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POLICY BRIEF

CORPORATE RENT-SEEKING, MARKET POWER AND INEQUALITY: TIME FOR A MULTILATERAL TRUST BUSTER?

Income inequality has been rising globally in recent decades, posing a serious challenge to economic growth and stability. Discussion initially focused on widening income and wealth gaps across households and population cohorts but has recently shifted to the long-term fall in the labour share of income, including in many developing and emerging economies since the 1990s. Explanations of this trend have to date been dominated by a "textbook story of globalization and technology", a narrative that ignores the role played by market power and corporate rent-seeking in widening income inequality.[1] *Growing public concern over the significant rise of large technology companies, the continued excesses of financial rentierism and the proliferation of abusive tax-related practices by large corporations has led to a renewed interest in how private corporate interests prevail over public interests of inclusiveness, higher income equality and sustainability.*[2] *Based on a new firm-level database on developed and developing countries, this policy brief discusses recent trends in the evolution of non-financial corporate rents and their core policy implications.*[3]

Key points

- Rising market concentration and corporate rentierism in core sectors of the global economy are a major driver of growing global income inequality.
- In 2009–2015, the surplus profits – due largely to rentierist profit strategies rather than productive investment – of the top 1 per cent of publicly listed firms in a new UNCTAD firm-level database for 56 developed, developing and transition economies represented 55 per cent of recorded operating profits.
- Measures to curb abusive business practices should include a review of the United Nations Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices and of bilateral and megaregional trade and investment agreements.

Corporate rents are on the rise globally

Gauging the size of corporate rents is challenging for both data-related and conceptual reasons. Several recent contributions have shed light on increases in rentierism in recent decades, yet their focus has primarily been on financial rentier incomes, variously defined, in a few developed countries. By contrast, the UNCTAD estimate of the size of corporate rentier incomes focuses on non-financial sectors and widens the geographical coverage to include both developed and developing countries. For purposes of measurement, rents are approximated as persistent upward deviations from benchmark results that capture typical firm performances in given market conditions. The aim is to measure the gap between actual profits and benchmark or typical profits. A positive gap means that some firms accumulate surplus or excess profits and, if this gap persists over time, the measure provides an indication of forces at work that may facilitate the transformation of temporary surplus profits into redistributive rents.[4] Balance sheet data is drawn from a new UNCTAD database

[1] AB Atkinson, 2015, *Inequality: What Can Be Done?* (Harvard University Press, Cambridge, United States of America): 83; International Monetary Fund, 2017, *World Economic Outlook April 2017: Gaining Momentum?* (Washington, D.C.).

[2] See, for example, W Keller and WW Olney, 2017, Globalization and executive compensation, Working paper No. 23384, National Bureau of Economic Research; G Standing, 2016, *The Corruption of Capitalism: Why Rentiers Thrive and Work Does Not Pay* (Biteback Publishing, London); and A Schechter, 2018, Angus Deaton on the underdiscussed driver of inequality in America: "It's easier for rent-seekers to affect policy here than in much of Europe", Pro-Market, Stigler Centre for the Study of the Economy and the State, University of Chicago Booth School of Business, 8 February.

[3] This policy brief draws on UNCTAD, 2017, *Trade and Development Report 2017: Beyond Austerity – Towards a Global New Deal* (United Nations publication, sales No. E.17.II.D.5, New York and Geneva).

[4] For technical details see UNCTAD, 2017, pp. 124–125 and the annex available at http://unctad.org/tdr2017/Annex. The results presented in this policy brief differ slightly, since firms are ranked by surplus profit rather than by market capitalization and a more refined sector classification is used.

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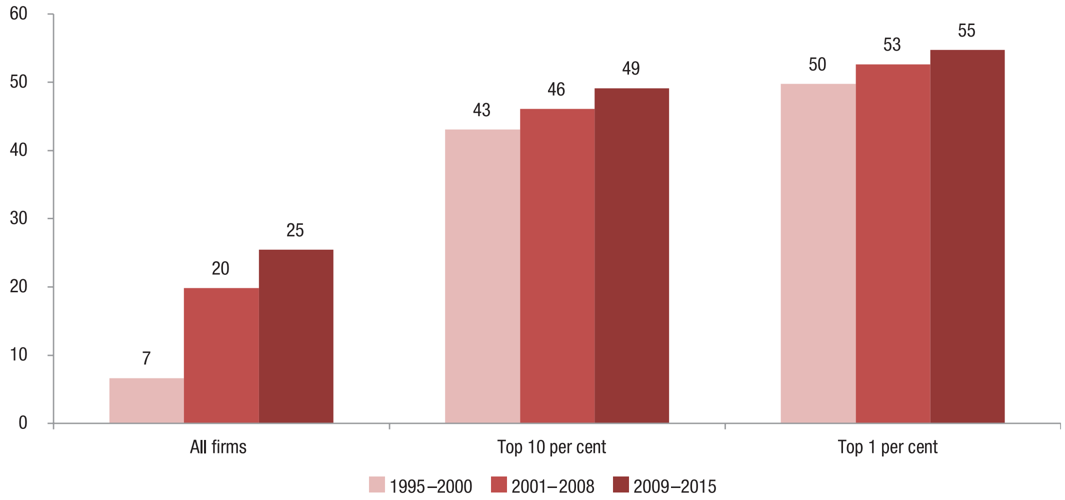
Figure 1 Evolution of the share of surplus profits in total operating profits
(Percentage)



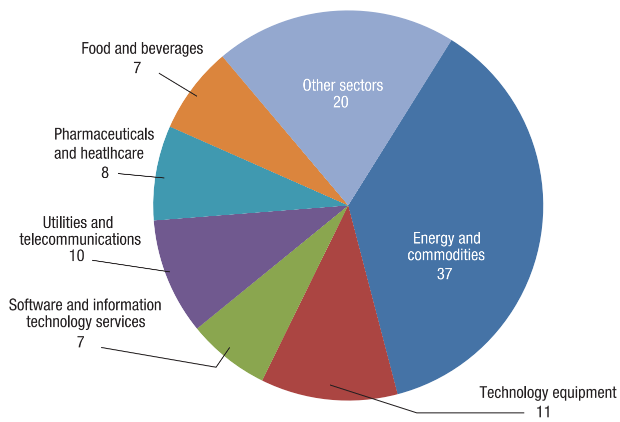
Source: UNCTAD database of consolidated financial statements, based on the Thomson Reuters Worldscope database

of the consolidated financial statements of publicly listed non-financial firms in 56 developed countries, developing countries and countries with economies in transition. The relevant variable is the operating profits of the non-financial firms and the period covered, 1995–2015, is divided into three subperiods separated by two major financial crises, namely the dot-com bubble in 2000–2001 and the global financial crisis in 2008–2009.

The share of surplus in total operating profits rose from 7 per cent in 1995–2000 to 20 per cent in 2001–2008 and 25 per cent in 2009–2015 (figure 1). This suggests a substantial increase in the ability of firms to generate and appropriate surplus profits since the early 2000s, with the global financial crisis somewhat curbing the pace towards corporate rentierism. However, these aggregate figures hide large and widening disparities between firms at the top and bottom of firm distribution. In 2009–2015, surplus profits represented 49 per cent of the recorded operating profits of the top 10 per cent of firms ranked by surplus profits and 55 per cent of those of the top 1 per cent of firms.

Furthermore, the top 1 per cent of firms generate a large part of their surplus profits in two types of sectors (figure 2). First, profits are generated in sectors that saw the large-scale privatization of the provision of public goods in the 1990s and 2000s, alongside subsidy schemes for private investors, such as the energy, utilities and telecommunications and health-care sectors. Second, profits are generated in leading high-technology sectors such as technology equipment, pharmaceuticals and software and information technology services. Some of these sectors, such as pharmaceuticals, have been characterized by high degrees of market concentration

Figure 2 Sectoral distribution of surplus profits of the top 1 per cent of firms, 2009–2015
(Percentage)



Source: UNCTAD database of consolidated financial statements, based on the Thomson Reuters Worldscope database.

for decades, while others have produced superstar firms more recently.

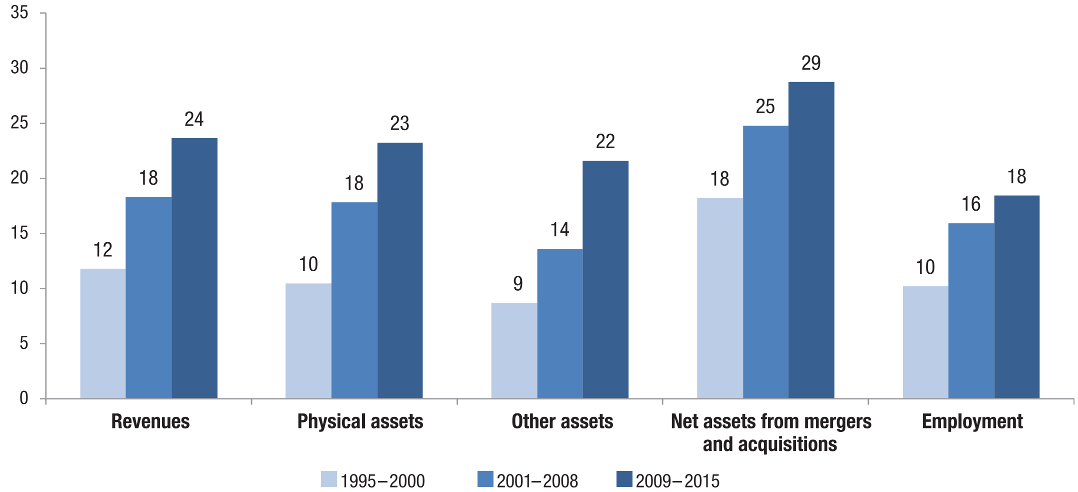
Market power, technology and the business of corporate rent-seeking

The rise of surplus profits and their concentration at the top end of firm distribution mirrors the trend of growing market concentration in core sectors such as those mentioned above. This has attracted renewed attention in recent years, primarily although not exclusively in studies of changing market structures in the United States.[5] The top 1 per cent of firms ranked by surplus profits have strengthened their market dominance according to different performance criteria such as revenues, physical assets, other assets and, to a lesser extent and pace, employment (figure 3).[6] Their share of revenues, for example, has doubled since 1995–2000, and reached 24 per cent in 2009–2015. In addition to organic corporate growth, the high pace of market concentration seems to have also been driven by mergers and acquisitions. In 1995–2000, the top 1 per cent of firms owned18 per cent of net assets from mergers and acquisitions; this figure had risen to 29 per cent by 2009–2015. By contrast, while market concentration has also risen with regard to employment, this increase is less pronounced and has flattened considerably since the 2000s. The widening gap between indicators of market concentration with regard to, on the one hand, revenues and assets and, on the other hand, employment, lends further support to the view that asymmetric market power is a strong contributory factor to rising income inequality.

Some analysts have stated that rising market power and winner-takes-most outcomes are primarily a technological phenomenon.[7] In this view, new high-technology sectors produce superstar firms due to economies of scale, for example in online services and software platforms, and the network effects of information-intensive goods and services make it difficult for newcomers to compete. A decline in the overall labour share of income, at least in the United States, is therefore explained by sectoral shifts towards a few more capital-intensive superstar firms and away from a larger number of firms with higher labour shares.

New technologies can undoubtedly play a role in raising barriers to entry, yet this explanation overlooks the interaction between technological and institutional or regulatory avenues to bolstering market power. Superstar firms benefiting from

Figure 3 Share of revenues, physical assets, other assets, net assets from mergers and acquisitions and employment of the top 1 per cent of firms ranked by surplus profits
(Percentage)



Source: UNCTAD database of consolidated financial statements, based on the Thomson Reuters Worldscope database.

[5] See, for example, McKinsey Global Institute, 2015, *Playing to Win: The New Global Competition for Corporate Profits*; and G Grullon, Y Larkin and R Michaely, 2017, Are [United States] industries becoming more concentrated?, available at https://ssrn.com/abstract=2612047 (accessed 3 May 2018).

[6] Physical assets refer to net property, plants and equipment; other assets refer to total assets minus physical assets, such as financial and other intangible assets; and employment refers to the total number of employees, excluding seasonal or emergency employees.

[7] See, for example, D Autor, D Dorn, LF Katz, C Patterson and J Van Reenen, 2017, The fall of the labour share and the rise of superstar firms, Working paper No. 23396, National Bureau of Economic Research.

initial technological barriers to entry can use this advantage to further expand their market power in other ways, for example through the aggressive use of intellectual property rights and pricing strategies or manipulations that make new entries non-viable or by systematically buying high-technology start-ups with new ideas and using their growing lobbying power to prevent regulatory authorities from intervening.

Generally, if growing market concentration, whether or not it originates in technological features, is left unattended, this raises the possibility of a "Medici vicious circle, in which money is used to gain political power and political power is then used to make more money".[8] The recent proliferation of a range of financial and non-financial corporate rent-seeking strategies – such as the strategic use of intellectual property rights; the raiding of public sectors through ineffective subsidy schemes, dubious privatization schemes and abusive tax-related practices; and systematic stock market manipulation to inflate chief executive officer remuneration – suggests that such a vicious cycle is well under way.

The need for a trust buster, nationally and globally

Rent-seeking means "getting an income not as a reward for creating wealth but by grabbing a larger share of the wealth that would have been produced anyway".[9] The combination of record high corporate profits in lead economies, stagnant or falling investment rates in the real economy and income inequality that is higher than at any point after the Second World War suggests a world in which rent-seeking has become prevalent. This is not the kind of enabling environment needed to ensure the inclusive prosperity envisaged in the 2030 Agenda for Sustainable Development, in particular under Goal 10.

This situation has triggered a growing policy debate on the need to tighten anti-trust legislation and enforcement, in particular in the United States and the European Union, which host most corporate headquarters. To be effective, anti-trust regulation needs to shift from a narrow focus on consumer welfare to a more comprehensive approach that considers market dominance and corporate abuses.

In the meantime, competition policies and measures aimed at curtailing restrictive business practices may be designed with an explicit distributional objective and greater protection against regulatory capture. Developed and major emerging economies have the most experience with competition-related problems in international markets. Developing countries mostly do not have such regulatory systems and are often the most exposed to the risks of competitive abuse in the absence of effective regulation. In this context, much of the regulatory structure dismantled in the last decades needs to be restored and updated. Given the global reach of multinational companies, close cooperation between lead economies that host the headquarters of most of these companies is essential for effective and coordinated reforms of anti-trust legislation, regulation and enforcement. There may be considerable political obstacles, yet efforts should ideally focus on a multilateral trust-busting framework. A starting point could be the United Nations Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices adopted by the General Assembly in 1980. These principles consider the interests of developing countries with regard to price fixing, collusion, transfer pricing, predatory behaviour towards competitors and the abuse of a dominant position.

In addition, stricter enforcement of existing national disclosure and reporting requirements for large corporations may be useful. A global competition observatory could facilitate the task of systematic information gathering on the wide variety of existing regulatory frameworks, as a first step towards coordinated international best practice guidelines and policies and the monitoring of global market concentration trends and patterns.

Finally, restrictions on the sharing of knowledge and intellectual property rights, negotiated at the bilateral and regional levels to be more constraining than multilateral agreements, need to be revisited. Bilateral and regional trade and investment agreements that facilitate abusive business practices should also be considered for reform.

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[8] For L Zingales, 2017, Towards a political theory of the firm, New working paper series No. 10, Stigler Centre for the Study of the Economy and the State, University of Chicago Booth School of Business.

[9] JE Stiglitz, 2015, Inequality and economic growth, *The Political Quarterly,* 86(51): 134–155.

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