**Corporate Power and Shared Prosperity**

**Statement of**

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Chairman Beyer, Ranking Member Lee, and members of the committee, thank you for inviting me to testify before today’s hearing, “A Second Gilded Age: How Concentrated Corporate Power Undermines Shared Prosperity.”

Before the economy fell into recession during the pandemic, it was delivering shared prosperity. In 2019, the unemployment rate fell to a 50-year low, wages were rising strongly, and wealth was rising the fastest for lower-income groups.[[1]](#endnote-1) Today, the economy is growing again, and we should be headed back toward pre-pandemic levels of prosperity.

I will discuss how leading corporations invest heavily in research, which gives them an edge in the marketplace but also generates broad benefits to society. At the same time, large corporations in every industry are being challenged and disrupted by technology driven startups. Vigorous competition by well-funded startups is the best way to check corporate power in our dynamic economy.

Policymakers should focus on reducing industry entry barriers and encouraging flows of risk capital to startups aimed at challenging dominant firms. Proposed capital gains tax increases would undermine the startup ecosystem and reduce competition, especially in America’s technology industries.

**Corporate Concentration**

There are growing concerns in Congress about rising corporate power. Senator Elizabeth Warren (D-MA) said we should not “let a handful of monopolists dominate our economy.”[[2]](#endnote-2) Senator Josh Hawley (R-MO) said big technology companies are the “gravest threat to American liberty since the monopolies of the Gilded Age,” and that the companies are a “techno-oligarchy with overwhelming economic and political power.”[[3]](#endnote-3)

Is there a monopoly problem in the economy? My colleague Ryan Bourne surveyed the academic literature on concentration and found that measures of national industry concentration have risen in recent decades, but that measures of local concentration have fallen.[[4]](#endnote-4) When a national coffee shop company adds locations to its chain, for example, national concentration in the industry may rise, but in many neighborhoods local competition would increase and consumers would benefit.

Rising national concentration in some industries is driven by a small number of highly productive companies that are expanding output but not raising prices. In a study for the Census Bureau, Sharat Ganapati found that from 1972 to 2012 increases in industry concentration were correlated with productivity and output growth but not correlated with price changes.[[5]](#endnote-5) By contrast, monopolies are a concern when they constrain output and raise prices.

Consider the historical example of the U.S. automobile industry. The number of U.S. car makers fell from 253 in 1908 to just 44 in 1929, at which time about 80 percent of output was from Ford, General Motors, and Chrysler. As the industry was consolidating, it was also innovating and cutting prices—Ford slashed the price of its Model T from $825 in 1908 to just $290 by 1927.[[6]](#endnote-6)

Back then, Ford was also known for paying high wages, which was made possible by the firm’s high productivity. Today, the higher productivity of large corporations is reflected in the higher wages they pay. In 2019, average wages in establishments with fewer than 100 workers were $976 per week compared to $1,914 per week for those with more than 1,000 workers.[[7]](#endnote-7)

International competition should also be considered regarding industry concentration. A recent study by Federal Reserve economists found that concentration in manufacturing has increased when considering just firms located in the United States, but including imports changes the results. Using detailed Census data they found that “once foreign firms’ sales in the U.S. are taken into account, market concentration did not rise but instead remained flat between 1992 and 2012.”[[8]](#endnote-8)

The global economy does enable successful multinational corporations to become huge, but it also makes them vulnerable to competition from everywhere. Germany’s Aldi grocery stores, for example, are currently growing rapidly across the United States, challenging dominant grocery chains. Spotify was a startup in Sweden but has grown to become the largest music streaming service, ahead of Amazon Music and Apple Music.[[9]](#endnote-9) Consumers are the beneficiaries—Aldi is undercutting even Walmart with its super discount grocery prices, and Spotify offers massively popular free streaming.[[10]](#endnote-10)

Some of the largest corporations are the most innovative. Their “corporate power” comes from investing their profits from global sales into research. PWC ranked the global companies with the most research spending in 2018, and 7 of the top 10 were U.S. multinationals in technology and pharmaceuticals.[[11]](#endnote-11) Similarly, Boston Consulting Group produced a list of the “most innovative” companies globally, and 14 of the top 20 are large U.S corporations.[[12]](#endnote-12) Two-thirds of U.S. business research and development is done by the largest corporations of more than 5,000 employees.[[13]](#endnote-13)

It is beneficial that the United States has large and profitable corporations investing in innovation because that creates broad-based spillover benefits. Economist William Nordhaus estimated that “only a miniscule fraction of the social returns from technological advances over the 1948–2001 period was captured by producers, indicating that most of the benefits of technological change are passed on to consumers rather than captured by producers.”[[14]](#endnote-14) He found that businesses received only about two percent of the benefits from their innovations, with the rest accruing to consumers.

Large corporations may be highly profitable if they are able to stay ahead of the pack on new products and technologies. But it is hard to stay ahead of the pack because high profits attract more competitors. Only 52 companies from the 1955 list of Fortune 500 companies are still on the list today.[[15]](#endnote-15) Indeed, the churn rate of top corporations has increased over time. Companies in the S&P 500 Index in 1980 stayed on the list for more than 30 years, on average, but today the average is down to about 20 years.[[16]](#endnote-16)

**Disruptive Innovation**

Rather than being all-powerful, large corporations today fear that their markets will be disrupted by upstart competition. Many times, we have seen new companies with new technologies shaking up industries with better products at lower prices. Former Harvard Business School professor Clayton Christensen highlighted the importance of such disruptive innovations that take dominant companies by surprise and undercut their businesses.[[17]](#endnote-17) He found this pattern in computers, disk drives, steel mills, retailers, motorcycles, ships, transistor radios, construction equipment, and other industries over the decades.

IBM dominated the mainframe computer market in the 1960s but was slow to recognize the shift to minicomputers, which were pioneered by new firms such as Digital Equipment Corporation. Then both mainframe and minicomputer firms missed the shift to personal computers pioneered by Apple and other startups in the late 1970s. Then Apple and IBM initially missed the shift to portable computers pioneered by Compaq in the 1980s. Then Dell Computer soared to the top with better machines shipped direct to the consumer.

New products and technologies are usually pioneered by new companies. Ridesharing was pioneered by startup Uber, not taxi companies. The home lodging industry was pioneered by startup Airbnb, not hotel companies. The leading electric car company in America is Tesla, not any of the major car producers, which is remarkable given the huge capital investment and marketing budgets of the majors.

The mRNA technology that led to the spectacular success of COVID-19 vaccination in America was pioneered by young biotech firms Moderna and BioNTech, not by the big pharmaceutical companies. One of the largest pharmaceutical firms, Merck, seems to have totally misjudged mRNA technology. Merck had examined it but “preferred to focus on proven technologies” instead, reported the *Wall Street Journal*.[[18]](#endnote-18) In July 2020, Merck’s chief executive “told an online audience hosted by Harvard University that those raising hopes for a widely available vaccine by the end of this year are doing ‘a grave disservice to the public.’”[[19]](#endnote-19)

The lesson is that the largest corporations make mistakes, and upstart competitors are eager to fill the void. The future is complex and unknowable and even the most sophisticated big corporations falter. As technology and markets keep changing, we will continue to see upstarts successfully challenging big corporations, and we will see turnover among the largest corporations in America.

Many dominant corporations in U.S. history have been surpassed by upstarts. By the 1870s, Western Union had gobbled up dozens of telegraph companies to become a virtual monopolist with 90 percent of the nation’s telegraph system.[[20]](#endnote-20) Policymakers at the time were alarmed, and they called for regulating the company or for the government to buy the system or build its own competing system. But then technology shifted. Western Union was in the best position to invent the telephone but missed it and was slow to realize the potential of Alexander Graham Bell’s 1876 invention. Western Union’s president described the telephone as a “toy” and rejected Bell’s initial offer to sell him the patent rights.[[21]](#endnote-21)

Today, big corporations may be more vulnerable than ever. The PC revolution of the 1980s and internet revolution of the 1990s gave small businesses the computer power that previously only big businesses could afford. More recently, technologies such as cloud computing, open-source software, computer simulation, and 3D printing have further reduced the costs of starting companies and performing research. The *Wall Street Journal* reports that two dozen startups are exploring nuclear fusion as a clean energy source: “Advances in computing, precision machinery and synthetic materials have allowed scientists to design reactors a fraction of the size and cost of those just a few years ago. Lower price tags have put fusion within reach of private investors, allowing ventures to sprout.”[[22]](#endnote-22)

CNBC publishes a list of young “disruptor” companies launching “attacks on the status quo in many industries,” including finance, health care, energy, transportation, and consumer products.[[23]](#endnote-23) Who benefits from all the disruption? Consumers do as upstart companies try to take business from big corporations and cut prices.

That is the goal, for example, of swarms of “fintech” companies invading the financial services industry. Neobanks—such as Chime with 12 million customers—offer basic account services online with lower fees than traditional banks. Some neobanks are targeting underserved communities such as Fair, which provides low-cost multilingual services to immigrant communities. There are online lending services such as Fundera, and payments services such as Square. Billionaire Mark Cuban backed startup Dave, which aims to cut bank overdraft fees, while Affirm “seeks to cut credit card companies out of the online shopping process by offering a way for consumers to secure immediate, short-term loans for purchases.”[[24]](#endnote-24)

Robinhood was launched in 2013 to provide commission-free stock trades. The company wants to “provide everyone with access to the financial markets, not just the wealthy.”[[25]](#endnote-25) More recently, Robinhood is aiming to “crack open one of Wall Street’s oldest clubs: those getting distribution of IPOs at the offering price, before shares begin trading. That early access gives investors a shot at the vaunted IPO ‘pop,’” or price appreciation.[[26]](#endnote-26)

Historically, the “largest financial rewards [have gone] to innovators who improved the lifestyle not of the wealthy few, but of the less-wealthy many.”[[27]](#endnote-27) Today’s innovators are following in the footsteps of Henry Ford, Sam Walton, and many others who got rich cutting prices for the poor.

**Supporting Risk Capital**

The economy needs entrepreneurs with big ambitions to disrupt industries and challenge dominant companies. But it also needs to fund those entrepreneurs with risk capital. Fast-growing startups in financial services, energy, biotech, renewable energy, batteries, and other dynamic industries are funded by wealthy angel investors and venture capital (VC). To limit corporate power, policymakers should support policies to keep capital flowing to growth-oriented startups.

Most leading U.S. technology companies began as startups that survived the early years with cash infusions and guidance from wealthy angels and VCs. Almost three-quarters of initial public offerings (IPOs) of recent years have been of VC-backed companies.[[28]](#endnote-28) In 2020, wealthy angels invested $25 billion into startups and VCs pumped $166 billion into startups and young growth companies.[[29]](#endnote-29) Moderna and BioNTech were funded by hundreds of millions of dollars of angel and VC investment.

Why is risk capital crucial? Because many potentially high-growth startups do not have substantial hard assets for collateral, and so they rely on equity investments, not bank loans. They depend on investors willing to take high risks and wait 5 to 10 years before a possible successful exit. Only about 1 in 10 angel and VC investments are big hits, but some of those hits become major corporations that drive the U.S. economy. When they exit successful businesses, entrepreneurs, angels, and VCs often realize capital gains and plough their money back into new startups. That virtuous cycle of wealth reinvestment is key to the success of innovation hubs such as Silicon Valley.

Here are three ways that policymakers can support risk capital.

First, policymakers should ensure that regulations permit large and diverse flows of angel and VC investment to startups. The JOBS Act of 2012 legalized equity crowdfunding and liberalized rules for accredited and nonaccredited investors. Congress and regulators should consider further reforms.

Second, policymakers should reduce the regulatory costs of public companies. The main exit for investors in startups used to be IPOs, but IPOs have declined in number, perhaps partly because of the higher regulatory costs of going public following the 2002 Sarbanes-Oxley law. The number of U.S. IPOs averaged 205 a year in the 1980s and 409 a year in the 1990s, but then just 126 a year since 2000.[[30]](#endnote-30) Congress partly mitigated costs with provisions in the JOBS Act to lighten compliance burdens for “emerging growth companies.”[[31]](#endnote-31)

The main way that entrepreneurs and investors in high-growth companies exit these days is a merger or acquisition (M&A).[[32]](#endnote-32) Major technology companies such as Apple, Microsoft, Google, Facebook, and Amazon make numerous acquisitions every year. In turn, that may contribute to the dominance of large companies in the marketplace. While federal policymakers are concerned about the power of big technology companies, federal rules that have raised the costs of going public may be partly to blame by inducing startups to favor an M&A over remaining as independent public companies.

Third, policymakers should keep capital gains taxes low. A capital gain is the financial reward for the effort, patience, and high risks that entrepreneurs and investors undertake in high-growth startups. The top federal tax rate on long-term capital gains is 23.8 percent, and with average state taxes included the top rate is about 28 percent. That is substantially higher than the average rate in the Organisation of Economic Co-operation and Development countries of 19.1 percent.[[33]](#endnote-33) Yet the Biden administration is proposing to raise the top federal rate to 43.4 percent, and thus the top federal-state rate to about 48 percent.[[34]](#endnote-34) If applied to startup investing, that would be a crushing blow to America’s innovation and technology industries.

Current provisions of the tax code allow investors and entrepreneurs in some startups to defer or eliminate capital gains taxes on exit. However, I fear that the general thrust of recent proposals—such as a proposal from Senator Ron Wyden (D-OR)—to treat capital gains as ordinary income would result in greatly reducing the benefits of startup investing.[[35]](#endnote-35)

Without beneficial capital gains tax treatment, technology entrepreneurs would rather take salary jobs, investors would move their funds to safer assets such as tax-free municipal bonds, and employees currently lured to technology companies by stock options would instead favor large and stable corporations. I urge policymakers not to upset the decades-long consensus that keeping a low capital gains tax rate is important for sustaining America’s lead in innovation industries.

**Supporting Open Markets**

Despite the dynamism in technology industries, the U.S. economy has shifted toward larger businesses and away from smaller businesses and startups in recent decades. Between 1998 and 2017, the number of small firms (less than 500 employees) increased 7 percent, while the number of large firms (more than 500 employees) increased 23 percent.[[36]](#endnote-36) Meanwhile, the U.S. business startup rate has drifted downward, falling from more than 10 percent in the early 1980s to 8 percent in 2018.[[37]](#endnote-37)

What is causing this economic shift? Many economists point to rising regulation as one factor.[[38]](#endnote-38) There are economies of scale in regulatory compliance, which favors large companies over small ones, and large companies can use their political power to create industry entry barriers. A 2019 study by [Germán Gutiérrez](https://www.nber.org/people/german_gutierrez) and [Thomas Philippon](https://www.nber.org/people/thomas_philippon) found that free entry to U.S. industries has stagnated the past 20 years.[[39]](#endnote-39) They found that “regulations drive down the entry and growth of small firms relative to large ones, particularly in industries with high lobbying expenditures. We conclude that lobbying and regulations have caused free entry to fail.”[[40]](#endnote-40)

Regulations tend to accumulate over time, and so reform-minded policymakers should pro-actively look for outdated and anti-competitive rules to repeal. When policymakers deregulate, entrepreneurs rush in and challenge dominant companies. Deregulation tends to increase competition and benefit consumers.

There are many examples from the 1970s and 1980s. Deregulation allowed MCI Corporation to challenge the AT&T telephone monopoly and slash long distance prices.[[41]](#endnote-41) Deregulation allowed Fed Ex to revolutionize package and express letter delivery, which had been dominated by a stagnant oligopoly of big companies and the U.S. Postal Service. Deregulation in the beer industry led to an explosion of craft beer making as hundreds of new producers challenged a moribund oligopoly of big producers.

Airline deregulation in the 1970s allowed low-cost startups to challenge major carriers. Most recently, Breeze Airways was launched in 2021 by David Neeleman, who had previously founded JetBlue. Neeleman has pumped $17 million of his own money into Breeze and gathered $83 million in risk capital from angels and VCs.[[42]](#endnote-42) Breeze will offer super low-cost direct flights connecting underserved U.S. markets.

Some regulations were loosened during the pandemic to positive effect. Federal and state reforms have expanded the provision of telehealth services, and startups in the industry are booming. VC investment in telehealth soared 70 percent in 2020 as governments loosened the rules.[[43]](#endnote-43)

These are successes, but there is more work to do. In the beer industry, state distribution rules continue to favor big breweries over small ones. In aviation, dominant airlines at airports can use their clout to block new competitors and their access to airport gates. In health care, 34 states have certificate-of-need rules that create barriers to new businesses and investments. These sorts of restrictions are anti-competitive and anti-consumer and should be repealed.

Some federal policymakers favor using antitrust rules to limit corporate power, but I would urge caution. A review of a century of antitrust policy by Brookings Institution economists found “no evidence that antitrust policy in the areas of monopolization, collusion, and mergers has provided much benefit to consumers and, in some instances, we find evidence that it may have lowered consumer welfare.”[[44]](#endnote-44) In the past, antitrust actions against technology giants such as IBM and Xerox were counterproductive, and it was upstart competitors that ultimately limited the power of these once-dominant companies.

The best approach to limiting corporate power to the benefit of consumers is vigorous competition from startup businesses. Policymakers should favor regulatory and tax policies that remove entry barriers from industries and encourage challenges from well-funded entrepreneurs.

Thank you for holding these important hearings.

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