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Power Laws in Economics and Finance

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Abstract

A power law (PL) is the form taken by a large number of surprising empirical regularities in economics and finance. This review surveys well-documented empirical PLs regarding income and wealth, the size of cities and firms, stock market returns, trading volume, international trade, and executive pay. It reviews detail-independent theoretical motivations that make sharp predictions concerning the existence and coefficients of PLs, without requiring delicate tuning of model parameters. These theoretical mechanisms include random growth, optimization, and the economics of superstars, coupled with extreme value theory. Some empirical regularities currently lack an appropriate explanation. This article highlights these open areas for future research.

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