Concentration trends in Europe

Professor Tommaso Valletti
Chief Competition Economist, DG COMP

Disclaimer

The views expressed in this presentation are the personal views of the speaker only and cannot be regarded as stating an official position of the European Commission.

Introduction

Recent debate **based on US data** observed that over the past decades

- Many industries have become **increasingly concentrated**
- **Profit margins** and firm market power **steadily increasing**
- **Profit inequality** increased – a few firm rips most returns
- **Income inequality** increased while labour income's GDP share decreased
- Has merger policy **gone too far** in allowing mergers?

Council of Economic Advisers (US, 2016) expressing concerns

Perception: Quotes from mainstream media

"Markets work best when there is healthy competition among business. In too many industries, that competition just doesn't exist anymore."

The New York Times

"The rise of the corporate colossus threatens both competition and the legitimacy of business."

The Economist

"From health insurance to internet search, fewer firms control more of their markets."

THE WALL STREET JOURNAL.

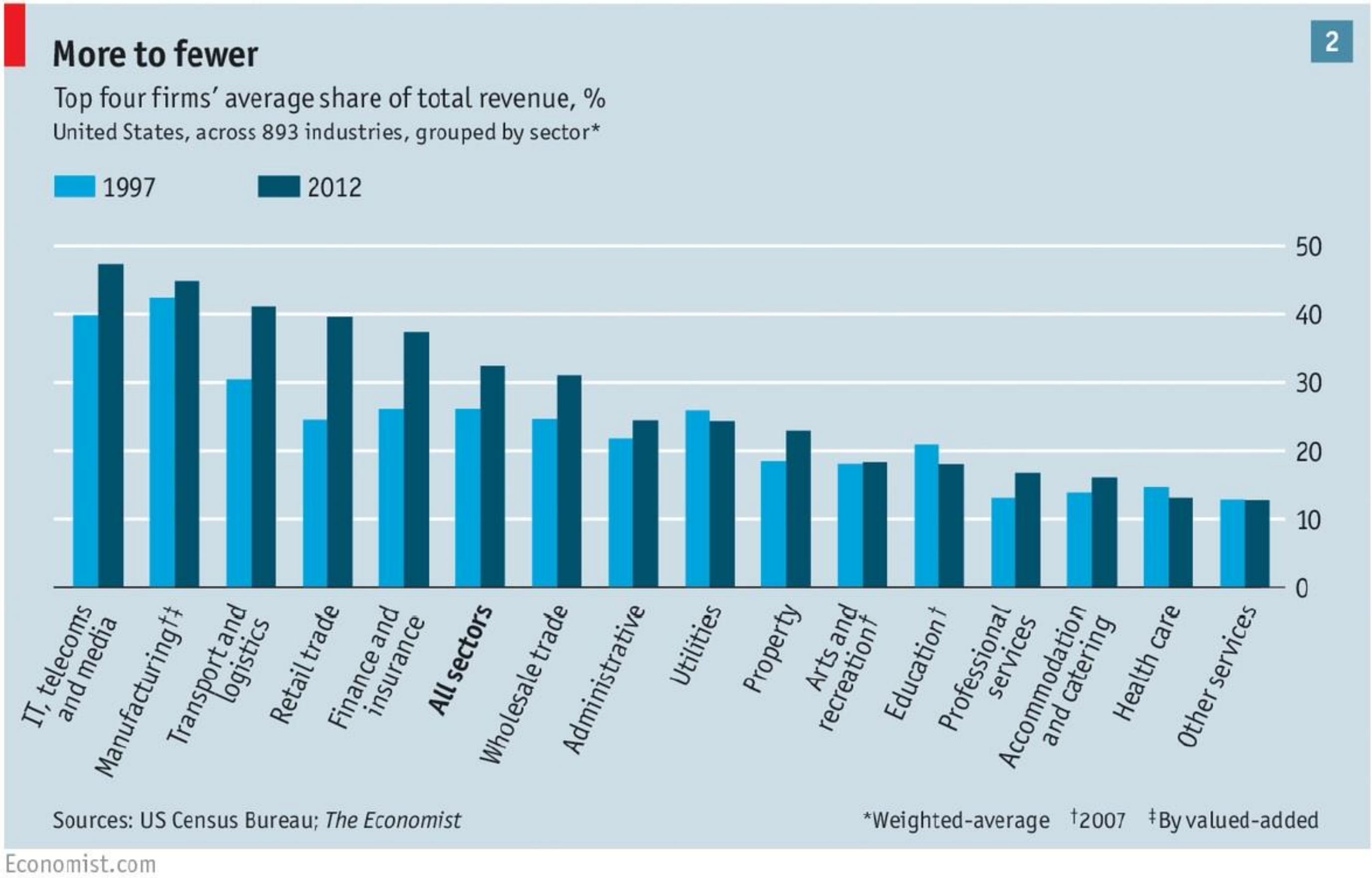
"Very persistent and very high profit margins are a sign of weak competition. […] This is bad for consumers, innovation and capital allocation. It is time for antitrust regulators to start blocking deals."

FT

European Commission

THE US EXPERIENCE

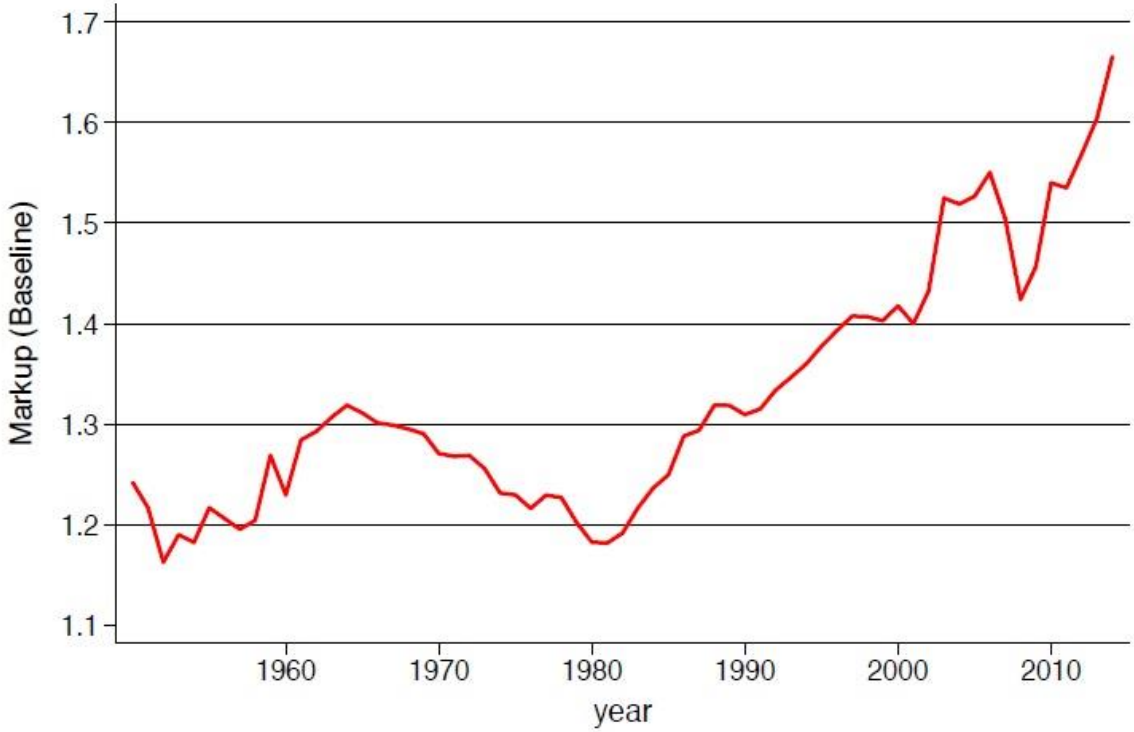
US: Concentration is increasing



US: Profit share of GDP has skyrocketed

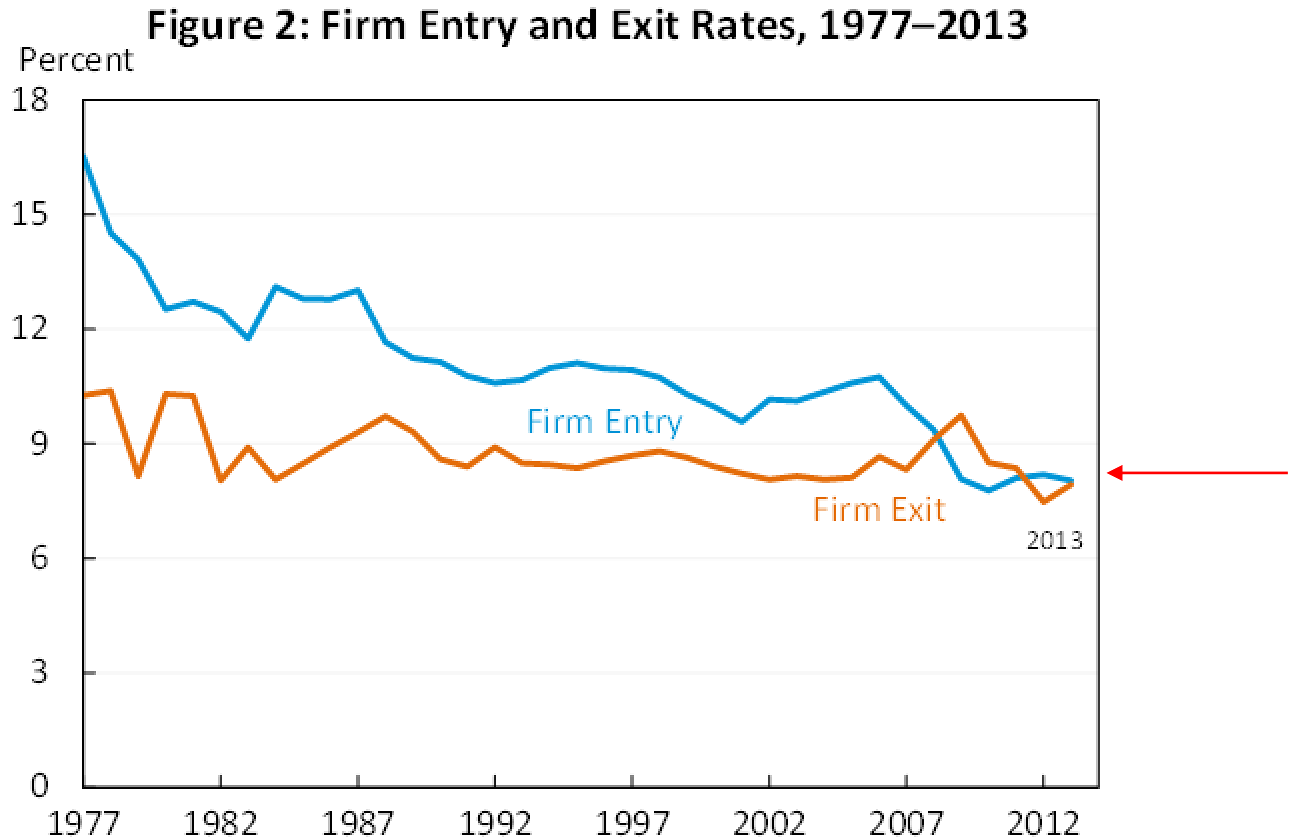
See Barkai (2017): Increase in profit share from around 5% (1990) to 15% (today)

US: Economic markups have increased even more



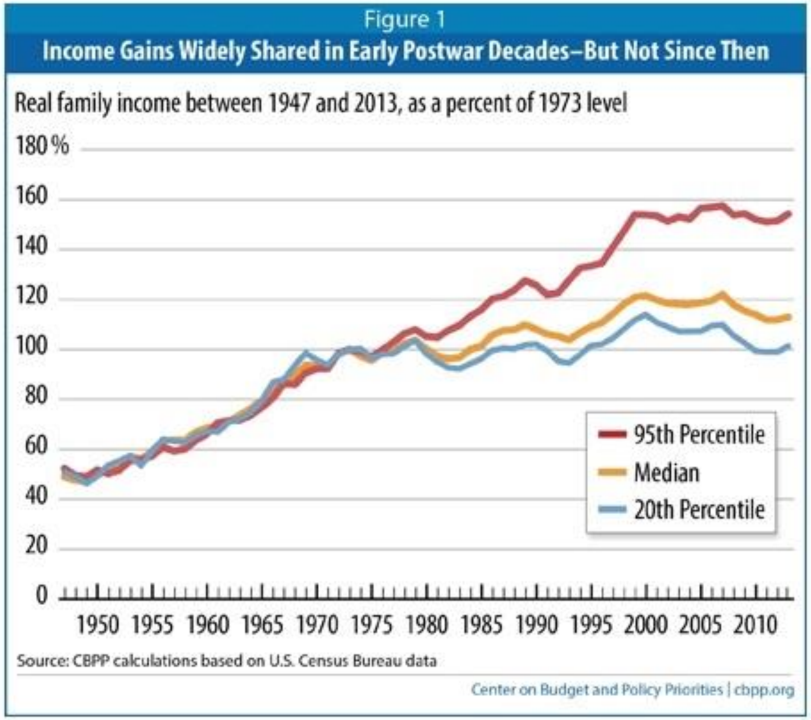
See De Loecker & Eeckhout (2017): This increase in markups implies an increase in the economic profit margin from around 20% (1980s) to 30% (2000) to 40% (today)

US: Downward trend in business dynamism



Source: U.S. Census Bureau, Business Dynamics Statistics.

…and US inequality has widened



See Piketty (2014)

European Commission

Reactions to these trends

There have been many:

… not properly defined **antitrust markets**

… not **suitable data** (e.g., fixed costs not taken into account, reactions to Piketty, etc.)

… analysis takes **market boundaries as given** over time (e.g., U.S. census data), but **markets have become wider** with both globalization and digitization (leading to spurious increases in local concentration)

…higher concentration (to the extent it is there) must not necessarily be **merger-induced**, but can also stem from efficiencies of **superstar firms** (they benefit from these changes and their **efficiency** results in high market shares <u>and</u> high profit margins)

THE EU EXPERIENCE POST CRISIS

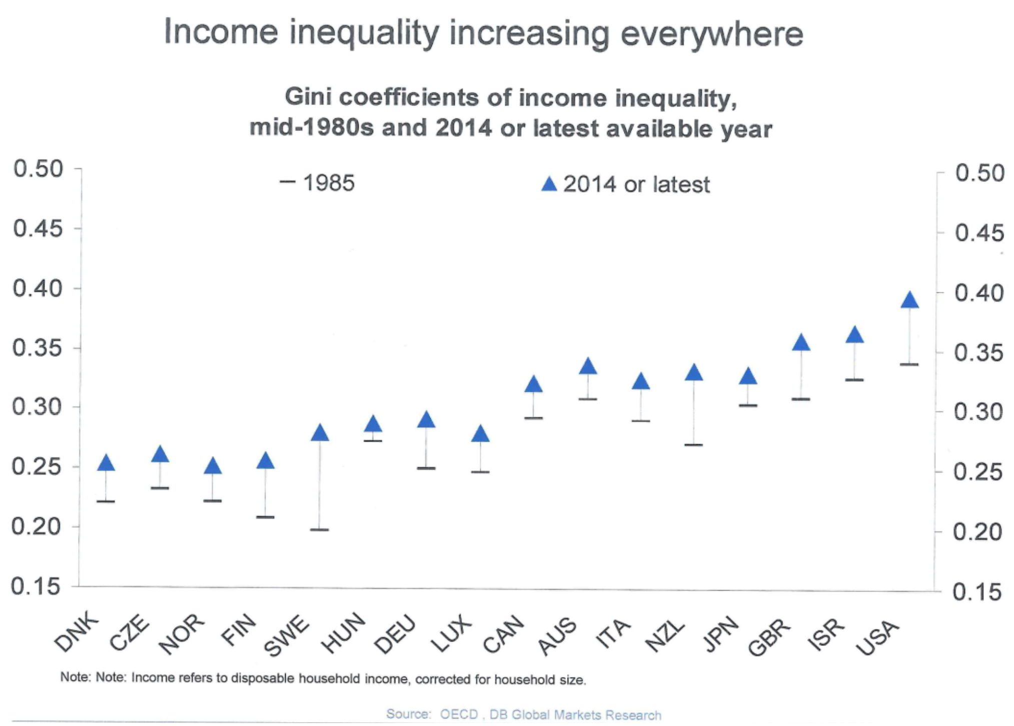
What about **Europe**?

We undertook some analysis post-crisis in the largest EU economies, 170+ industries

Caveats

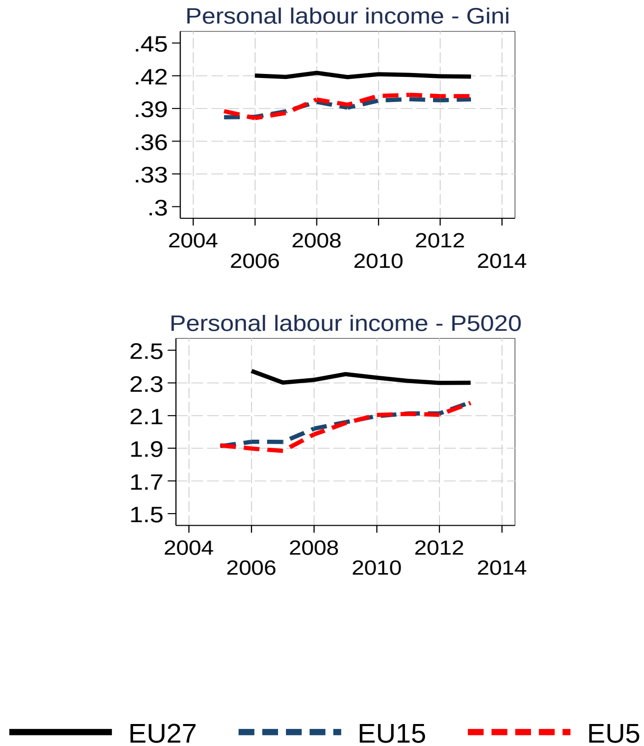
- Less data, and less consistently available
- Geographic and time coverage weaker
- Less academic analysis with systematic results

Income inequality: EU still below US



Inequality in Europe after the financial crisis

Gini and P5020 indices in 2005-2013 (gross income, PPP-adjusted)

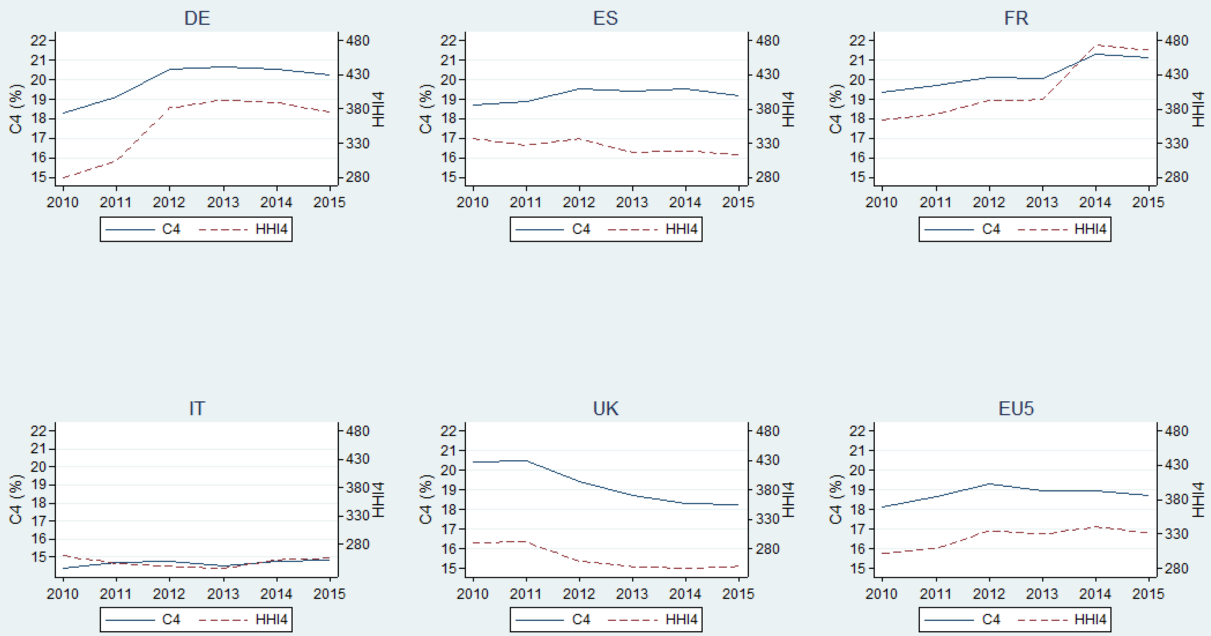


- Income inequality did not increase since the crisis on average, **but**
- Lowest 20 percent became poorer compared to median

Source: **JRC** calculations from EU-SILC microdata

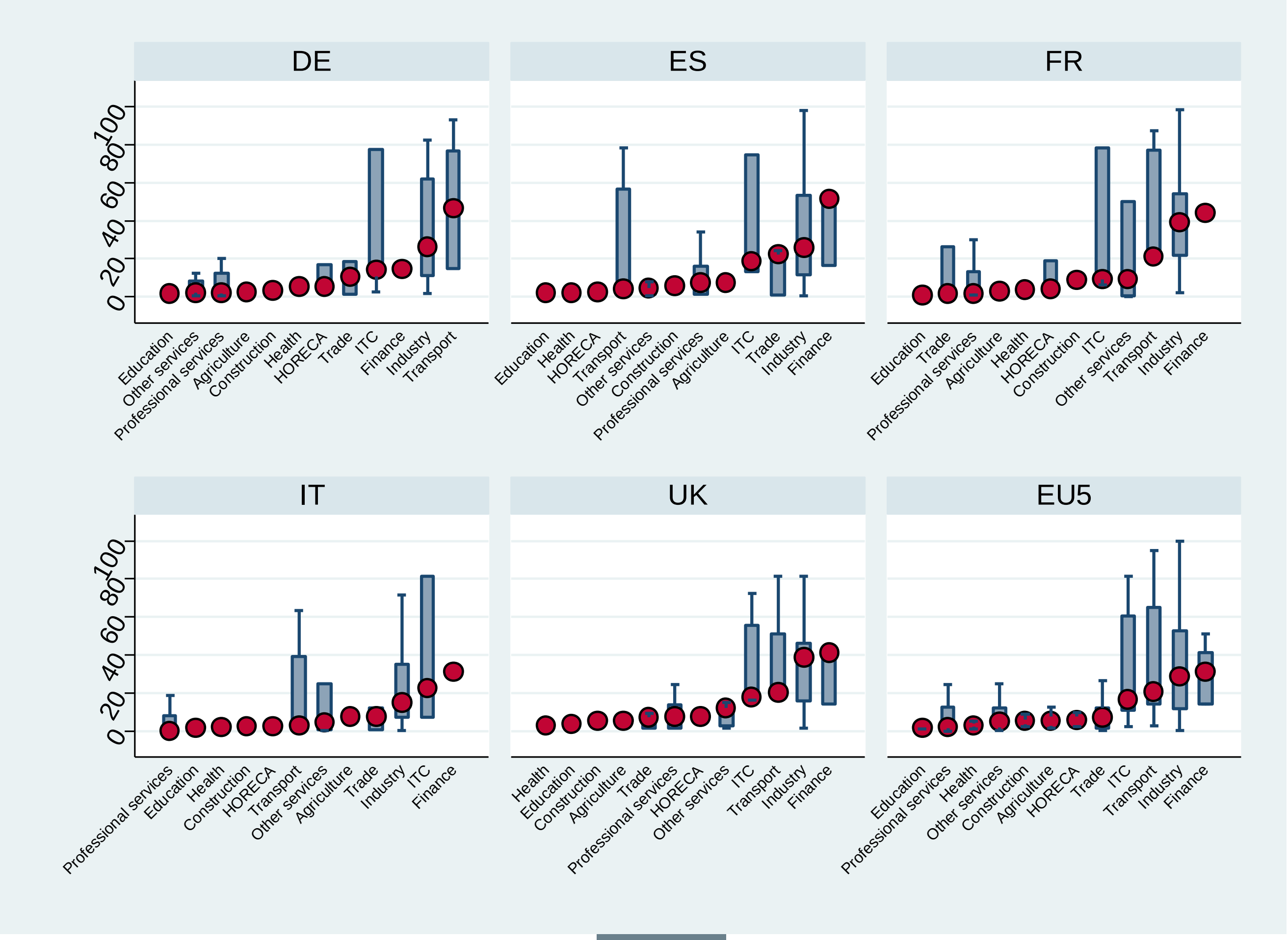
No increase in concentration after the crisis, EU5

Evolution of C4 and HHI4 in EU5, 2010-2015



C4: Weigthed average share of 4 largest firms of each country/industry.
HHI4: Weigthed average of sum of squared shares of 4 largest firms of each country/industry.
Source: Euromonitor data, EC calculations.

Most concentrated sectors:
ITC, Transport, Industry and Finance



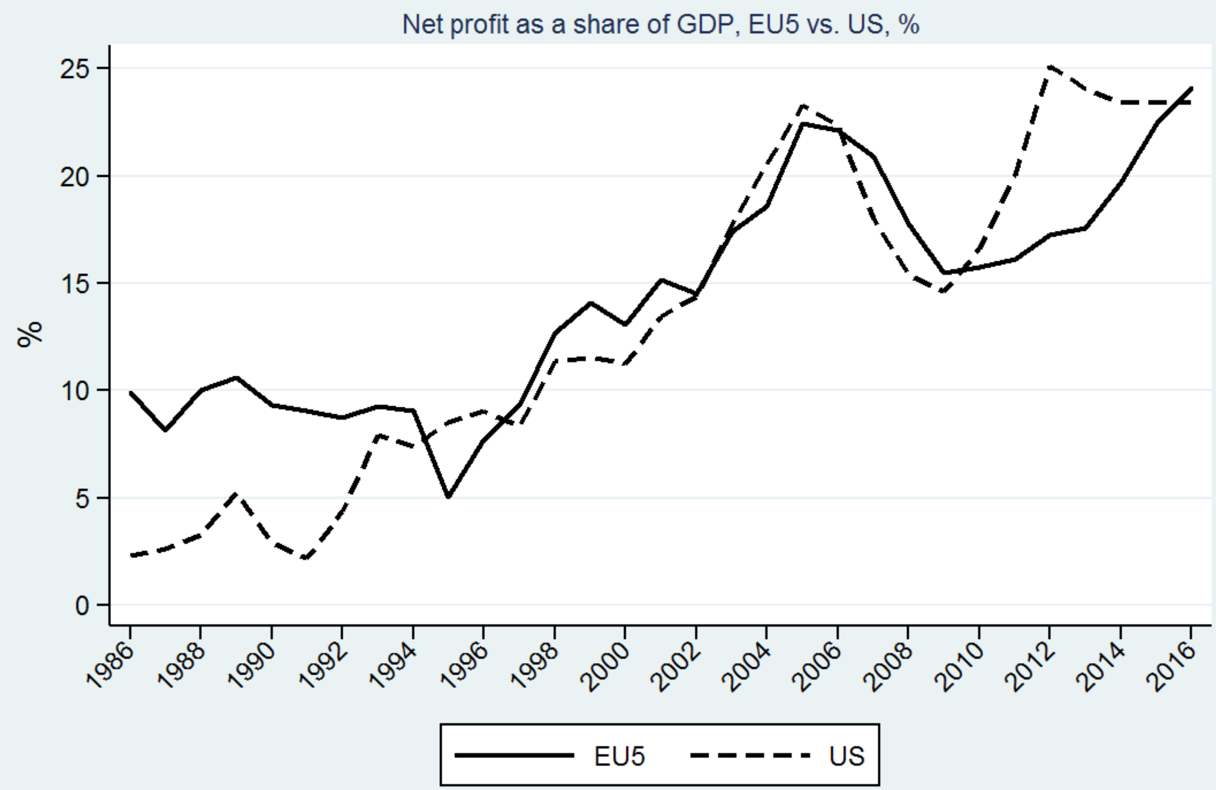
Increase typically not in high concentration industries

Counter examples: increase in industries with 60 to 80% C4

Concentration in Europe since the financial crisis
(2010-2015, five largest economies)

- Concentration did not change on average
- At country level, small increases (FR and DE) or decreases (UK)
- Most concentrated sectors in 2015: ICT, Transport, Industry and Finance
- Change in these sectors was country-specific but increase typically not in high concentration industries

Profitability in EU diverged from US post-crisis, but now…



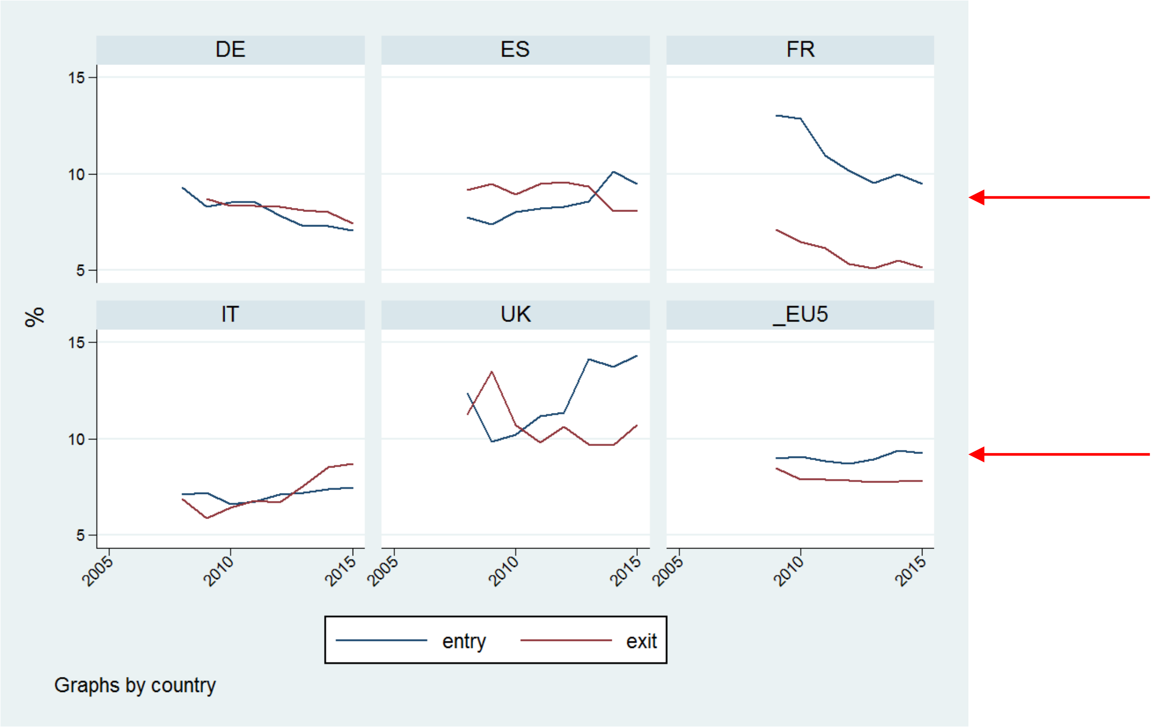
Source: European Commission (AMECO) based on National Accounts from Eurostat and Bureau of Economic Analysis.
EU5: France, Germany, Italy, Spain, UK
Net profit = net operating surplus - capital costs.
Capital cost = net capital stock times 10 year government bond yield minus expected capital good inflation.

Profitabilty in Europe since the financial crisis
(Five largest economies)

- EU-US profitablity diverged post-crisis…
- But they are on the same historical trend
- Profitability trend increase in: agriculture, finance and education
- Profitability trend decline in: ITC

Business dynamism: No trend post-crisis

Entry and exit rates, EU5, 2008-2015



Source: Eurostat. EU5: France, Germany, Italy, Spain, UK.

Summary of "stylized facts"

Europe vs US?

Less, and less consistent data available but exercise is **doable**

=> Engage with the public debate and support concerted data effort **to permit evidence-based determination of policy**

Post-crisis industry **concentration rather stable** (but high-ish)

Recent (post-crisis) **profit margins increased less** than in US (but high)

Income inequality – increased in past 30 years but still less and is **below that of US**

Income **inequality** post-crisis stayed stable (but for **bottom 20%)**

Implications for **merger policy**

The implications can be viewed from **two different vantage points:**

Ex-ante perspective: Was competition enforcement too lax and has *caused* market power (e.g., by permitting excessive concentration)? Or are there are plausible alternative explanations (e.g., globalization and digitization favoring "superstars")?

Ex-post perspective: Given that large firms' margins have considerably increased (and potentially also concentration), what does it imply for competition policy *going forward*?

Ex-post perspective is **easier to determine**, because it does not require agreeing on whether lax enforcement was causal for the increase in market power (or secular shifts such as globalization).

Implications for **merger policy**

Determinants of anticompetitive merger effects:

… concentration (parties have high *market shares*)

… closeness of competition (high *diversion ratios*)

… market power (parties have high *profit margins*)

In other words: The higher the merging parties' margins in a given case, the more likely traditional market share thresholds will **underestimate competitive effects** (all else equal).

Implications for **competition policy**

With respect to antitrust, the upward trend in margins increases the **potential for anticompetitive leverage**.

Merger control **matters especially** in preventing anticompetitive effects in a world of high margins.

Potential competition: do we have the 'right' standard?

=> If we do not properly adapt to changing markets, the risk is **politics will** (in ways we might not approve of).

European Commission

Thank you!

…and special thanks to…

- Gabor Koltay
- Szabolcs Lorincz
- Hans Zenger