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Efficiency in Large Markets with Firm Heterogeneity

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Efficiency in Large Markets with Firm Heterogeneity[☆]Swati Dhingra^{1,*}, John Morrow^{1,1,**}

Abstract

Empirical work has drawn attention to the high degree of productivity differences within industries, and its role in resource allocation. In a benchmark monopolistically competitive economy, productivity differences introduce two new margins for allocational inefficiency. When markups vary across firms, laissez faire markets do not select the right distribution of firms and the market-determined quantities are inefficient. We show that these considerations determine when increased competition from market expansion takes the economy closer to the socially efficient allocation of resources. As market size grows large, differences in market power across firms converge and the market allocation approaches the efficient allocation of an economy with constant markups.

JEL Codes: F1, L1, D6.

Keywords: Efficiency, Productivity, Limit theorem, Market expansion, Competition

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