Industry Dynamics with Variable Markups

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Abstract

Do larger barriers-to-entry significantly reduce aggregate productivity? We study the losses from reduced competition in an industry dynamics model with endogenously variable markups. In the model, increased barriers to entry reduce produce turnover and put incumbent producers under less competitive pressure leading to larger markups and larger profits for incumbents, larger cross-sectional markup dispersion, and a reduction in aggregate productivity. For our benchmark parameters, we find that a 1% increase in barriers-to-entry is associated with a 0.3% fall in the number of producers, 0.4% fall in aggregate productivity, and 0.3% increase in the aggregate profit share. This decrease in aggregate productivity and increase in profits is driven by a reallocation of production towards large dominant producers who face relatively inelastic demand.

Keywords: competition, barriers-to-entry, turnover, misallocation, profits, dynamism.

JEL classifications: D2, D4, E2, L1, O4.

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