Università Cattolica del Sacro Cuore - Milano

Ph.D. School in Economics and Finance

Distributional Effects of Market Power

Rajssa Mechelli

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Supervisor: Professor Andrea Colciago

Abstract

This work studies the interactions between market power, inequality, and welfare in a dynamic, general equilibrium framework. Doing so requires departing from two building blocks of the neoclassical general equilibrium model: the representative agent paradigm and perfect competition. The aim of the first chapter is to understand whether market power affects the distributions of wealth and income among households. Results suggest that a relatively simple extension of the Aiyagari model, namely oligopolistic competition with endogenous firms' dynamics, is successful at reproducing the wealth and income distributions observed in the U.S. Additionally, an increase in concentration in the markets for final goods, due to an increase in entry costs, leads to a lower labor share and a higher profit share of income. These dynamics, in turn, imply higher income inequality. Importantly, these trends are broadly in line with those observed in the U.S. in the last thirty years. The second chapter extends the framework developed in chapter one to study the role of the dividend income tax as a redistributive tool. The analysis considers alternative redistribution regimes. The main finding is that a reduction of the dividend income tax rate, from the US Status Quo, is associated with a social welfare loss. A lower dividend income tax rate implies lower transfers to households. From a welfare point of view, this is particularly costly for poor households. Furthermore, a reduction in transfers forces households to save more for precautionary reasons. To do so, wealth poor households must sacrifice consumption. Given the high concentration of wealth, this implies that the majority of the population suffers a welfare loss.

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