

Product and Labor Market Power: Evidence from Firm-to-Firm Networks

EUGENIA MENAGUALE CHIARA MOTTA
Princeton Berkeley

Theory presented at Princeton, data partnership Bank of Italy

Extended Abstract.

This paper studies how distortions in product and labor markets jointly shape resource misallocation and productivity. While existing research has shown that misallocation can explain large cross-country differences in total factor productivity (TFP), most frameworks analyze one distortion at a time. At the same time, empirical evidence points to rising market power on both sides of the economy: firms charge higher markups in product markets and exercise monopsony power in labor markets. Whether the same firms dominate both sides, and how such overlap affects aggregate outcomes, remains largely unexplored.

We develop a general-equilibrium model in which heterogeneous firms compete imperfectly in both product and labor markets. The model extends the standard Restuccia–Rogerson (2008) framework to a multi-distortion setting, allowing for correlated markups and markdowns. We show analytically that even modest distortions can generate large aggregate productivity losses when market power is concentrated in the same firms. In particular, the correlation between product and labor market power amplifies misallocation: economies where the same firms have both high markups and high markdowns exhibit lower output, employment, and wages.

We test these predictions using newly-linked Italian administrative data combining firm-to-firm transaction records, balance sheets, and matched employer–employee information. This rich dataset allows us to measure firm-level market shares and concentration indices on both sides of the market within narrowly defined geographic and sectoral cells. We construct Herfindahl–Hirschman indices for product and labor markets and quantify their local correlation, providing the first empirical measure of the extent to which product and labor market boundaries overlap.

When market power coincides across margins, the efficiency losses from imperfect competition are magnified, implying that the gains from competition policy, labor-market regulation, or place-based interventions depend critically on the joint structure of firm dominance. Ongoing work quantifies these amplification effects and evaluates policy counterfactuals to assess the productivity gains from reducing correlated distortions.