The Economist

The next capitalist revolution

To rebuild public faith in markets, restore competition

Capitalism has suffered a series of mighty blows to its reputation over the past decade. The sense of a system rigged to benefit the owners of capital at the expense of workers is profound. In 2016 a survey found that more than half of young Americans no longer support capitalism. This loss of faith is dangerous, but is also warranted. Today's capitalism does have a real problem, just not the one that protectionists and populists like to talk about. Life has become far too comfortable for some firms in the old economy, while, in the new economy, tech firms have rapidly built market power. A revolution is indeed needed—one that unleashes competition, forcing down abnormally high profits today and ensuring that innovation can thrive tomorrow.

Countries have acted to fuel competition before. At the start of the 20th century America broke up monopolies in railways and energy. After the second world war West Germany put the creation of competitive markets at the centre of its nation-building project. The establishment of the European single market, a project championed by Margaret Thatcher, prised open stale domestic markets to dynamic foreign firms. Ronald Reagan fostered competition across much of the American economy.

A similar transformation is needed today. Since 1997 market concentration has risen in two-thirds of American industries. A tenth of the economy is made up of industries in which four firms control more than two-thirds of the market. In a healthy economy you would expect profits to be competed down, but the free cashflow of companies is 76% above its 50-year average, relative to GDP. In Europe the trend is similar, if less extreme. The average market share of the biggest four firms in each industry has risen by three percentage points since 2000. On both continents, dominant firms have become harder to dislodge.

Incumbents scoff at the idea that they have it easy. However consolidated markets become domestically, they argue, globalisation keeps heating the furnace of competition. But in industries that are less exposed to trade, firms are making huge returns. We calculate the global pool of abnormal profits to be $660bn, more than two-thirds of which is made in America, one-third of that in technology firms (see Special report).

Not all these rents are obvious. Google and Facebook provide popular services at no cost to consumers. But through their grip on advertising, they subtly push up the costs of other firms. Several old-economy industries with high prices and fat profits lurk beneath the surface of commerce: credit cards, pharmaceutical distribution and credit-checking. When the public deals with oligopolists more directly, the problem is clearer. America's sheltered airlines charge more than European peers and deliver worse service. Cable-TV firms are notorious for high prices: the average pay-TV customer in America is estimated to spend 44% more today than in 2011. In some cases public ire opens the door to newcomers, such as Netflix. Too often, however, it does not. Stockmarkets value even consumer-friendly entrants such as Netflix and Amazon as if they too will become monopolies.

Rising market power helps solve several economic puzzles. Despite low interest rates, firms have reinvested a stingy share of their bumper profits. This could be because barriers to competition keep out even well-funded newcomers. Next, since the turn of the millennium, and particularly in America, labour's share of GDP has been falling. Monopolistic prices may have allowed powerful firms to eat away at the purchasing power of wages. The labour share has fallen fastest in industries with growing concentration. A third puzzle is that the number of new entrants has been falling and productivity growth has been weak. This may also be explained by a lack of competitive pressure to innovate.

Some argue that the solution to capital's excesses is to beef up labour. Elizabeth Warren, a possible American presidential candidate, wants to put more workers on boards. Britain's Labour Party promises compulsory employee share-ownership. And almost everyone on the left wants to reinvigorate the declining power of unions (see Briefing). There is a role for trade unions in a modern economy. But a return to 1960s-style capitalism, in which bloated oligopolies earn fat margins but dole cash out to workers under the threat of strikes is something to be avoided. Tolerating abnormal profits so long as they are distributed in a way that satisfies those with power is a recipe for cronyism. Favoured insiders might do well—witness the gap between coddled workers and neglected outsiders in Italy. But an economy composed of cosy incumbents will eventually see a collapse in innovation and hence a stagnation in living standards.

Far better to get rid of rents themselves. Market power should be attacked in three ways. First, data and intellectual-property regimes should be used to fuel innovation, not protect incumbents. That means liberating individual users of tech services to take their information elsewhere. It also entails requiring big platforms to license anonymised bulk data to rivals. Patents should be rarer, shorter and easier to challenge in court.

Second, governments should tear down barriers to entry, such as non-compete clauses, occupational licensing requirements and complex regulations written by industry lobbyists. More than 20% of American workers must hold licences in order to do their jobs, up from just 5% in 1950.

Third, antitrust laws must be made fit for the 21st century. There is nothing wrong with trustbusters' remit to promote consumer welfare. But regulators need to pay more attention to the overall competitive health of markets and to returns on capital. America's regulators should have more powers, as Britain's do, to investigate markets that are becoming dysfunctional. Big tech firms should find it much harder to neutralise potential long-term rivals, as Facebook did when it acquired Instagram in 2012 and WhatsApp in 2014.

These changes will not solve every ill. But if they drove profits in America to historically normal levels, and private-sector workers got the benefits, real wages would rise by 6%. Consumers would have greater choice. Productivity would rise. That might not halt the rise of populism. But a competition revolution would do much to restore the public's faith in capitalism. ■