Title: Low Interest Rates, Market Power, and Productivity Growth

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Abstract:
We build an endogenous growth model to show how low interest rates can increase market power and lower aggregate productivity growth. The model delivers both a traditional expansion in productivity growth in response to lower interest rates, and a slowdown in productivity growth from an increase in market power. When interest rates fall to low levels, the strategic competition effect dominates: the distance between a market leader and a follower increases which reduces investments in productivity by both. The model predicts that very low interest rates lead to an increase in market concentration and mark-ups, a decline in creative destruction and firm entry, a widening productivity-gap between the leader and followers within an industry, and ultimately a decline in productivity growth. We provide empirical evidence in support of these predictions.