Non-technical summary for 'How Costly are Mark-ups in Australia? The Effect of Declining Competition on Misallocation and Productivity'

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What did we set out to do?

There is substantial evidence that the amount of competition in the Australian economy declined over the decade or so leading up to the COVID-19 pandemic:

- industries became more concentrated, with the largest firms accounting for a greater share of sales in their industries
- leaders within industry became more entrenched, and less likely to be displaced by new and growing firms
- estimates of mark-ups – the ratio of price to marginal cost – increased.

At the same time, productivity growth in Australia slowed, and this has significant implications for our living standards, as well as for fiscal and monetary policy.

One way in which weaker competition may have led to lower productivity is by causing a misallocation of resources across firms. If some firms have higher mark-ups, they will be producing too little at too high a price relative to other firms with lower mark-ups. It would be a more productive use of the economy's scarce resources to have the high mark-up firm produce a little more, and the other firm to produce less.

To try to quantify these costs, we apply a large macro model developed overseas to Australian data to answer the following question: If the amount of competition had not declined from mid-2000s levels, how much higher would aggregate productivity and GDP be due to resources being better allocated across firms throughout the economy?

What did we learn?

Using the model, we found:

- If competition had not declined, then productivity and therefore output would have been 1–3 per cent higher due to resources being better allocated across firms in the Australian economy, equating, at the upper end, to around $3,000 per person in today's dollars.
- The misallocation costs differ across industries and tend to be larger in upstream sectors like wholesale trade and manufacturing.
- Accounting for the broader costs of mark-ups, in particular the effect of the level of mark-ups on firms' choices about how much to produce, leads to higher estimates of lost economic activity, though the range of estimates is quite large.

What was our key takeaway?

The past decline in competition has significantly dragged on aggregate productivity over the period but, according to the model, should not weigh on future productivity growth. However, if competition continues to weaken, or if weaker competition was to weigh on a firm's impetus to improve (which is not captured in the model), there still could be ongoing effects.