When do Firms Profit from Wage Setting Power?

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Summary

This Paper

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- Build a model of dynamic monopsony w/ search on the job & recruiting expenditure
  - Firms use both wages and recruiting expenditures to attract workers
  - Search frictions + worker preferences → wage setting power of firms
- Estimate firm wage-size elasticity based on model predictions
  - Using AKM and the decomposition of firm size and wage effects
  - Using DiD around firm expansion and worker switching into expanding firms (Friedrich et al. 2023)

Main Findings

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2. The profit share is tightly linked to the elasticity of optimal wages to firm size
   - Wage setting power alone is not sufficient to explain profit share
3. Estimates of the profit share of marginal products
   - AKM: profit shares are estimated at 0.09 (single-unit firms), 0.03 (multi-unit firms)
   - Firm expansion events (Friedrich et al. 2023): switchers experience higher wage growth at expansion (but no further gains afterwards) → Indicative of elastic labor supply and zero profit share

Comments

Overview

This paper nicely:

- Investigates the extent to which wage setting matters for firm profits with a tractable model
- Offers a resolution to the existent puzzles through recruiting + separation elasticities
  - Narrow the gaps lying in i) various labor supply elasticities and ii) profit share puzzle

Overview

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Some comments:

1. Recruiting Costs and Decomposition of Marginal Products
2. Wage-Size Elasticity Estimation
3. Alternative channel for the Profit Puzzle

Recruiting Costs and Decomposition of Marginal Products

- Useful to decompose marginal products into wage, recruiting costs, and profit, which depends on the functional form of recruiting costs

$$C(N, V) = c \times \left(\frac{V_t}{N_{t-1}}\right)^{\chi} N_{t-1}^{\sigma\chi}$$

  - The share of wages: $\frac{(1+\chi)\varepsilon}{1+(1+\chi)\varepsilon+\sigma\chi}$, recruiting costs: $\frac{1}{1+(1+\chi)\varepsilon+\sigma\chi}$, profits: $\frac{\sigma\chi}{1+(1+\chi)\varepsilon+\sigma\chi}$

- **Higher** χ: the share of **wages** ↑, but if $\chi = \infty$, this **converges back** to the level at $\chi = 0$
- **Higher** σ: the share of **wages** ↓ and the share of **profits** ↑

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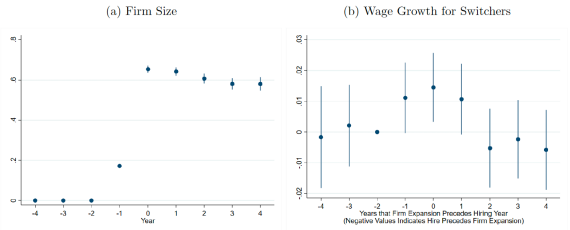
⇒ Further insights could be provided behind this dynamics & how these parameters interact

⇒ $\rho = 0$, $\varepsilon = 5$, $\chi = 1$ assumed: how sensitive are they for the profit share?

Wage-Size Elasticity Estimation

- Using DiD for firm expansion events



$$\Delta \log(N_{j,t+s,t+s-2}) = \beta_s \mathcal{I}\{\text{expansion in year } t\} + \tau_{jt} + w_{j,t+s-4,t+s-2}$$

$$\Delta \log(w_{ijk,t+s,t+s-2}) = \sum_s \beta_s \mathcal{I}\{\text{switcher arrives in year } s\} \times \mathcal{I}\{\text{expansion firm}\} + \tau_{jt} + w_{j,t+s-4,t+s-2} + d_j + \kappa \hat{\psi}_k + \xi X_{i,t+s-2}$$

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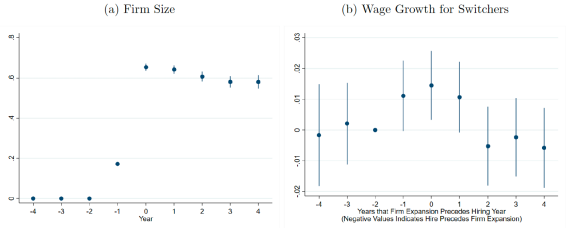

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$\Rightarrow$ Alternative story? e.g., optimal scale of firms

$\Rightarrow$ Hard to see it as direct evidence for the shape of recruiting costs ($\chi > 0$, $\sigma = 0$)

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  - Labor and profit shares vary across firms a lot and are highly skewed
  - The change in aggregate labor share results from a redistribution across firms (Kehrig and Vincent 2017; Autor et al. 2020)

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$\Rightarrow$ Incorporating firm heterogeneity and composition may have a different story

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Review:

- Interesting question. Provide a tractable model with consistent wage-size elasticity estimates
- Direct evidence and importance for the channel can further be enhanced