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What Is Behind the Rise in Markups?

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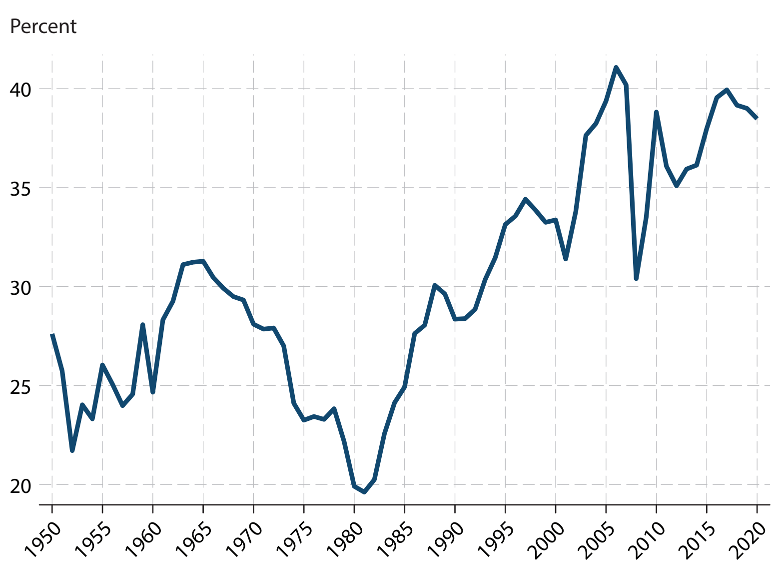
Policymakers and economists around the world are concerned that markups—the ratio of firms' prices to their marginal cost of production—have risen noticeably over the past decades. Why is this a concern? Firms operating in a competitive market would have little power to raise their prices above their costs. If a firm did raise its price, another competing firm could offer the same good or service at a lower price and get all its business. In contrast, firms facing less competition can charge higher markups. A rise in markups could then suggest that competition has declined, harming consumers along the way.

Figure 1 shows the average markup in the U.S. from 1950 to 2020. Lower values indicate more competitive markets, while larger values indicate some degree of market power. Markups in the U.S. averaged 26% from 1950 to 1980. Starting in 1980, markups increased noticeably and are now averaging above 38%.[1]

To understand what is driving the rise in markups, we can rewrite the average markup as the weighted mean of markups across sectors of the economy, using sectoral shares as weights.[2] Ongoing research (Marto, 2024) shows that the services sector played a key role in driving the rise in markups: The average markup within services has been higher and has grown faster than in the manufactured goods sector.

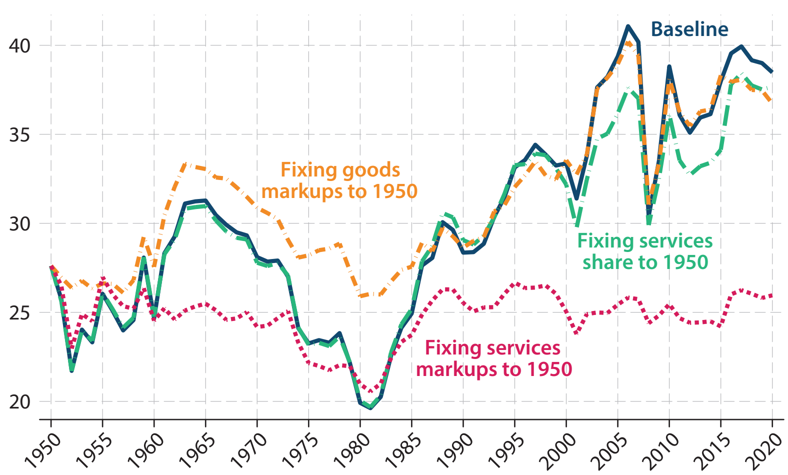
To illustrate this, Figure 2 presents counterfactual markups—that is, what the average markups would be if we were to keep either sectoral shares or the average markup within the services or goods sectors constant over the past 70 years. If the markup of manufactured goods was fixed at its value in 1950 (orange line), the average markup for the U.S. economy would trail closely the observed trend (blue line), particularly starting in the early 1980s. If sectoral shares were held constant at their 1950 levels (green line), the average markup would be lower from the 2000s onward. In contrast, if we were to shut down changes in the services markups (red line), the average markup would have barely moved over the past 70 years. The fact that the red line is far below the blue line indicates that the increase in services markups played a significant role in the overall rise in markups in the U.S.

Figure 1
Average markup in the U.S.



SOURCE: BEA KLEMS, Compustat, and author's calculations.

Figure 2
Income Elasticity and Real Consumption Growth, 2021-24



NOTE: The sectoral shares, goods' average markups, and services' average markups are held at their 1950 values.
SOURCE: BEA KLEMS, Compustat, and author's calculations.

Was the rise in markups driven by changes in supply or demand? The number of services-producing firms and establishments grew significantly over the past four decades, which hints that a decline in competition might not be the main driver of this increase. In addition, rises in R&D spending and other fixed costs have followed similar trends across sectors, which suggests that barriers to entry have not disproportionately affected services-producing firms relative to goods-producing firms. The emergence of foreign competition might help explain the slower increase in the markup of goods, but not the swift increase in the markup of services. Instead, demand might have played a more important role than previously thought in driving these increases. For instance, as households became wealthier over time, thanks to technological progress, their willingness to pay for services might have increased a lot more than it did for basic necessities. Wealthier households do consume a relatively greater proportion of their incomes on services.[3]

In sum, the services sector was key in driving the rise in markups in the U.S.—thanks to a stronger increase in services' markups. There is, however, only limited evidence that this was the result of a generalized decline in competition. Instead, technological progress that lifted consumers' incomes appears to be a stronger driver of the rise in markups over the past 70 years. ■

Notes

[1] Suppose the cost of producing a widget was $1 in 1980; a firm would sell it to consumers for $1.20 in 1980. Assuming the cost of producing the same widget was still $1 today, then that widget would now sell for $1.38.

[2] Sectoral shares correspond to the contribution of each sector to the aggregate costs in the economy (the sum of labor compensation and intermediate inputs).

[3] Marto, Ricardo. "What To Know About the Rise of Services." Federal Reserve Bank of St. Louis *Economic Synopses*, No. 6, 2024; https://doi.org/10.20955/es.2024.6.

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