



APRIL 8, 2019

Why Do Central Banks Care About Market Power?

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

G7 conference hosted by Banque de France

Carolyn A. Wilkins

SENIOR DEPUTY GOVERNOR
BANK OF CANADA



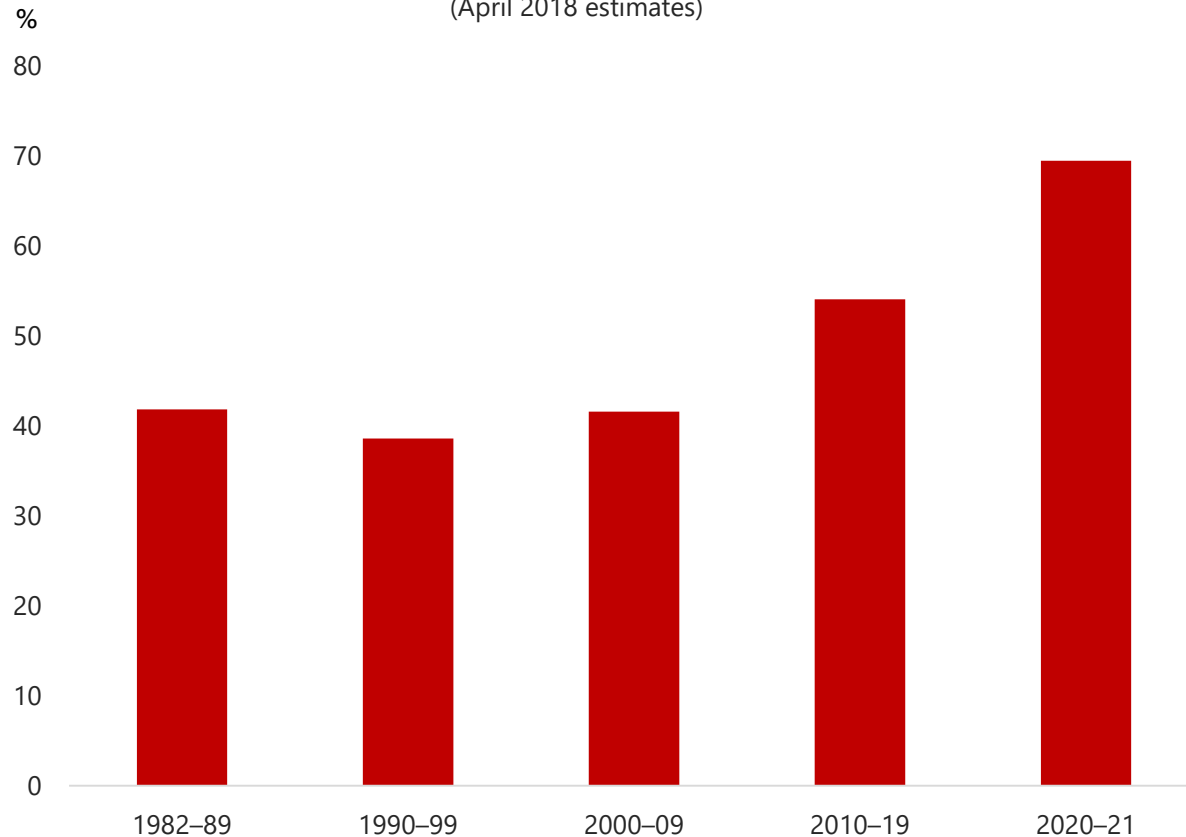
Structure of markets matters for fundamentals of the economy

- 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)



Sources: Statistics Canada and Bank of Canada estimates and projections.

- 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^*)

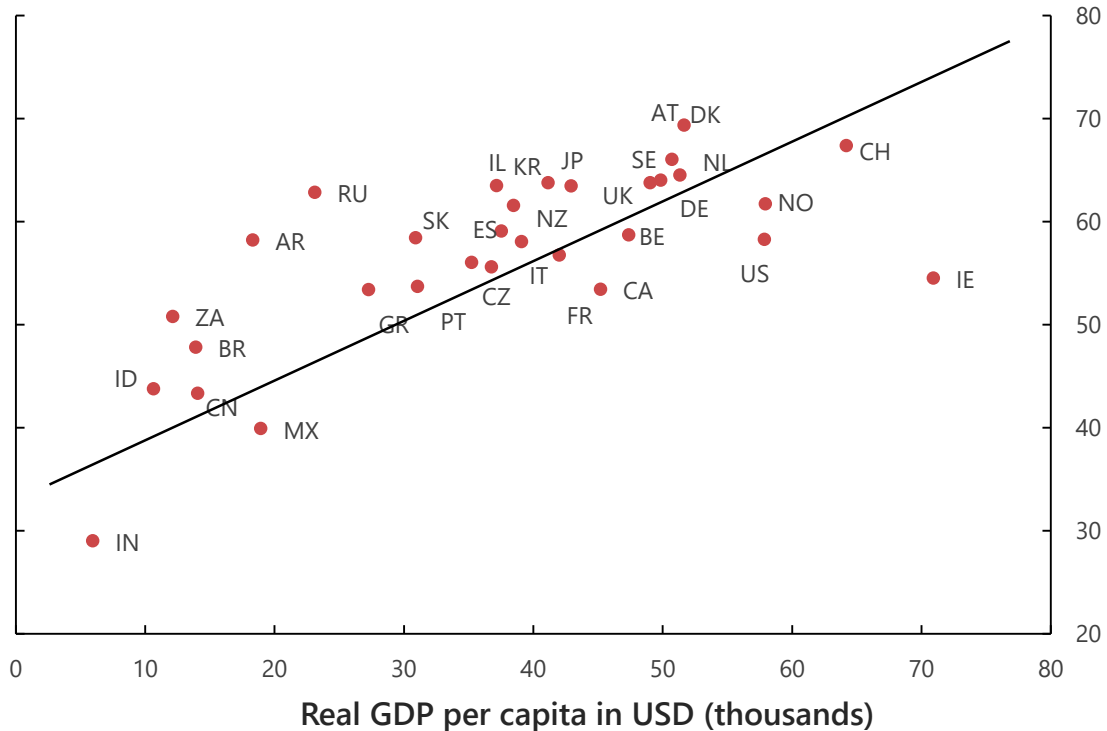
Gains will depend on how firms and households adjust

Businesses must adopt new tech to compete



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

Technology adoption index

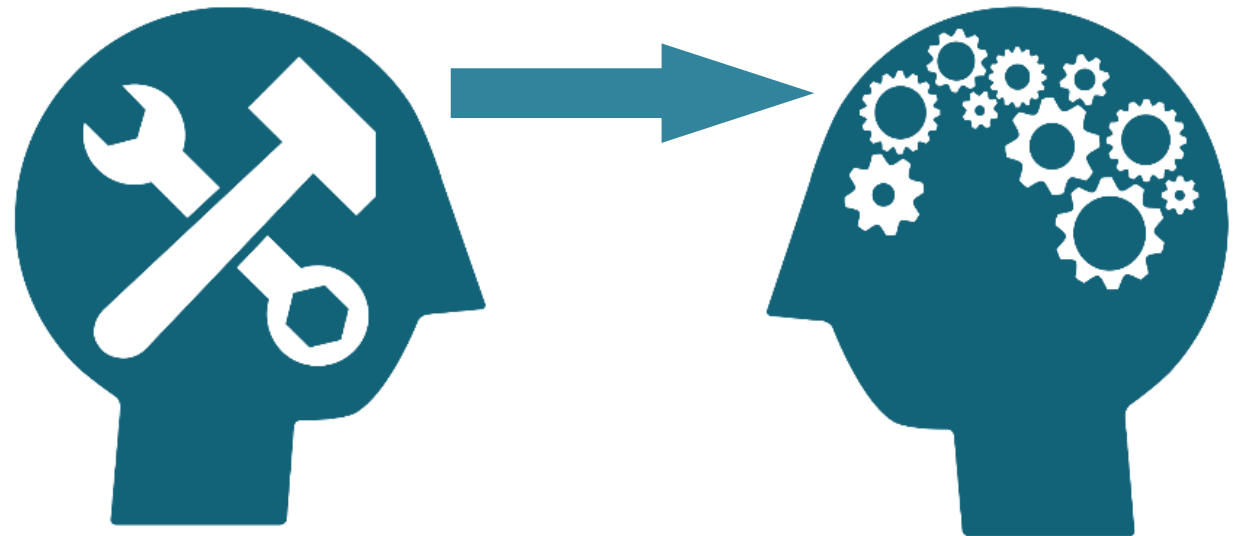


*2016 value at current PPP

Sources: Bank of Canada calculations using OECD and World Bank data via Haver Analytics

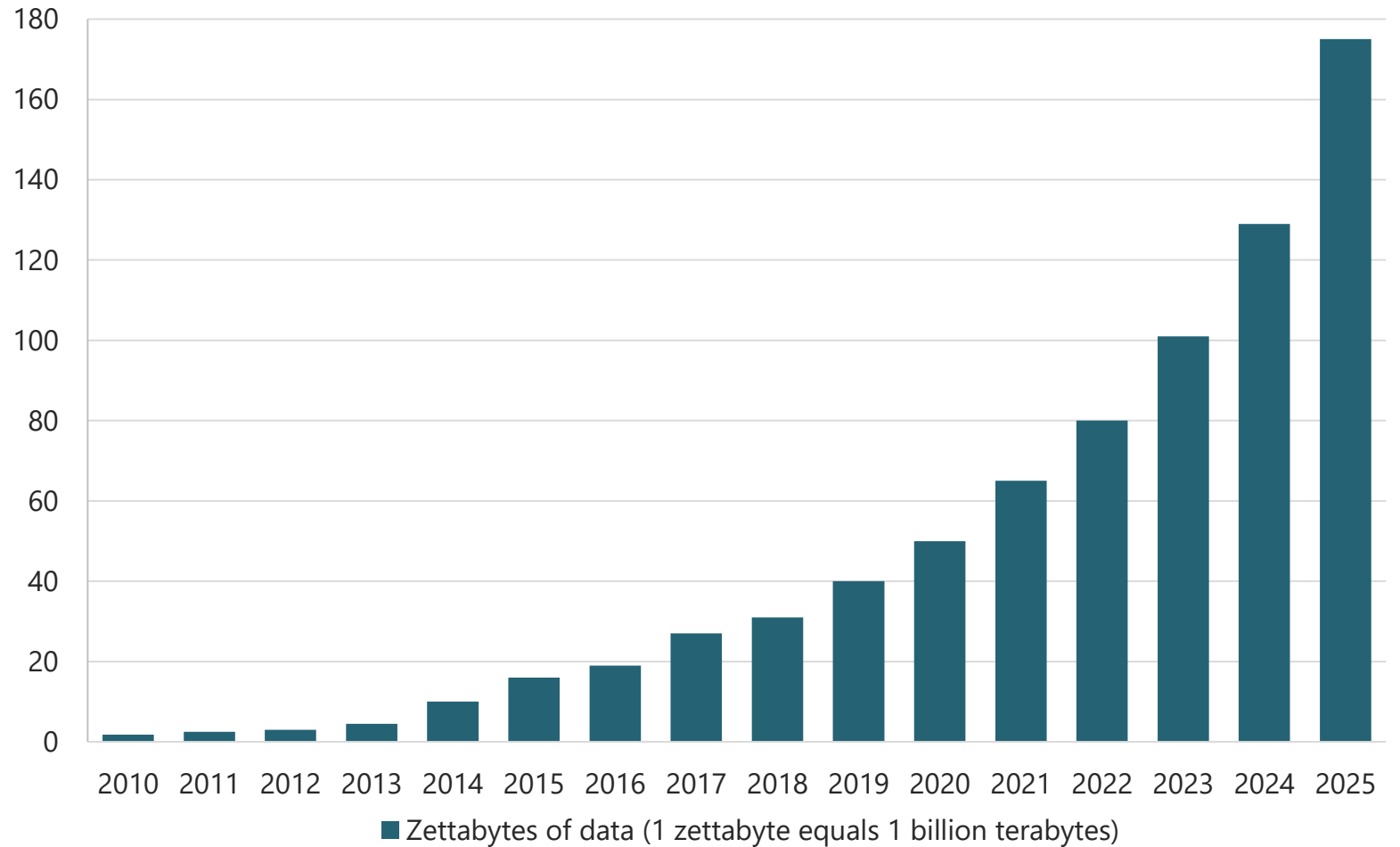
Workers will need to upgrade skills to adapt

- 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



Data has exploded this decade and will continue to expand

Global data growth



Source: International Data Corporation

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:

$$\pi_t = \gamma_b \pi_{t-1} + \gamma_f E_t \{ \pi_{t+1} \} + \lambda \widehat{mc}_t$$

Inflation

Proportion
of backward-
looking
agents

Proportion
of forward-
looking
agents

Real
marginal
cost

...which will affect transmission, conduct of monetary policy

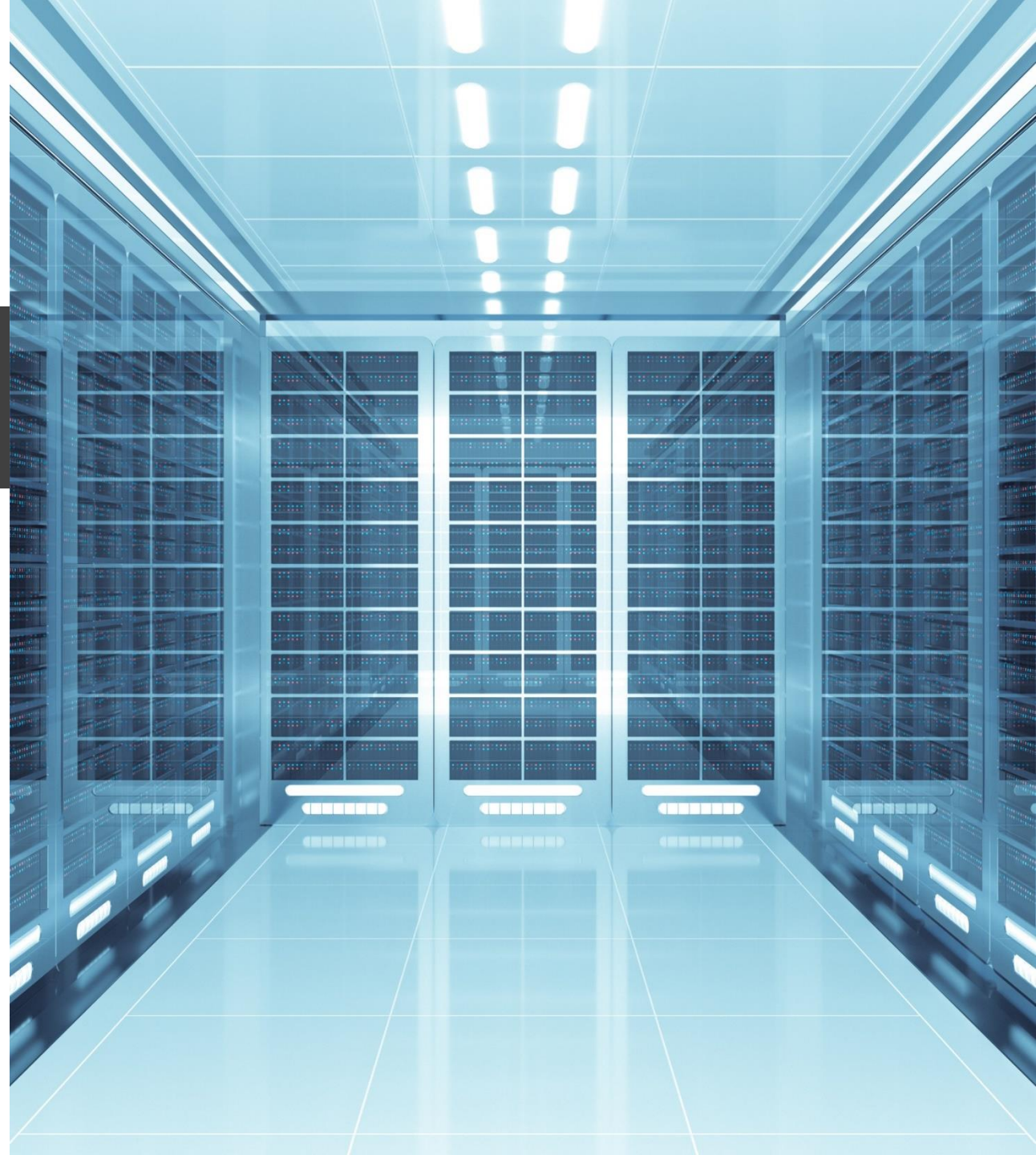
- Competition, digitalization impact economic potential
 - Innovation boosts sustainable growth—under the right conditions
 - Higher economic potential = more wealth to share broadly

- 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

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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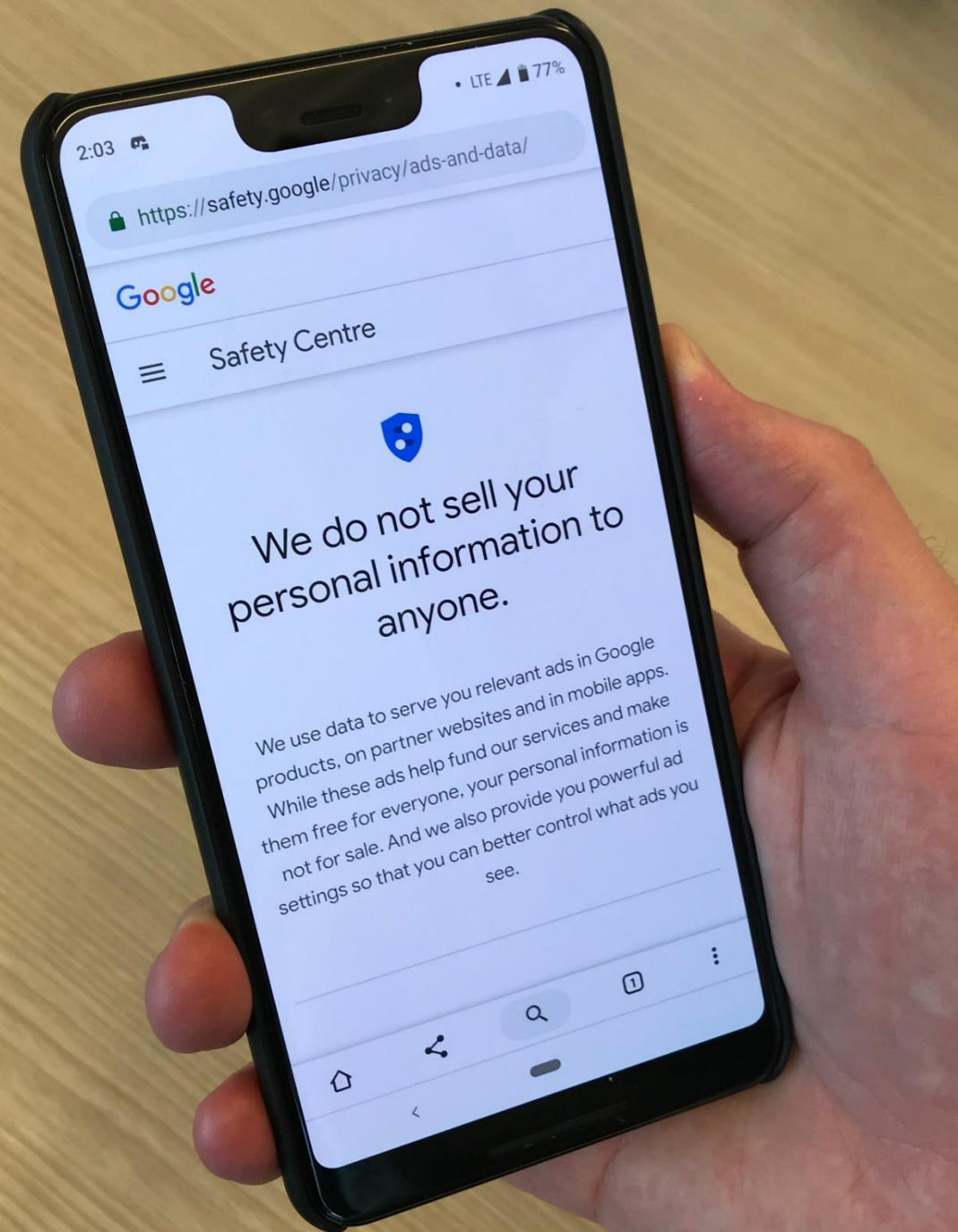
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The Uber logo, consisting of the word "Uber" in a bold, black, sans-serif font.The Airbnb logo, featuring a red outline of a stylized 'A' followed by the word "airbnb" in a red, lowercase, sans-serif font.

Bottom line: there's a lot at stake

- 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

