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BRIEFING NOTE
Market Power and Wealth Distribution

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Executive Summary

This policy brief explores the link between **corporate market power** and **wealth inequality** in eight developed economies. The study examines how firms' ability to set prices above their costs, in the absence of vigorous competition, contributes to a more unequal distribution of wealth. Updating and expanding a 1975 study by Comanor and Smiley, it quantifies the impact of **supra-competitive profits** on different levels of wealth, revealing that this power tends to **favor holders of financial assets** at the expense of poorer households who bear higher prices. Finally, the paper suggests that government action targeting **illegitimate forms of market power** could be one way to reduce wealth inequality.

Keywords:
Market power
Wealth inequality
Distribution of wealth
Super-competitive profits
Poor impact
Market Power and Wealth Inequality

Main Themes:
This paper examines the impact of market power (monopoly power) on wealth distribution in eight countries (Australia, Canada, France, Germany, Japan, the Republic of Korea, the United Kingdom, and the United States). The study calibrates the effect of supra-competitive profits generated by market power on the distribution of wealth across different wealth deciles of the population. The central idea is that the lack of competition, by allowing firms to set prices above marginal costs, has significant distributive consequences, particularly disadvantaging the poorest.

Definition of Market Power: Market power is defined in this study as the presence of a return on capital that exceeds the competitive rate of return. It results from the difference between price and marginal cost.
"For the purposes of this study, monopoly power, or market power, is deemed present when there is a return on capital above the competitive rate of return."

Disproportionate Impact on the Poor: Higher prices resulting from market power negatively affect low-income households disproportionately. These households spend a larger share of their budget on essential goods and services whose prices are inflated by the lack of competition, without benefiting from a compensating share of increased profits.

"The increased margins charged to customers as a result of market power will disproportionately harm the poor, who will pay more for goods without receiving a counterbalancing share of increased profits."

Benefits for Financial Asset Holders: Individuals with significant financial assets may benefit overall from market power. Although they also pay higher prices for their consumption, they receive a more than compensatory increase in income from the increased profits generated by their financial stakes in firms with this market power.
"Firms that possess market power can charge supracompetitive prices for their products and earn profits above the competitive rate of return. The impacts of these higher prices can, on net, be beneficial to holders of substantial financial assets because these holders may pay higher prices for their con-sumption but will receive more than a counterbalancing boost in income from the increased profits arising from their financial holdings."

Wealth Impact Calibration: The study uses a model extending the Comanor and Smiley (1975) approach to simulate the distribution of profits from market power to shareholders. The results show a substantial impact on wealth inequality in the eight countries studied.
"Using new data, this study calibrates the overall impact of market power, showing a substantial impact on wealth inequality in the eight countries examined."

Increase in the Share of Wealth of the Richest 10%: Typical results show that the share of wealth held by the richest 10% of households increases by 10 to 24% in the presence of market power.
"In typical results, the share of wealth of the top 10 percent of households (by wealth) rises by 10 to 24 percent in the presence of market power." "In a typical result, we find that, of the wealth share of the top 10 percent (the richest), about one-tenth to one-quarter comes from market power."

Model Assumptions: The model is based on several important assumptions, including:

The ratio of market power profits to GDP remained constant over the analysis period (1920-2010).

Profits from market power have a fixed lifetime and are created and destroyed in a state of equilibrium.

The gains from market power are distributed proportionally to the current distribution of total financial wealth.

Higher prices due to market power affect each unit of consumption equally, regardless of the consumer's wealth decile.

Legitimate and Illegitimate Sources of Market Power: The study recognizes that market power can have legitimate (e.g., intellectual property) and illegitimate (e.g., illegal cartels, exclusionary behaviors, undue government regulations) origins. The aggregate size of illegitimate effects is considered potentially non-trivial.
"At the same time, some sources of market power are considered illegitimate-mate, such as market power coming from illegal cartels, exclusionary behavior by dominant companies, and government regulations that imbue market power on select companies, while creating undue barriers to entry for others."

Potential for Government Action to Reduce Inequality: The study concludes that the extent of illegitimate market power and resulting wealth inequality could be reduced by government actions aimed at controlling the illegal sources of market power or reducing the regulations that create or reinforce it.

"This study concludes that the extent of illegitimate market power, and wealth inequality that arises from it, can be reduced by government actions either to control the illegal origins of market power or to reduce government regulations that create or enhance market power."

Country-by-Country Results: The study presents detailed tables showing the current wealth distribution and the hypothetical distribution in the absence of market power for each of the eight countries studied. For example, in Australia, the wealth share of the richest 10% is 50% with market power, and would be 42% without it. France has the lowest impact (10%), while Canada, Japan, Korea, the United Kingdom, and the United States have the largest impacts (between 21 and 24%).

***Impact on the Poorest Households*:** The model suggests that the poorest households lose wealth due to market power, as their low share of business ownership does not compensate for the higher prices they pay as consumers. In the absence of market power, the wealth share of the poorest would be positive.

Sensitivity Analysis: Analyses show that a reduction in the overall impact of market power on the economy (from 3% to 1% of GDP) does not lead to a proportional reduction in its impact on wealth inequality.

Limitations and Future Directions: The study acknowledges the limitation of assuming constant market power as a percentage of GDP and suggests avenues for future research, including the inclusion of data from developing countries, a more detailed analysis of different sources of market power (legal with and without government assistance, illegal), improving the precision of the parameters with survey or tax data, an increased focus on the richest 1%, and the estimation of confidence intervals for the results.

Conclusion and Policy Implications:
This paper highlights the significant role that market power can play in exacerbating wealth inequality. By demonstrating that supra-competitive profits tend to concentrate wealth at the top of the distribution, the study suggests that policies aimed at reducing illegitimate market power (through stricter enforcement of competition law and revision of excessive regulations) could be an important lever for reducing wealth inequality, complementing direct redistributive mechanisms. The study highlights that while some forms of market power are beneficial (incentivizing innovation), reducing illegitimate forms could have a dual benefit by promoting competition and reducing inequality.

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