Labor's Share, the firm's market power and TFP

Robert Dixon^a and Guay C. Lim^b

a Department of Economics, The University of Melbourne, Victoria 3010, Australia. r.dixon@unimelb.edu.au

b Melbourne Institute of Applied Economic and Social Research, The University of Melbourne, Victoria 3010, Australia. g.lim@unimelb.edu.au

Robert Dixon is the corresponding author, email address is above.

Abstract

We investigate the relationship between labor's share, firm's market power and the elasticity of output with respect to labor input using an approach based on an unobserved components model. The approach yields time-varying estimates of market power and the elasticity. Evidence on the market power of firms (which we find to be rising since 2000) gives a deeper understanding of movements in labor's share and the labor wedge. The generated values of the elasticity yield revised estimates of TFP growth which is informative about the extent of the downwards bias inherent in traditional estimates which use labor's share as a proxy for the elasticity.

JEL codes: O47, C32, E25

Keywords: labor's share, market power, TFP growth, labor wedge, state-space modelling

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Author/s:

Dixon, R;Lim, GC

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