

Market Power Affects Suppliers and the Broader Economy



Have markets become less competitive? It's an important question to study, as Tim Sablik and Nicholas Trachter discuss in this year's annual report essay, which begins on the following page. Firms that face less competition might charge more and produce less. They might pay lower wages or forgo productive investments.

The question is also difficult to answer. For example, the increasing concentration of most industries in the United States would seem to be evidence that market power has increased. But, as Tim and Nico note, it's possible that industries could become more concentrated because the most efficient firms are outcompeting their rivals. In addition, while concentration has increased nationally, in many industries concentration actually has decreased locally, suggesting that competition remains relatively strong in local markets.

Looking through my lens as a former consultant, one aspect of market concentration that strikes me as particularly important is the effect on suppliers: when firms get large, they acquire more bargaining power. This may be easiest to see in the retail sector. In 2017, the five largest retailers in the United States accounted for more than 35 percent of the 100 largest retailers' total U.S. sales. Manufacturers report being pressured to sell their products at lower prices lest they lose their places on stores' shelves. And, as the costs of transportation and information have declined, it has become easier for retailers to develop new suppliers, both domestic and foreign, to take the place of suppliers who can't meet their requirements. This increase in bargaining power is one reason why consumer goods inflation has been quite low over the past twenty years.

One way this bargaining power has been put into practice is the shift toward "private label" goods. Long gone are the days of "generic" food sold in black and white cans. Today, large retailers have the scale to develop their own brands, and the products they can distribute range from gourmet chocolate to pet food to clothing. By one estimate, the dollar share of private label goods will account for more than 25 percent of U.S. sales within the next decade.

Retail isn't the only sector where bargaining power has increased. Beginning in the auto industry, companies across sectors have invested significantly in the capabilities and sophistication of their purchasing departments. Executives are incentivized to avoid price increases, so they look for creative ways to reconfigure their operations to reduce purchasing volume and capture margin dollars from suppliers. When these efforts are successful, they paint a different picture of how market concentration might lead to higher profits—a picture with far lower inflationary pressures. Understanding how market power affects suppliers, and in turn the economy more broadly, is a topic I'm continuing to study.

The issues explored by Tim and Nico in this year's essay are timely and relevant for both policymakers and consumers. I hope you enjoy reading their essay, as well as the other sections of this year's annual report, including a message from our first vice president, Becky Bareford, and a review of the Fifth District's economic performance in 2018.

A handwritten signature in black ink that reads "Tom".

Tom Barkin
President