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Digitalization

Time to Rethink Competition Policy in the Digital Age: The G20 should create a WORLD COMPETITION NETWORK To address 'Superstar Firms'.

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The digital economy is creating a new divide between capital and labor. This divide is driven by 'winner takes most' markets in which one firm (or a small number of firms) can gain a very large share of the market. These superstar firms are operating globally affecting market concentration in many countries at the same time. To address these global superstar firms national competition authorities in the G20 should be strengthened to cooperate in a WORLD COMPETITION NETWORK.

Challenge

We are living in a world with a new digital divide between capital and labor. Income inequality is not only increasing between different groups of workers (the top 1 percent versus the rest), but also between capital and labor. Income is shifting to capital. We are experiencing a global decline in the labor share in GDP in many of the G20 countries. In the post-war period there used to be an economic rule: 70 percent of national GDP went to labor income and 30 percent to capital income. John Maynard Keynes described this rule as an 'economic miracle'. This rule has broken down. Since the mid-1980s the labor share has declined to today 58 percent and the capital share has risen to 42 percent (see Karabarbounis and Neiman 2013). What drives the global decline in the labor share?

The global decline in the labor share is generated by two forces of the digital economy.

Force 1: The digital technology is a capital biased technology in which people are replaced by robots, for more details, see Marin 2017.

Force 2: The digital technology gives rise to 'winner takes most' markets in which one firm (or a small number of firms) can gain a very large share of the market. These large firms have excessive market power which allows them to raise prices without losing many customers. These superstar firms emerge because the digital technology favors products with network effects in which a product becomes more desirable the more people use it. Moreover, software platforms and online services may be expensive to install, but not costly to expand which lowers the number of workers these firms employ. All these factors explain why the digital technology favors large firms with a smaller labor share in production. Moreover, a higher market concentration can also arise because of anti-competitive forces in which these giant firms are able to prevent actual and potential rivals from entering and expanding. Autor et al (2017) show that market concentration grew considerably in the last 15 years and they find that the faster market concentration grew in the US, the bigger was the drop in labor's share. Moreover, they find that similar patterns emerge in other OECD countries, for more details, see Marin 2017.

Proposal

The increased concentration of markets in which firms have excessive market power is a reason for concern (see The Economist 2016), because it drives inequality between capital – firms that own the robots – and labor – workers which are potentially replaced by robots. Thus, anti-trust needs to be reinvented for the digital age.

This requires the following steps:

1. The G20 should create a

   'WORLD COMPETITION NETWORK'

   among national competition authorities in the G20 countries to address these superstar firms. National competition authorities in the G20 countries are not well equipped to deal with the rise of superstar firms, because these firms are often multinational firms operating globally and affecting market concentration of many countries at the same time.

2. The G20 may use the 'European Competition Network' of the European Commission as a blueprint for the design of a competition network at the G20 level. The objective of the World Competition Network is to build an effective legal framework to enforce competition law against companies who engage in cross-border business practices which restrict competition. The network should be used to coordinate enforcement decisions and investigations, to help each other with investigation and to develop new guidelines how to capture market power in an online economy.
3. The G20 cannot trust that global competition will self-correct this tendency to more market concentration, since globalization may advantage the most productive and largest firms in each industry. Global competition leads to the exit of smaller less productive firms and the expansion of large productive firms. As a result industries will become increasingly dominated by superstar firms with a low share of labor in firm-value added (for the tendency of international trade to favor large superstar firms see Melitz 2003, Bernard et al 2007 for the US, and Mayer and Ottaviano 2007 for Europe
4. Anti-trust has to be reinvented for the digital age. The described tendency to large superstar firms is not a problem as long as these large firms do not prevent new firms to enter the market and to thrive. The G20 should explore the changing nature of competition in the age of big data and algorithms. Network effects can raise barriers to entry enabling big platforms to engage in behaviors such as collusion with a shift in power to a few super-platforms. Moreover, leading firms are able to lobby better and create barriers to entry making it more difficult for smaller firms to grow or for new firms to enter.
5. The US is a case in point, because it hosts many of these giant firms. The G20 should learn from the US experience for why anti-trust authorities in the US have not been very successful in constraining the market power of its giant firms (see the conference held in March 2017, Stigler Center University of Chicago).

References

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More Information

More information

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To the document