Why Do Central Banks Care About Market Power?

“Competition in a globalized world: the role of public policies”

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Carolyn A. Wilkins
SENIOR DEPUTY GOVERNOR
BANK OF CANADA
Macroeconomic performance & living standards
Inflation & wage dynamics
Transmission & conduct of monetary policy

There is enough evidence to merit a closer look at how best to foster contestability of markets in the digital age
Productivity is the key driver of living standards

Share of potential output growth in Canada explained by trend labour productivity growth (April 2018 estimates)

- Digitalization should be positive for productivity (and incomes)...
- ...but will increased market power stifle investment and innovation?
  - Research on this is mixed (Diez, Leigh & Tambunlertchai 2018; De Loecker & Eeckhout 2017)
- This matters for neutral rate ($r^*$)

Sources: Statistics Canada and Bank of Canada estimates and projections.
Gains will depend on how firms and households adjust

Businesses must adopt new tech to compete

Adopting new technologies more readily is correlated with being a richer country*

Workers will need to upgrade skills to adapt

- New jobs are being created, some in entirely new fields
- Skills in demand are changing, jobs are becoming less stable
- Even with adaptation, potential for amplification of income inequality

*2016 value at current PPP
Sources: Bank of Canada calculations using OECD and World Bank data via Haver Analytics
Data has exploded this decade and will continue to expand.
The competitive landscape will help shape the gains...

**Data control**
- Governance and regulation of data control and how data’s protected and shared
- Countries starting to tackle these issues (e.g. Australia, Canada, UK open banking)

**Mergers & acquisitions**
- M&A activity can carry new implications for competition due to data
- M&As can come with markup increases by the acquiring companies (Blonigen & Pierce 2016)

**Potential for collusion**
- AI could allow for tacit collusion without humans (Calvano et al. 2018)
- EU, Japan actively pursuing anti-trust cases
- Others taking broad look at competition policies
...and may be changing inflation dynamics...

To understand how, here is a New Keynesian Phillips Curve equation:

$$\pi_t = \gamma_b \pi_{t-1} + \gamma_f E_t \{ \pi_{t+1} \} + \lambda \hat{m}c_t$$

| Inflation          | Proportion of backward-looking agents | Proportion of forward-looking agents | Real marginal cost |
Competition, digitalization impact economic potential

- Innovation boosts sustainable growth—under the right conditions
- Higher economic potential = more wealth to share broadly

The degree of income inequality affects the transmission of monetary policy

- Interest rate changes matter more for less wealthy, highly indebted households
- Higher income inequality can mean a less stable macroeconomy and financial system...which will affect transmission, conduct of monetary policy
Measurement matters

Areas where we need to upgrade:

1. Shift from tangible to *intangible* investments

2. Growing role of digital services trade

3. Economic value of data

4. Online prices and CPI

5. GDP data and household activities like Uber and Airbnb
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Digitalization of the economy should be positive for productivity and living standards.

How much is gained (and who gains) will depend on:
- how well businesses and workers adjust
- the competitive landscape in a digital age

Still-unanswered questions for central banks about implications for people, inflation dynamics, and monetary policy transmission.

Bottom line: there's a lot at stake.