Micro-Mechanisms behind Declining Labor Shares: Rising Market Power and Changing Modes of Production

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Speaker:

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Abstract

This article derives a micro-founded theory offering three competing explanations for a fall of labor’s share: a falling aggregate output elasticity of labor, an increase in firms’ product market power, or an increase in firms’ labor market power. I apply my framework to 20 years of German manufacturing sector micro data containing firm-specific price information to study how these three distinct forces relate to a fall in labor’s share. Coinciding with the fall of labor’s share, I report an undocumented high and severely increasing level of aggregate firm labor market power, whereas aggregate product market power, although increasing, stays low. Increasing labor and product market power account for half of the decline in labor’s share. The other half is explained by a falling aggregate labor output elasticity which reflects a transition of firms towards less labor-intensive production activities and questions common production models featuring constant output elasticities of production factors.