Do Increasing Markups Matter? Lessons from Empirical Industrial Organization

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Markups and Market Concentration

- Many policymakers / economists expressing concern about rising economy-wide market power

- Many recent studies examine market power and markups (P-MC) and suggest a positive correlation between these things across industries

- Historically, IO economists looked at this relationship in structure-conduct-performance paradigm with regressions of price / markups on market concentration

- IO (as you will see) moved away from this in the late 80s and hasn't looked back. A lot of lessons for those in other fields.

Problems with Recent Studies

- Typical format: regression of market outcome (e.g. price, markup) on market concentration

- Interpret coefficient as impact of competition on outcomes

- IO largely rejected this approach in the 80s for a variety of reasons including, broadly:
  - -- Measurement problems
  - -- Many underlying reasons, with different implications, for a given SCP result

- Implication: question of "impact on concentration on markups / prices is not well-posed"

Problems with Recent Studies

Measurement problems:

1. Economic markets not well observed in data, e.g. Census industrial classifications
2. Geographic outcomes
3. Product differentiation
4. Profits (usually accounting profits)
5. Costs (not true marginal costs typically)

Problems with Recent Studies

One correlation, many possible implications!

Assume regression shows correlation between markups and market concentration. Is this bad?

- One explanation: firms in concentrated industries exercise market power, price highly, and consumers suffer
- Another explanation: firms in concentrated industries have high sunk / fixed costs from investing in product quality. Costs are low and quality is high. Markups are high but (i) consumers benefit from higher quality and (ii) marginal costs are low precisely because of the sunk / fixed cost that will be recovered with profits

Problems with Recent Studies

Key takeaways:

1. No well defined “causal interpretation of concentration on price”
2. Set of hypotheses, with different implications, can explain same outcomes
3. Understanding mechanisms and primitives allows for more subtle analysis of relationship, telling us whether link between market concentration / outcomes is indicative of good vs. bad implications for welfare
4. Doing broad cross-industry stuff is fundamentally challenging

Key Ingredients In IO Studies

Typically focus on single industries, rather than many industries

Economic primitives:

- Price
- Demand
- Marginal Costs
- Fixed / Sunk Costs (possibly endogenous)
- Pricing conduct

Conditions of Competition:

- Differentiated products
- Entry
- Multiproduct firms

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Some Facts

- Ganapati (2018): “concentration indices are positively correlated to productivity and growth, uncorrelated with price changes and overall payroll, negatively correlated with labor revenue share”
- Autor et al. (2017): increase in concentration largely due to reallocation of market share towards large / productive firms
- Production function approach papers show that markups have been rising
- Facts are useful to have baseline, but still, mechanisms needed to understand implications / best policies

Ganapati (2018b)

- Studies large wholesaling sector of economy
- As wholesaler sector has grown, more concentrated, more markups
- Largest wholesalers increased spending on IT / supply chain management
- Uses standard IO tools (that we will learn!) to model demand, pricing, entry
- Concludes that growth in wholesale sector driven by lower MC, higher demand due to higher quality
- Benefits of improvements constrained by markups over MC
- Sunk costs could reflect “productive investments” or “unproductive investments” so still some room to debate. Nevertheless, richer story.

Other examples

- Airlines (some quality / fixed cost implications)
- Television / media content (some quality / fixed cost implications)
- Hospitals: most evidence points to “bad” market power hypotheses
- Nuanced and subtle implications of link between market concentration and markups. Authors advocate for single-industry studies and then some broad aggregation of these studies to inform macro trends people are writing about (not much content on exactly *how* to do this)

reduced marginal costs.

We have provided examples of three kinds of results from detailed industry studies. In some cases, such as wholesaling, investments may be generating product quality improvement together with a shift from marginal to fixed costs, yielding an improvement in consumer welfare. In other industries, such as airlines, markups may be associated with some quality improvement, but some mergers have also clearly resulted in price increases. In other markets, such as hospitals, there is no evidence that consolidation is resulting in systematic product quality improvements or clear cost reductions, but there is strong evidence of price increases (or quality reductions). The diversity of results across these industries is evidence of the value and richness that can be obtained from careful industry studies. It also serves as a caution of the difficulties of drawing useful inferences from aggregate studies across industries.

Potential Reasons for Rising Markups

- **Rising fixed and sunk costs**
- Increasing rent-seeking and organizational economics
- Network effects
- Monopsony
- Globalization

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Enforcement of Antitrust

- Enforcement of antitrust has become much less aggressive over time

- With so much murkiness, what can we do?

- Common current concerns

1. Vertical restraints
2. Coordinated effects
3. Digital platforms
4. Exploitation of intellectual property
5. Acquisition of potential competitors
6. Exclusionary conduct (MFN, foreclosure)
7. Data hoarding

Enforcement of Antitrust

Some lessons for action moving forward:

1. Uncertainty should not mean inaction in enforcement
2. Focus on promoting robust entry (limiting acquisitions of smaller potential competitors, exclusionary conduct)
3. Remove obvious regulatory issues related to antitrust that arise from non-antitrust-enforcing agencies

This is a little unsatisfying, though realistic. Devil is in the details though!

Questions

What are your key lingering questions after reading this article?

Are current correlational studies in macro / trade type literatures useful at all?