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## THE GREAT ECONOMIC DILEMMA: COMPETITION VS. CONCENTRATION

*The basic goal of the article is to present global trends of concentration business activity. This process has accelerated during the pandemic Covid-19. The article argues that the more markets are digitised, the more likely they are to become concentrated. Covid-19 is shifting the business landscape in a way that portends further market concentration. This process has its advantages and disadvantages. The article suggests some proposals how to balance them.*

### Introduction

There is a general evolutionary trend in each economy all over the world: concentration of wealth and business activity. Successful companies are growing by acquisitions. At the beginning of the previous century there were hundreds of small shops involved in hand manufacturing of cars in U.S. At the end of the century only three carmakers survived: General Motors, Ford and Chrysler. Similar processes could be observed in many other industries and in many other countries.

There is a common opinion that too big concentration in business is not good for economies both in the scale of countries and the whole global economy. There is a constant tension between incumbent companies and new startups entries. The mature successful firms defend their competitive advantage by creating institutional barriers what is according to the theory of strategic management by M.Porter (1985; 2008).

Countries have acted to fuel competition before. At the start of the 20th century America broke up monopolies in railways and energy. In 1934, the United Aircraft and Transport Corporation founded by William Boeing, was required to separate its airplane manufacturing from its air transportation activity. Therefore, Boeing Airplane Company became one of three major firms to arise from dissolution of Boeing Airplane & Transport Corporation. The other two entities were United Aircraft (later United Technologies) and United Airlines.

After the second world war West Germany put the creation of competitive markets at the centre of its nation-building project. The establishment of the European single market, a project championed by Margaret Thatcher, prised open stale domestic markets to dynamic foreign firms. Ronald Reagan fostered competition across much of the American economy by deregulation of majority of industries.

There are several markets in U.S. with limited competition. Three firms (American Express, MasterCard and Visa) control 95% of the credit-card market. Google has 60% of the browser market. The mobile signal is transmitted on one of the three networks that control 78% of the telecoms market. Four airlines control 69% of journeys within America. Described

this way, America's economy has become a capitalist dystopia; a system of extraction by entrenched giants. Europe shows signs of the same sickness. Growing protectionism and increased digitisation may make things worse.

### **Advantages and disadvantages of competition and concentration**

Competition spreads wealth today by lowering consumer prices and giving workers more choice of jobs, reducing firms' monopsony power over them. It boosts productivity tomorrow by pushing firms to create better products for less. Without competition, capitalism is torpid and favours the few (Polowczyk 2010; Simao *et al.* 2021).

Big firms are too powerful and that they are stifling competition. New antitrust movement that believes the ideal economy is made up of lots of smaller firms with fragmented economic power. It wants to smash concentrations of capital in the name of liberty. But the story is more complex and powerful firms are often efficient and pass the gains to consumers, like Walmart. They are often innovative, too.

But society benefits if successful entrepreneurs are constantly toppled by others. The levelling effect of competition means a constant struggle with vested interests that has played out for hundreds of years. Adam Smith (2003), a Scottish economist, attacked the guilds that stifled 18th-century Britain.

As America boomed in the 19th century industrial empires were created that later broke up. Cartels were instrumental in 20th-century totalitarianism. In 1946 American administrators dissolved Japan's zaibatsu (large industrial and banking conglomerates), and Germany's Christian Democrats made competition their first priority in their economic manifesto in 1949. Margaret Thatcher used competition to revive Britain's economy in the 1980s. In the 1990s the European Union used the single market to strengthen and modernize prospect industries. But after 2000 the West became complacent. Globalisation was assumed to guarantee competition.

Powerful firms were gaining more shares what reduce competition. Many takeovers aimed at creating pricing power or efficiency gains whose benefits are not passed to consumers. It has become fashionable for managers to build barriers to entry. That is reflected in the philosophy of Warren Buffett, who has built Berkshire Hathaway, the world's most valuable investment vehicle by betting on mature oligopolies in America. Clever firms found new ways to constrict competition. A fifth of all American workers are covered by non-compete clauses. Patents are "evergreened". Arbitration clauses and complex contracts are used to hobble competitors. A few fund managers own big stakes of most firms. This situation does not support competition.

The good side of the above process is the rise of an innovative elite that is an engine of efficiency. Its members are companies that have mastered digital technologies and enjoy network effects that help them fend off slower competitors. In the tech sector this is clear.

In old-fashioned industries, however digitalisation is less likely to explain powerful firms' clout. Whether they were created by cronyism or entrepreneurial genius, if extraordinary profits are maintained for many years with no sign of new entrants, it is a proof that competition is not working. In America and Europe there is a growing body of evidence that this is the case.

### **Problems with business concentration identification**

In the 1930s economists viewed an uncompetitive industry as one in which a few firms had a large share of output and prices were high or quality low. Now competition regulators take refuge behind legal definitions of types of misconduct, such as price-fixing. They often insist that there are no analytical concepts or satisfactory data that allow that question to be answered.

This helplessness reflects the concept of R.Bork (1978) who wrote an influential book “*The Antitrust Paradox*”. Bork pointed out that many big firms were efficient and many concentrated industries competitive. He argued there was no logical or empirical link between competition, profits and concentration. He also wrote that, when assessing takeovers, it did not matter if consumers were damaged by higher prices and less supply, as long as firms captured enough profits from efficiencies, so that in aggregate both were better off.

Forty years later the economy has changed. New studies link concentration, profits and falling wages (Furman and Orszag 2018). Intellectual property, not physical objects, is where the action is, and tech has created networked business models. Since 1978 total profits (that is corporate free cashflows) have risen from 1.9% of GDP to 4.5%. It is sensible to ask why competition is not bringing earnings down to earth and what might be done to boost it.

A working definition is that an industry may be uncompetitive if there is a concentration of sales, employees, intellectual property or data, and if returns on capital are abnormally high for long periods of time, with little sign of new entrants. At the national level, America and Europe can be examined using three tests: concentration, abnormal profits and openness.

Take concentration first. The weighted average market share of the top four firms in an industry increased from 26% to 32%. A tenth of the U.S. economy is made up of industries where four firms have more than two-thirds of the market.

Profits are indeed abnormally high. A good measure is the free cashflow of corporate firms. This is 76% above its 50-year average, relative to GDP. Profits and prices are high compared with other countries, including airlines, credit cards, telecoms, pharmaceutical distribution and credit checking.

As for openness, America is still the world’s largest centre of innovation. It spends \$450bn a year on R&D, 20% more than China and more than Europe, Japan and South Korea combined. Fewer new firms are being started. And America’s opening up to the world has stalled, with trade to GDP falling steadily since 2011 and the output of foreign firms’ subsidiaries in America stagnating.

America became a unitary market more than 100 years ago. Europe has not finished this process. The typical big European firm is smaller than its American rival. There are few big tech firms. The largest generators of excess profits include Unilever and Nestlé, drugs firms, and luxury-goods leaders such as LVMH.

Europe relies on American tech firms. Concentration is growing (Bajgar *et al.* 2018). The average market share of the top four firms in each industry has risen by three percentage points since 2000, roughly half of the rise in North America. The free cashflow of non-financial firms as a share of GDP is 18% above its 20-year average. A very profitable listed firm in 1997 had a 46% chance of still being very profitable in 2017. Like America, Europe has suffered a decline in the number of new firms. It is weak on innovation, spending half as much on R&D in absolute terms as America.

Other signs point towards entrenched power. The high stockmarket values of profitable firms show that investors think their advantages will endure and protectionism will reduce competition. There are few new entrants in internet search or American airlines or telecoms. And powerful firms intend to stay powerful tomorrow. Of the total capital spending and R&D done by America’s leading 500 companies, the top 20 firms account for 38%. Big firms are buying innovative start-ups.

### **The paradoxical effect of technology companies on the economy**

Most economists in the West agree on different kinds of problem with the big tech firms. The list of common complaints is long: the giants have high market shares and

concentrated ownership so they mainly benefit from their growth, cause addiction, censor free speech, do not censor free speech, are infiltrated by Russian spies, cooperate with Chinese autocrats, do not pay customers for their data, give private data to third parties, refuse to give data to third parties, don't invest much, bully their critics, underpay workers, poach too many experts from universities, pay too little tax, corrupt politics, etc.

Tech firms get so much flak that it is worth considering the case for the defence. Consumers love their products. Between them the big Silicon Valley platform firms have 8 bln customers. They have increased choice for consumers. Amazon has 353 mln products on sale, 3500 times more than the typical supermarket.

Today's tech firms are not unprecedentedly large. Ranked by sales Amazon is 2nd in America, Apple is 3rd, Alphabet 9th and Facebook 34th. Uber and Airbnb are still small and do not reach the top Fortune 500. The tech firms are accused of extracting giant rents from society. But the largest five have lower earnings relative to the economy than the mightiest monopolists of the past did, with a median profit of 0.16% of GDP. That compares with a median of 0.24% of GDP for four historical goliaths in the year that antitrust regulators hit them: Standard Oil and US Steel (1911), IBM (1969) and AT&T (1974).

The technology leaders' effect on the economy has been positive in many ways. Online inflation is running at one percentage point below official inflation, reflecting the bargains available on the web. They are investing at a massive pace: some \$137bn in 2017. As a result their combined hoarding rate (their free cashflow) actually fell from a peak of 0.66% of GDP 2015 to 0.61% in 2016.

Apple has a large market share and high profits but is innovative, although faces strong competitors. Google and Facebook are similar, but there is no sign of new entrants. Amazon has a large market share in e-commerce and is very innovative.

The new tech platforms might be a threat, if we take into consideration a different kind of corporate concentration: the market share of people's minds. Due to the network effect mean big firms are hard to dislodge. As they accumulate data on their users they become more enmeshed in their lives, making it expensive for customers to switch. And as artificial intelligence and data mining get cleverer, the platforms will manipulate their users even more.

Tech firms are becoming the conduit through which people interact with the world. Their business model is to impose a levy, either by charging users subscriptions and commissions, or by manipulating their buying decisions, or by charging other firms that want to access the platforms' captive customers through advertising. The tech sector becomes a layer that covers across the entire consumer economy.

The big tech firms have the capacity to disrupt new industries. They are ruthless about buying up nascent competitors. Facebook's purchase in 2012 of Instagram, a rising social platform, for \$1bn is perhaps the most famous example. The following year it tried to buy Snap, another potential rival, and when it could not, replicated many of its features. In 2014 it bought WhatsApp for \$22bn. Alphabet has invested in over 300 start-ups since 2013.

The tech platforms are the business superstars of the Western world, but their business models have potential threats to fair competition. Their market values imply they will become more powerful. Their conduct suggests that they will avoid major confrontations with each other and wipe out potential competitors. There are four main categories of possible solutions.

The first is to break the firms up. In some cases this could be done without huge damage. For example AWS, Amazon's cloud division, could survive happily as an independent company, eliminating the danger of data about third parties gathered from it being used to influence Amazon's e-commerce arm. But for many firms break-ups would also eliminate the benefit that customers say they get from participating in a network.

The second approach would be to turn platform firms such as Facebook, Alphabet or Uber into regulated utilities. Their prices and return on capital would be capped. Economic regulation would sit alongside a broader attempt to police the firms' behaviour, just as utilities have to promise to provide clean water and reach every home. But state supervision would douse these firms' innovative spirit.

The third approach would be to counter the platforms' power with users' power. Users might team up to form large "customer unions" that bargained collectively with the tech firms, demanding better privacy terms or even payments for users in return for their data, ensuring that privacy terms were met and search results were fair, and arranging any flow of payments in return for the use of data.

The fourth solution is creating competition by force. Across the world governments have opened up consumer markets for energy and telecoms. In the case of the tech big firms could be prohibited from buying smaller ones and they could be forced to share their data and intellectual property with new entrants on reasonable terms. In 1956 regulators forced IBM to give other firms access to its patents in return for a fair fee. This regulation helped new tech firms emerge.

#### **Important tasks for antitrust regulators**

The above changes need skilled regulators operating in strong institutional frameworks. The regulatory regimes on either side of the Atlantic have a lot in common. In America, the Federal Trade Commission (FTC, answerable to Congress) and the Department of Justice (DoJ, a part of the executive) look at firms and bring cases to court. In Europe the European Commission and national regulators divide the load. The commission can punish firms, which can then go to the courts to appeal. The control institutions purpose is a consumer welfare. Their actions fall into three categories: punishing cartels, policing mergers and dealing with dominant firms that abuse their position.

Antitrust regulators suffer from three main problems. The first is a lack of curiosity. The big economic trends are high profits, high and persistent returns on capital, takeovers, tech platforms, some spread of tech through older sectors, a decline in new entrants and the use of patents to protect from competition. Investors have been aware of this for at least 15 years, and the best ones have profited hugely from it. The world of macroeconomics woke up in 2015 after a landmark paper by Furman and Orszag (2018) on the link between companies and inequality, and there has been a surge of studies since.

In America the DoJ and FTC seem to lack basic knowledge about the economy. European antitrust institutions have a better record. They began to examine digitisation several years ago. They have also been strict with telecoms and airlines.

The second problem is a lack of clarity. There is no definition of what competition, or its absence, looks like, other than the near-tautology that it is whatever is good for consumers. Instead there are technical offences. Lots of emphasis is placed on whether prices rise. But consumers can suffer even while prices fall: the cost of a long-distance call was dropping even when telecoms was a monopoly but collapsed after deregulation. In many modern markets there is no price. Payment is in kind, for example in the form of data, not cash.

The third problem is that competition regulators are not independent and not follow digital trends in economy. Financial regulators were swayed by theories about the efficiency of financial markets and they denied about the build-up of risk before 2008. Competition regulators have a dated view of the economy. Academics are paid as witnesses or are sponsored by firms without disclosing it. Officials rotate between the agencies and law firms which defend big companies. The old anti-monopoly system should be changed.

The first step would be to identify the industries in the economy where competition might be a problem. The next step is translating this economic and financial analysis into a legal one. In both Europe and America a body of case law and rules has defined narrow kinds of misdemeanour, but these apply to old industries and have to be adapted to present circumstances.

The European Commission's competition arm is an example of what happens when well-meaning energy is used to contort economic problems into a flawed legal framework. The EU has scrambled to find ways in which tech firms might be deemed to offend existing doctrine. It has examined whether, from the mid-2000s, Google forced manufacturers to pre-install its browser, fining Google \$5bn in 2018. In 2016 it found Apple guilty of receiving state aid through tax breaks from Ireland. These kinds of fines are a tolerable cost of doing business for tech firms.

Another case regards Facebook's takeover of WhatsApp in 2014. The commission permitted it on the basis of declaration that the two firms would not link their data. But they did it next and Facebook has been fined \$125m. The takeover deal will not be reversed.

The legal frameworks need to be updated. In 2017, at the behest of the Bundeskartellamt, the German competition watchdog, several tweaks were introduced to the law to adjust it for the digital age. Among other things, these confirmed that a market can exist even if money does not change hands, with payments made in data, for example. They also changed the threshold for looking at takeovers in order to capture expensive purchases of small firms with few revenues, which typically happen when big firms buy putative competitors. Germany also has more legal flexibility to scrutinise powerful firms that treat customers unfairly, which it has used to investigate Facebook's approach to customers' data.

In America the chance of turning sensible economic analysis about competition into action appears more difficult. Part of the reason is bad architecture of institutions. The two agencies, the FTC and the DoJ, have retreated from a swathe of the economy that does not work well. A legal doctrine established in 2004, in a case known as Trinko, states that the benefits of antitrust action in regulated sectors, "will tend to be small". The sectoral regulators do not realize antitrust tasks.

In Europe the commission has the benefit of the doubt: it makes decisions and then firms can appeal. In America the courts must decide, what give them enormous power. Their reluctance to act has intensified since the 1980s, partly as a result of an ideological shift. Some experts, and even senior officials, talk about starting over and redrawing the entire antitrust architecture, much as America did in 1890 when it passed the Sherman act, and again in 1914 when the FTC was formed.

### **How to reinstate effective competition?**

Ever since the financial crash of 2008-09, capitalism has not been working well. The symptoms are lower growth, less dynamism and greater inequality. After 30 years of globalisation, growing profits and rising executive pay, businesses have forgotten how far the pendulum can swing in democracies. History shows that those swings can be surprisingly large. America saw a backlash against big business in the 1910s and 1930s. Even in the 1970s President Richard Nixon accused supermarkets of profiteering and introduced price controls. In Europe state ownership became popular after the second world war, and France under President François Mitterrand nationalised banks and industrial firms in the 1980s.

America and Europe have three main sources of ideas on how to make business work better for everyone: the left, the right, and incumbent firms with their self-interested agenda. Each is bad in its own way. Clever activists on the left have already spotted how antitrust could be another lever. The trick would be to change the objective of competition policy from

consumer welfare to a broader set of goals such as reducing inequality, increasing minority rights or saving small firms.

The right, meanwhile, argues that business can work for all if only it is freed from its constraints. This is the present line of the Republican party in U.S., and of some right-leaning politicians in Europe. Some of the proposals being put forward, such as simplifying regulations and tax codes, make sense.

The third party are big incumbent businesses. Executives in charge need more power: to help frame government policy, to retain more profits and to disregard shareholders. Often this is packaged as “long-termism”, corporate responsibility or patriotism. Yet the companies that support this agenda (e.g. JP Morgan, Berkshire Hathaway, BlackRock, McKinsey and Unilever) are clearly part of the establishment. But what the West needs now is dynamism and openness, not happier incumbents.

Advantages of real competition are obvious: lower prices, a wider choice of products, more potential employers and an economy in which upstarts have a chance. Competition has credentials as a remedy for the contemporary world’s problems. It can help spread wealth by making goods cheaper and reducing the monopsony power that firms can have over workers. It creates wealth by pushing firms to innovate.

A pro-market initiative would see governments set a broad agenda based on commonsense proposals to deal with problems that have emerged. It should be communicated to the public. Existing legal doctrine should be a tool of the agreed policy. A screening process should identify industries threatened by oligopolistic or even monopolistic practices.

Next the institutional architecture should be reformed. That means updating laws for the 21st century. Digitalized markets can exist even when no money changes hands; concentration can include intangible assets; dominant firms can kill competitors by buying them. Europe’s competition bodies can improve the way they are run: the European Commission takes too long to investigate cases. In America the entire system may need to be redesigned. A far stricter attitude is needed towards conflicts of interest among officials and lawyers.

Levying modest fines years after offences were committed makes little difference to the public. The priority should be systematically to open up markets. That means removing legal or regulatory impediments for new firms, and open big data and patents controlled by one firm so that they are available, on commercial terms, to everyone. It means replacing industry regulators who are too friendly for incumbents, and preventing powerful companies from taking out emerging rivals.

### **The Covid-19 effect on competition-concentration dilemma**

The growth of remote working is the latest stage of a decades-long technology shock. It began in the 1990s when personal computers took over offices, continued with the development of the smartphone and social media in the 2000s, and in the 2010s led to cloud computing and artificial intelligence. It has contributed to two features of the world economy: the dominance of “superstar firms” that have amassed valuable know-how, data and intellectual property which is hard to replicate; and an associated decline in the share of GDP accruing to workers in wages (a trend that is most evident in America).

Will covid-19 accelerate these trends? The pandemic period has been a good time for technology giants, whose shares fuelled a bull run in America’s stockmarkets. Covid-19 is shifting the business landscape in a way that portends further market concentration. Greater dependence on technology is not the only mechanism at play. Another is the possibility that the downturn kills off small firms unable to weather the shock, whereas large, listed giants benefit from the liquidity backstops governments have placed behind capital markets.

Firms vary in their ability to adapt. It is expected the rising importance of technology to boost winner-takes-all effects, and increasing the value of large technology investments that small firms find harder to make. Pandemic has not just been a good period for big technology firms. It has been good for technology in general, as it becomes more sophisticated and more crucial to success. And it is probably a principle that the more digitised a market, the more likely it is to become concentrated.

Confirmation of above discussion are the actual results of the U.S. companies. Table 1 presents the most profitable companies for two years: 2019 (the last pre-covid year) and 2020 (the first covid year). We can notice strengthening role of technology companies: Apple, Microsoft and Alphabet. Moreover Facebook and Amazon have advanced to the top 10 most profitable companies. In effect the half of the top 10 are occupied by technology firms. The rest of the top companies from other industries reduced their profits in 2020.

**Table 1** - The top 10 profitable companies in U.S.

	<b>2019</b>	<b>bln USD</b>	<b>2020</b>	<b>bln USD</b>
1.	Berkshire Hathaway	81,4	Apple	57,4
2.	Apple	55,3	Microsoft	44,3
3.	Microsoft	39,2	Berkshire Hathaway	42,5
4.	JP Morgan Chase	36,4	Alphabet	40,3
5.	Alphabet	34,3	Facebook	29,1
6.	Bank of America	27,4	JP Morgan Chase	29,1
7.	Intel	21,0	Amazon	21,3
8.	Wells Fargo	19,5	Intel	20,9
9.	Citi Group	19,4	Bank of America	17,9
10.	Verizon Communications	19,3	Verizon Communications	17,8

Source: Fortune, America's Biggest Companies (<https://fortune.com/fortune500/>)

The additional confirmation of above conclusions we can find in the Table 2 presenting the top 10 most valued (in term of market value, e.g. capitalisation) U.S. companies for September 2021. The first five positions are occupied by the above mentioned technology companies. Market value represents the expectations of the market (e.g. investors), what will happen in future: which companies will continue successful development.

**Table 2** - The top 10 most valued (capitalized) companies in U.S., 2021

	<b>2021, September 8th</b>	<b>bln USD</b>
1.	Apple	2.563
2.	Microsoft	2.256
3.	Alphabet	1.923
4.	Amazon	1.785
5.	Facebook	1.064
6.	Tesla	755
7.	Berkshire Hathaway	632
8.	Nvidia	557
9.	Visa	503
10.	JP Morgan Chase	474

Source: <https://companiesmarketcap.com/>

### Summary

Market power of giant companies („*too big to fail*”) should be attacked in three ways according to Special Report by The Economist (*Could the pandemic leave markets more concentrated?*, 2020) . First, data and intellectual-property regimes should be used to fuel innovation, not protect incumbents. That means liberating individual users of tech services to take their information elsewhere. It also entails requiring big platforms to license anonymised bulk data to rivals. Patents should be rarer, shorter and easier to challenge in court.

Second, governments should tear down barriers to entry, such as non-compete clauses, occupational licensing requirements and complex regulations written by industry lobbyists. For example, more than 20% of American workers must hold licences in order to do their jobs, up from just 5% in 1950.

Third, antitrust laws must be made fit for the 21st century. There is nothing wrong with trustbusters' remit to promote consumer welfare. But regulators need to pay more attention to the overall competitive health of markets and to returns on capital. Regulators should have more powers to investigate markets that are becoming dysfunctional. Big tech firms should find it much harder to neutralise potential long-term rivals, as Facebook acquired Instagram and WhatsApp.

These changes will not solve all problems. Consumers would have greater choice. Productivity would rise. And finally, the competition revolution would do much to restore the public's faith in capitalism.

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