

Product Diversity, Endogenous Markups, and Development Traps

Jordi Galí *
New York University

March 14, 1995

Abstract

We analyze the implications of endogenous markups for the dynamics of capital accumulation, in an environment in which the degree of competition increases with economic development. In equilibrium, markups are inversely related to the aggregate capital stock, which makes it possible for the marginal revenue product of capital to be non monotonic, even if the marginal product of capital is strictly diminishing. That feature raises the possibility of multiple steady states and, most interestingly, multiple equilibrium paths (converging to different steady states) for given initial conditions. We conclude by discussing some of the implications of our model and assessing their empirical relevance.

JEL Classification Numbers: L13, O41

Keywords: Multiple Equilibria, Growth Models, Endogenous Markups

Department of Economics, New York University, 269 Mercer Street, New York, NY 10003.
Tel: 212.998.8926, E-Mail: galij@fasecon.econ.nyu.edu . This project has benefited, at different stages, from financial support of the Columbia Business School Faculty Research Fund, the C.V. Starr Center for Applied Economics, a DGYCIT Grant PB93-0388, as well as the hospitality of Universitat Pompeu Fabra. The author thanks an anonymous referee and participants at the NBER 1993 Summer Institute Workshop on Macroeconomic Complementarities for helpful comments.