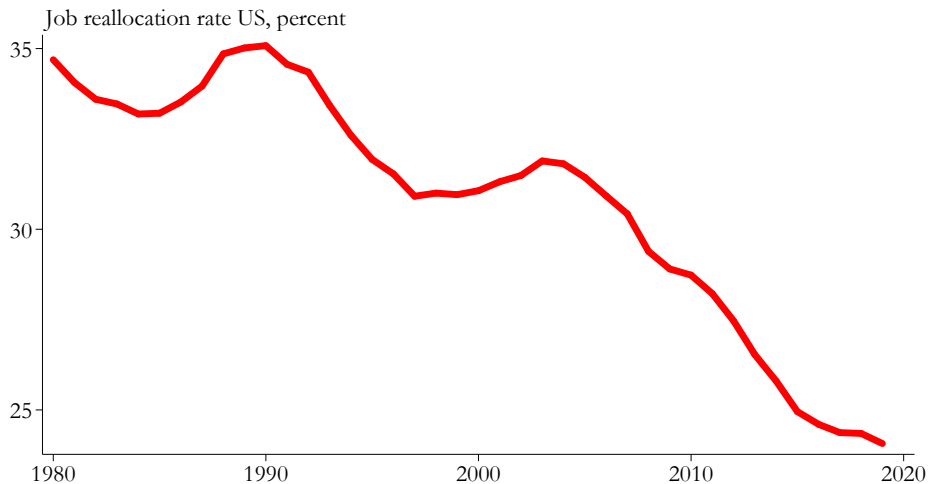
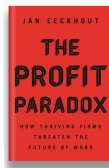
Labor Share: Wage Stagnation



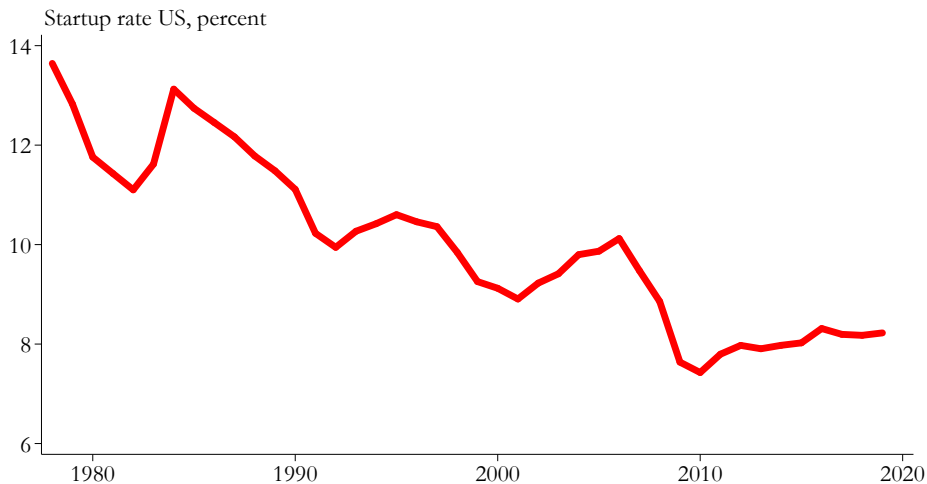
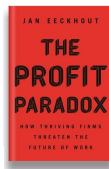
Labor Share: Labor Force Participation



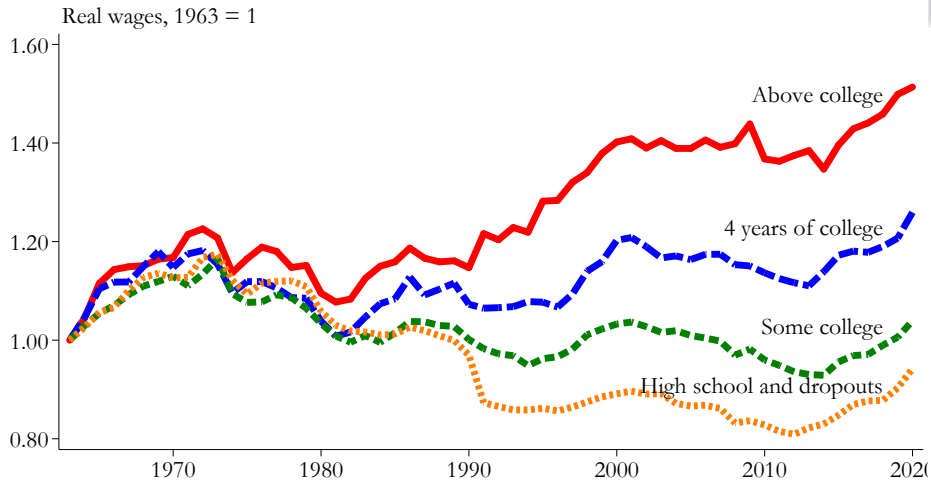
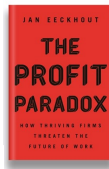
Business Dynamism: Job Reallocation



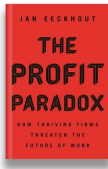
Business Dynamism: Startups



Wage Inequality



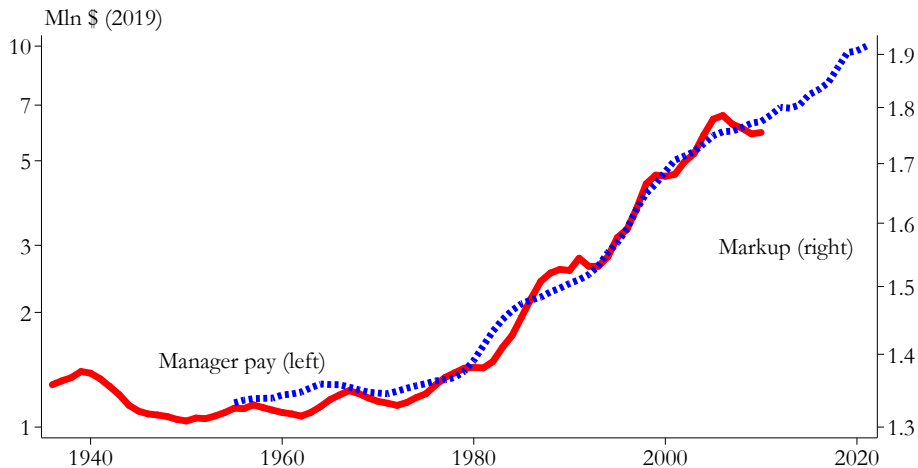
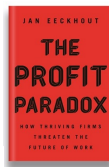
Wage Inequality



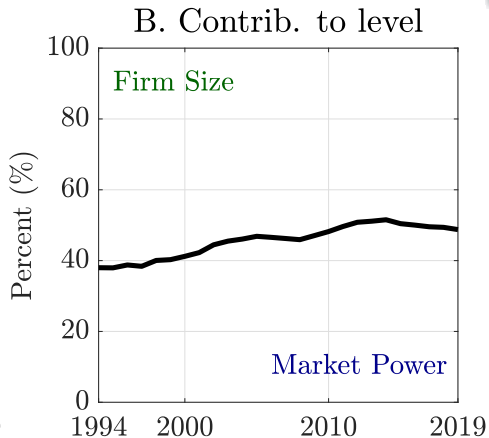
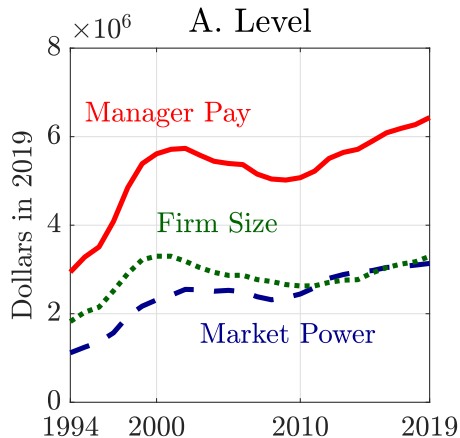
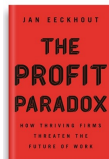
The role of Market Power

- Between-firm inequality: increases due to market power ($> 50\%$)
- Wage stagnation: wage decline even without technological regress

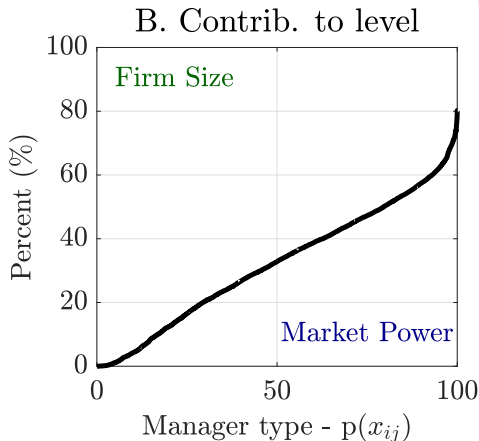
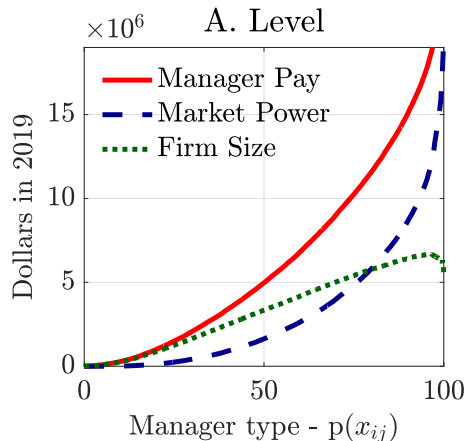
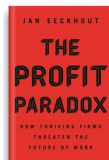
Wage Inequality: Superstar Pay



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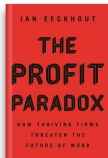
Wage Inequality: Superstar Pay





“I don’t want a business that’s easy for competitors. I want a business with a moat around it. [...] Our managers of the businesses we run, I’ve got one message for them, which is to widen the moat.” – Warren Buffett (2007)

ECONOMIC MECHANISMS

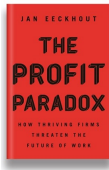


What are the economic mechanisms (including General Equilibrium effects)

Causes

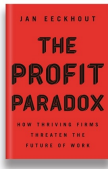
1. Lax antitrust enforcement – ‘Bork doctrine’ starts in early 1980s
2. Fast technological change
 - Scale economies: Fixed cost + 40%; Returns to scale: from 1 to 1.05
 - Rising dispersion in productivities: $\sigma = .03 \rightarrow .07$
3. Globalization

WELFARE COST



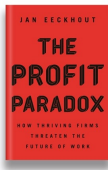
- Output (and welfare) loss: 8% of GDP – De Loecker e.a. (2022), Edmonds e.a. (2022)
 - Large reallocation towards most productive firms
 - Even larger decline due to rent-extraction (deadweight loss)
- Efficiency gain + market power:
 - price $p \searrow$
 - cost $c \searrow \searrow$
 - markup $\frac{p}{c} \nearrow$

POLICY



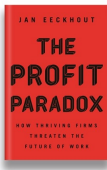
- Taxation: can redistribute, but cannot get rid of inefficiency
- Only reducing economy-wide market power will reduce inefficiency

POLICY



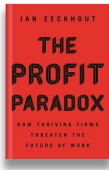
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- Only reducing economy-wide market power will reduce inefficiency
- But, current antitrust/regulation
 - focuses on direct harm to consumers and workers
 - has limited tools to deal with (pecuniary) externalities from economy-wide market power

Policy



- More competition
 - Split up firms? Maybe
 - Regulation: **interoperability** – separate network from operators (pro-competitive)
 - Antitrust policy: merger review, Ex ante regulation, market investigations,...
 - Regulate dominant firms as utilities

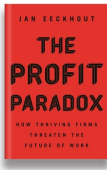
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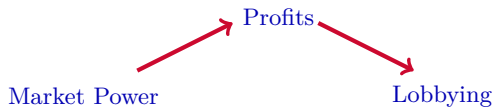
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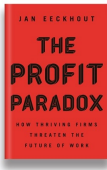
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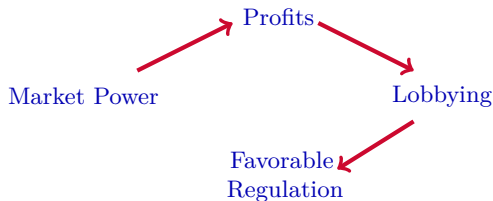
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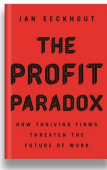
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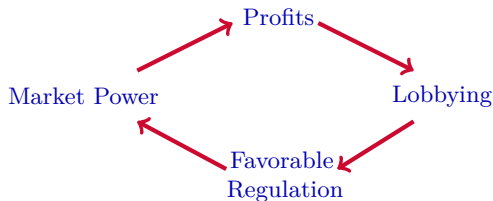
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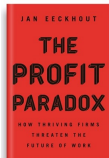
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DOMINANT FIRMS IN THE DIGITAL AGE



- Fast technological change → market power → economy-wide implications
- Large welfare cost (8% of GDP); future?
- Not first time:
 - 1900, electricity, telegraph, railways → now all are regulated utilities
 - But... it took 2 wars and the great depression to undo market power

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