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Big companies are not the problem

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The following is an excerpt from testimony last week to the Joint Economic Committee of the U.S. Congress by Chris Edwards, director of tax policy studies at the Cato Institute, Washington, D.C. His complete testimony is available at Cato's website.

Is there a monopoly problem in the U.S. economy? My colleague Ryan Bourne surveyed the academic literature on concentration and found that measures of national industry concentration have risen in recent decades, but that measures of local concentration have fallen. When a national coffee shop company adds locations to its chain, for example, national concentration in the industry may rise, but in many neighbourhoods local competition would increase and consumers would benefit.

Rising national concentration in some industries is driven by a small number of highly productive companies that are expanding output but not raising prices. In a study for the Census Bureau, Sharat Ganapati found that from 1972 to 2012 increases in industry concentration were correlated with productivity and output growth but not correlated with price changes. By contrast, monopolies are a concern when they constrain output and raise prices.

Consider the historical example of the U.S. automobile industry. The number of U.S. car makers fell from 253 in 1908 to just 44 in 1929, at which time about 80 per cent of output was from Ford, General Motors, and Chrysler. As the industry was consolidating, it was also innovating and cutting prices — Ford slashed the price of its Model T from $825 in 1908 to just $290 by 1927.

Back then, Ford was also known for paying high wages, which was made possible by the firm's high productivity. Today, the higher productivity of large corporations is reflected in the higher wages they pay. In 2019, average wages in establishments with fewer than 100 workers were $976 per week compared to $1,914 per week for those with more than 1,000 workers.

International competition should also be considered regarding industry concentration. A recent study by Federal Reserve economists found that concentration in manufacturing has increased when considering just firms located in the United States, but including imports changes the results. Using detailed Census data they found that "once foreign firms' sales in the U.S. are taken into account, market concentration did not rise but instead remained flat between 1992 and 2012."

The global economy does enable successful multinational corporations to become huge, but it also makes them vulnerable to competition from everywhere. Germany's Aldi grocery stores, for example, are currently growing rapidly across the United States, challenging dominant grocery chains. Spotify was a start-up in Sweden but has grown to become the largest music streaming service, ahead of Amazon Music and Apple Music. Consumers are the beneficiaries — Aldi is undercutting even Walmart with its super discount grocery prices, and Spotify offers massively popular free streaming.

Some of the largest corporations are the most innovative. Their "corporate power" comes from investing their profits from global sales into research. PWC ranked the global companies with the most research spending in 2018, and seven of the top 10 were U.S. multinationals in technology and pharmaceuticals. Similarly, Boston Consulting Group produced a list of the "most innovative" companies globally, and 14 of the top 20 are large U.S corporations. Two-thirds of U.S. business research and development is done by the largest corporations of more than 5,000 employees.

It is beneficial that the United States has large and profitable corporations investing in innovation because that creates broad-based spillover benefits. Economist William Nordhaus estimated that "only a miniscule fraction of the social returns from technological advances over the 1948–2001 period was captured by producers, indicating that most of the benefits of technological change are passed on to consumers rather than captured by producers." He found that businesses received only about two per cent of the benefits from their innovations, with the rest accruing to consumers.

Large corporations may be highly profitable if they are able to stay ahead of the pack on new products and technologies. But it is hard to stay ahead of the pack because high profits attract more competitors. Only 52 companies from the 1955 list of Fortune 500 companies are still on the list today. Indeed, the churn rate of top corporations has increased over time. Companies in the S&P 500 Index in 1980 stayed on the list for more than 30 years, on average, but today the average is down to about 20 years…

Some federal policymakers favour using antitrust rules to limit corporate power, but I would urge caution. A review of a century of antitrust policy by Brookings Institution economists found "no evidence that antitrust policy in the areas of monopolization, collusion, and mergers has provided much benefit to consumers and, in some instances, we find evidence that it may have lowered consumer welfare." In the past, antitrust actions against technology giants such as IBM and Xerox were counterproductive, and it was upstart competitors that ultimately limited the power of these once-dominant companies.

The best approach to limiting corporate power to the benefit of consumers is vigorous competition from start-up businesses. Policymakers should favour regulatory and tax policies that remove entry barriers from industries and encourage challenges from well-funded entrepreneurs.

Chris Edwards is the director of tax policy studies at Cato and editor of DownsizingGovernment.org. He is a top expert on federal and state tax and budget issues. Before joining Cato, Edwards was a senior economist on the congressional Joint Economic Committee, a manager with PricewaterhouseCoopers, and an economist with the Tax Foundation.