

What Happened to the U.S. Business Dynamism?^{*†}

Ufuk Akcigit
University of Chicago, NBER, CEPR

Sina T. Ates
Federal Reserve Board

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Abstract

In the last several decades the U.S. economy has witnessed a number of striking trends that indicate a rising market concentration and a slowdown in business dynamism. In this paper, we make an attempt to understand potential common forces behind these empirical regularities through the lens of a micro-founded general equilibrium model of endogenous firm dynamics. Importantly, the theoretical model captures the strategic behavior between competing firms, its effect on their innovation decisions, and the resulting “best vs. the rest” dynamics. We focus on four potential mechanisms that can potentially drive the observed changes and use the calibrated version of the model to assess the relative importance of these channels. One particular exercise replicates the transitional dynamics of the U.S. economy through joint moves in all four channels and decomposes the contribution of each channel to the resulting trends. Our results highlight the dominant role of a decline in the intensity of knowledge diffusion from the frontier firms to the laggard ones in explaining the observed shifts. We conclude presenting new evidence that shows an increasing concentration of innovative activity.

Keywords: Business dynamism, market concentration, competition, knowledge diffusion, step-by-step innovations, transitional dynamics

JEL Classifications: E22, E25, L12, O31, O33, O34

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†E-mail addresses: uakcigit@uchicago.edu, sina.t.ates@frb.gov