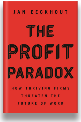

THE PROFIT PARADOX

How Thriving Firms Threaten the Future of Work

BY JAN EECKHOUT

Deaton Review:

Market Power and Labor Market Inequality

Jan Eeckhout

UK = US

- We don't care about inequality between firms *per se*, only inequality of households
- But: firm inequality $\rightarrow$ Market Power $\rightarrow$ inequality of workers
- This chapter confirms: UK = US on major macroeconomic trends:
  1. Markups: increase and dispersion $\nearrow$
  2. Firm size: increase and dispersion $\nearrow$
  3. Labor share: decline and dispersion $\nearrow$
  4. Wages: stagnation and dispersion $\nearrow$
  5. Productivity: slowdown and dispersion $\nearrow$
  6. Startups and Business Dynamism: decline

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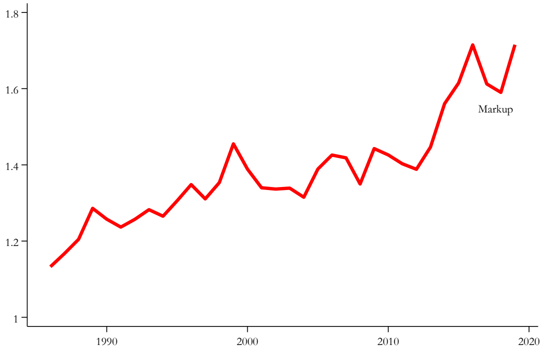
  6. Startups and Business Dynamism: decline
  7. Labor force participation: decline

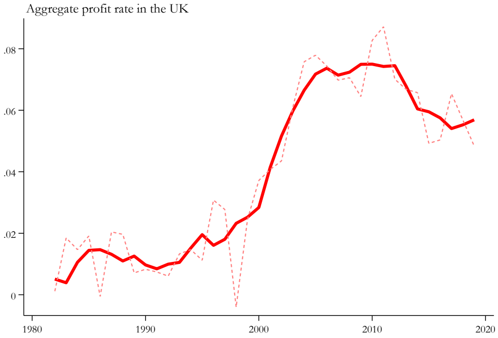
Inequality

Sources of Inequality due to Market Power:

1. Distribution profits vs labor income
2. Inequality between workers (especially profit-sharing at top)
3. Inequality between entrepreneurs (market power upstream)
4. Concentration of profit $\Rightarrow$ wealth inequality increases

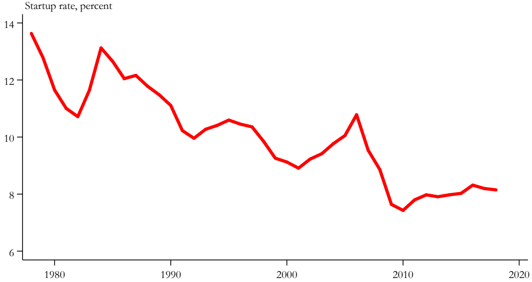
Rising Market Power

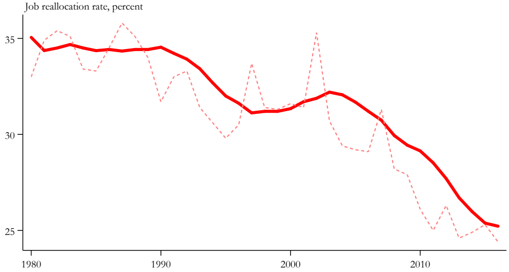




- Small fraction of firms
- Big conflict between firms
- Across all sectors

Startups and Business Dynamism





Startups (young firms) are the building blocks of the economy:

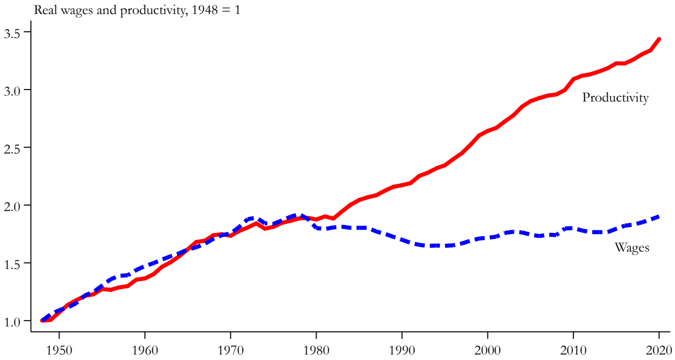
- grow faster
- hire more (especially young) workers
- innovate more

Mechanism

- Permanent productivity advantage
    - Digital age: network effects, scale economies
    - Permanent productivity advantage $\rightarrow$ natural monopoly
    - Unlike temporary advantage under Schumpeterian creative destruction
- Prices $\nearrow$ $\Rightarrow$ consumption + production $\searrow$ $\Rightarrow$ demand for labor and wages $\searrow$
- Small firms: lower profits + taken over, killer acquisitions,...

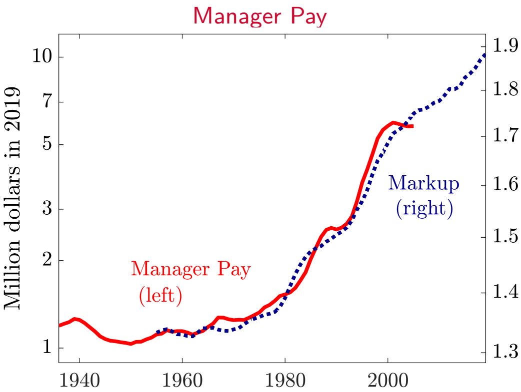
Wage Inequality

Monopsony vs Monopoly



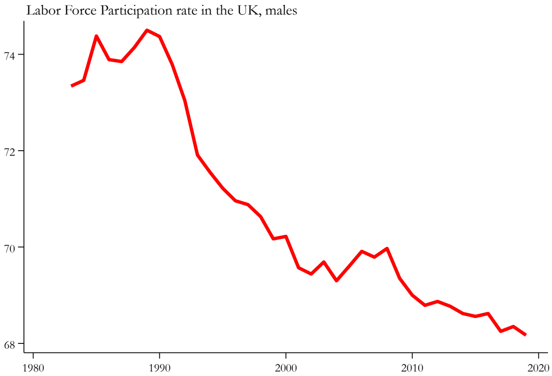
- Monopsony accounts for 1/3 of wage-productivity gap; stable over time
- Monopoly 2/3: Important for policy implications

Wage Inequality



- Most of the rise in wage inequality is in the top percentiles
- Profit sharing: managers paid for market power
  1. On average: 52% of pay due to market power (up from 38% in 1994)
  2. Higher for top managers: 88%

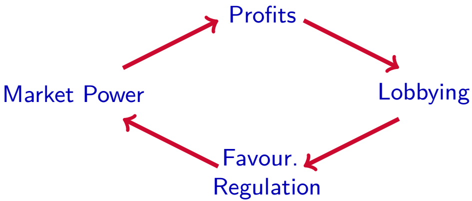
Social Cost of Market Power

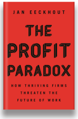


- Efficiency Cost: 9% of GDP
  1. Inequality
  2. Deadweight loss from higher prices
  3. Falling labor force participation (the great resignation)

Policy

- More competition
  - Split up firms? Maybe
  - Regulation: interoperability – separate network from operators (compete on same network)
  - Antitrust policy: Mergers, market investigations,...
- Vicious circle:





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