# Market Power

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# Demsetz (1973)

Classic discussion of competition and monopoly profits.

Where do profits come from?

1. successful entrepenuership, superior technology;
2. collusion / entry barriers.

It is important to distinguish these when designing public policy.

**Modern day twist: is big bad? (Lina Kahn, later...)**

# Is concentration monopoly?

Historical\policy use of the word monopoly:

- 'artificial scarcity'
- think of the 'trusts' of the late 1800s (Rockefeller, Carnegie, etc.)

Antirtust policy aimed at breaking up 'trusts.'

Demsetz: difference between monopoly (artificial) and profit (superior performance).

Demsetz proposes a simple, but potentially useful, view of industry concentration.

1. Many firms v few firms
2. Collusion v Competition

One does not imply the other. Empirical work must be careful in dientangling these different forces.

# The risk of "deconcentration" policy

*"To destroy [market power] when it arises may very well remove incentive for progress."*

In other words: Will anti-monoply policy destroy one deight-weight-loss in favor of another?

# Demsetz (extreme) view of regulation

(this is controversial)

"Deconcentration" policy can be bad even if it is aimed at decreasing collusion because large firms might have superior efficiency.

# Demsetz's empirical agenda

*Correlating industry rate of return with concentration will not be enlightening for this problem, for even if concentrated industries exhibit higher rates of return, it is difficult to determine whether it is efficiency or monopoly power that is at work.*

*A successful collusion is very likely to benefit the smaller firms, and this suggests that there should be a positive correlation between the rate of return earned by small firms and the degree to which the industry is concentrated. By the same token, if efficiency is associated with concentration, there should be a positive correlation between concentration and the difference between the rate of return earned by large firms and that earned by small firms; that is, large firms have become large because they are more efficient than other firms and are able to earn a higher rate of return than other firms.*

## Modern Interpretation

We need a model to evaluate competitive forces and welfare.

# Berry, Gaynor, and Morton (2019)

*Do Increasing Markups Matter? Lessons from Empirical Industrial Organization*

What are the causes and consequences of market power / markups?

Markup = $\frac{p-c}{p}$

# Does this regression make any sense?

$$p_{jm} = X_{jm}\beta + HHI_{jm} + \varepsilon_{jm}$$

**Increased attention to market power**

IO rejected the regression analysis paradigm 30 years ago.

Macro/trade/labor using these methods to study market power.

# Problems I: Measurement

Economic markets not often observed, especially for many markets.

- industry classifications can be terrible.

Outcomes

- profits are accounting data;
- costs, what is marginal/fixed?
- compare prices across industries?

# Problems II: Interpretation

Imagine large firms have high FC and low MC, and low MC -> high markups.

Concentration is *econometrically endogenous.*

But concentration also endogenous from a model point of view.

*"Different changes in primitives, with very different positive and normative implications, can produce the same observed correlations between concentration and markups."*

# Demsetz recap

*Case 1: improved marginal cost leads to efficient firm shakeout.*

- higher markups, lower prices, higher consumer welfare.

*Case 2: Exogenous merger.*

- higher markups, higher prices, lower welfare/efficiency.

# The "industrial organization approach"

Relate economic primatives to market outcomes:

- markups,
- consumer/producer welfare,
- efficiency.

Hard to get economic primatives right in cross-industry studies.

# Primatives

Market structure is an equilibrium outcome.

What is exogenous?

- Technology,
- Fixed costs,
- costs of inputs,
- public policy (trade, vertical restraints),
- geography,
- what else?

# Public Policy

If you think concentration is a problem and want to regulate, what is the externality that you are regulating?

Otherwise, we should probably expect either

- The same outcome,
- or distortion from the regulation.

(the govt can't just force there to be one more competitor, AA example)

# Learning Market Power from Prices and Quantities

Demand

$$Q = f(X, p; \theta)$$

Prices (multi-product oligopolist)

$$(p_j - c_j)\frac{\partial Q_j}{\partial p} + Q_j + \sum_{k \in J^f}(p_k - c_k)\frac{\partial Q_k}{\partial p}$$

(where $J^f$ are all products owned by the same firm)

# Learning about concentration

$$pQ - C(Q) - FC > 0$$

# Extra: "Amazon's antitrust paradox"

(Lina Khan, *Yale Law Review,* 2016.)

Is big, bad?

What is the metric we measure bad/good?