

## THE DECLINE OF US BUSINESS DYNAMISM

Declining knowledge diffusion in the US economy has played a key role in rising market concentration and a slowdown in business dynamism in recent decades. That is one of the conclusions of new research by **Ufuk Akcigit and Sina Ates**, to be presented at the annual congress of the European Economic Association in Manchester in August 2019.

Their study documents a higher concentration of patenting in the hands of firms with the largest stock and a changing nature of patents, especially in the post-2000 period, which suggests a heavy use of intellectual property protection by market leaders to limit the diffusion of knowledge.

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The US economy has witnessed striking trends in recent decades that indicate rising market concentration and a slowdown in business dynamism, and some of which have also been shared by European economies.

This research highlights the dominant role of a decline in the intensity of knowledge diffusion from the frontier firms to the laggard ones – the process in which laggard firms learn about best practices from the best firms in their sector – in explaining these observed shifts.

The authors also present new empirical evidence that corroborates declining knowledge diffusion in the US economy: among others, patenting activity is increasingly concentrated in the hands of firms with the largest stock.

The US economy has been losing its business dynamism since the 1980s, while market power of firms appears to have increased. These changes manifest themselves in a number of empirical regularities, as shown by past research:

- Market concentration has risen.
- Average mark-ups have increased.
- The profit share of GDP has increased.
- The labour share of output has gone down.
- The rise in market concentration and the fall in labour share are positively associated.
- Productivity dispersion of firms has risen. Similarly, the labour productivity gap between frontier and laggard firms has widened.
- Firm entry rate has declined.
- The share of young firms in economic activity has declined.

- Job reallocation has slowed down.
- The dispersion of firm growth has decreased.

There is little consensus in the research literature on the underlying cause(s) that could jointly account for these potentially related developments. This study investigates some likely candidates: a fall in corporate taxes, a rise in R&D subsidies, an increase in entry costs, a decline in knowledge diffusion, a decline in interest rates, a fall in research productivity, and a decrease in workers' market power relative to employers/firms.

In particular, the authors focus on the relationship between market competition and firms' innovation decisions. Knowledge diffusion ensures followers learn from the market leaders and stay competitive.

The analysis finds that a decline in knowledge diffusion accounts for at least 50% of all considered trends, with the remaining channels rarely explaining more than 10% of the observed trends. A slowdown in knowledge diffusion works as follows:

- As a direct effect, market leaders are shielded from followers learning their technology, which helps them establish stronger market power.
- The followers get discouraged and slow down. Then, the productivity gap between leaders and followers opens up, while markets become more concentrated.
- Stronger leaders charge higher mark-ups, which increases the profit share and decreases the labour share of aggregate output.
- Entrant firms become discouraged observing the strengthening of incumbents and get discouraged as well; therefore, entry goes down.
- Discouraged followers and entrants imply lower competitive pressure on the market leader. Then, market leaders relax and experiment less. Hence, overall dynamism and experimentation decrease in the economy.

Then, what caused a decline in knowledge diffusion? To elaborate on this question, the researchers present new evidence on the use (or abuse) of patents in the United States. Their findings indicate that heavy use of intellectual property by established firms to deter competition is likely one of the key factors that has led to a decline in the diffusion of knowledge.

They show that concentration in patent production and reassignment has surged, with firms that own the largest patent (knowledge) stock further expanding their intellectual property arsenals. Moreover, the nature of patents has shifted to more protective from explorative.

These trends have drawn notable attention from academic as well as policy circles. In terms of policy, the results suggest that the appropriate response to revive business dynamism should focus on post-entry distortions that impede competition between

leader and follower firms. Such competition policy would not only affect incumbent firms, but also provide incentives for business entry through positive trickle-down effects.

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