Deaton Review: Firms and Inequality

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Aims of our Chapter

1. Pull together evidence on what's happened to UK business landscape over last few decades (esp. '96-)
   - New evidence from (near) universe of UK company accounts & administrative ONS sources

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   - Increase in inequalities of firm-level productivity, wages, and size (industrial concentration ↑)
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3. Assess some explanations and policy implications

Key Conclusions

1. Major UK problem is 15 years of low/no productivity growth
   – Has led to a stagnation of wage growth across distribution (median and mean)
2. Since mid-1990s, big growth in inequality of productivity & pay across firms (like the US)
   – "Superstar firms" pull away from the rest. Workers in top 10% of firms had sustained productivity & pay growth, those in middle stagnated
3. Increase in aggregate price-cost markups and rise in concentration (firm product market power up)
4. Focus should be on raising productivity, e.g. competition reforms & innovation policy

OUTLINE OF TALK

Why Look at Inequality Between Firms?

Firm level findings

Explanations

Policy

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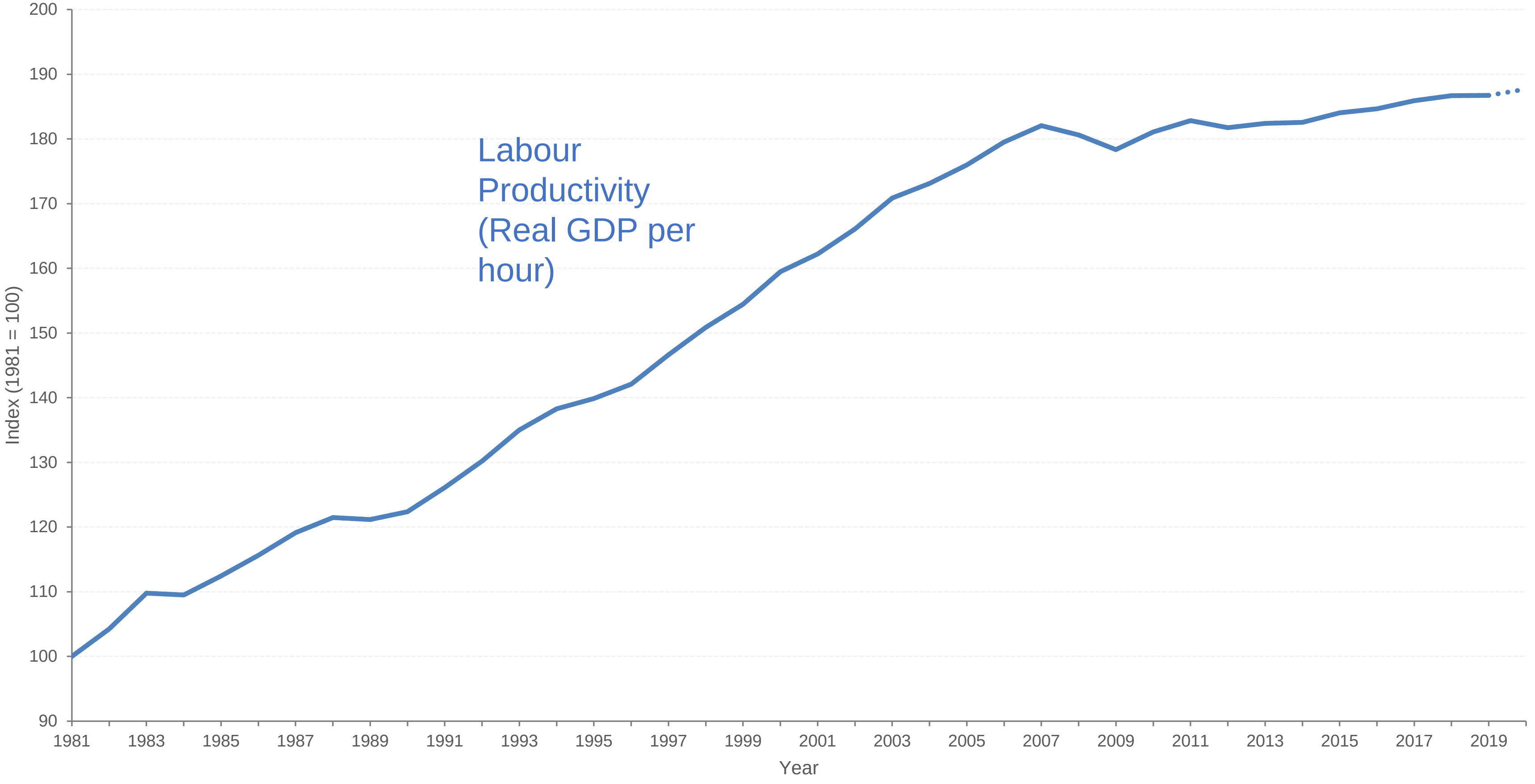
- Many reasons to be concerned about inequality of opportunity & outcomes for families & communities
  - But firms are generally <u>not</u> households
- Some reasons why firm inequality matters:
  1. The firm you work for is important for your wages & wellbeing. So increased inequality between firms puts upward pressure on increased inequality between people
  2. Firm inequality can matter for aggregate outcomes like productivity (the main long-run determinant of wages)
     - e.g. Diffusion of technology from superstar leaders to followers decreases, macro productivity growth slows
  3. Increasing lobbying strength of large firms could shift laws and regulations in their favour

<u>The Challenge:</u> Macro Productivity growth dismal since Global Financial Crisis; Output per hour 1981-2020



Source: ONS

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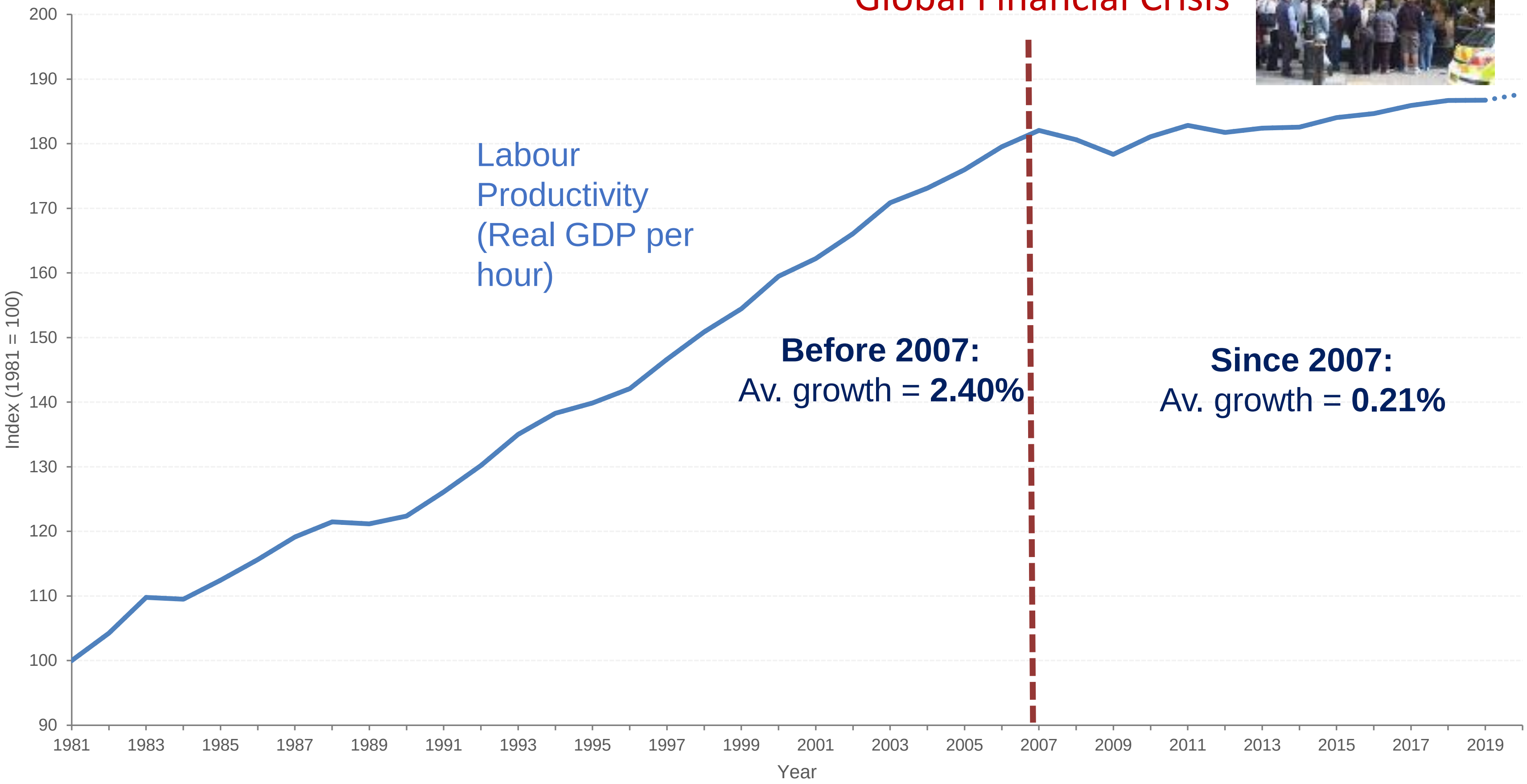
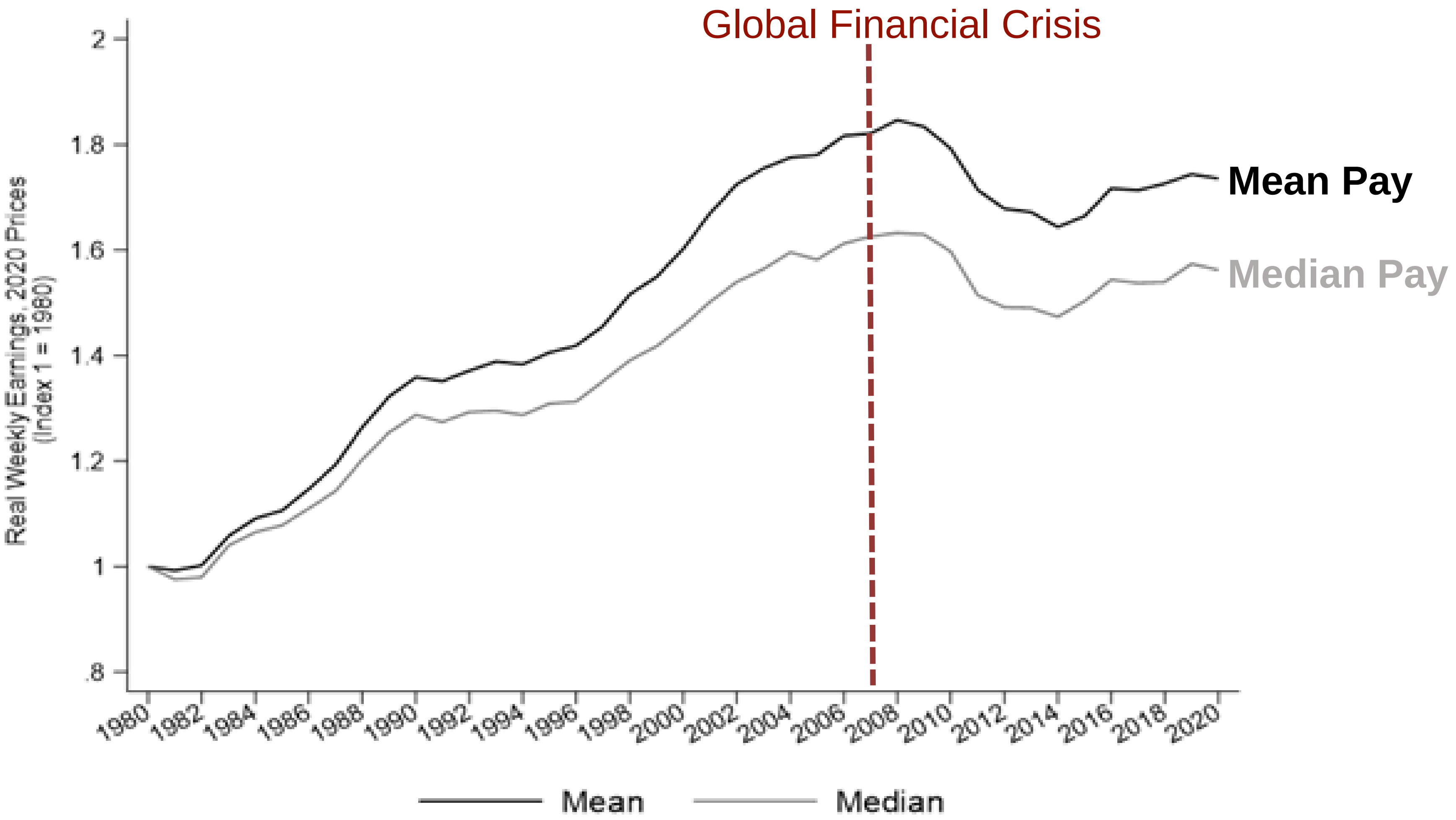


Source: ONS and OECD data

Mean and Median individual Wages have also both stagnated since Financial Crisis



Notes: ASHE data

OUTLINE OF TALK

Why Look at Inequality Between Firms?

$\boxed{\textbf{Firm level findings}}$

Explanations

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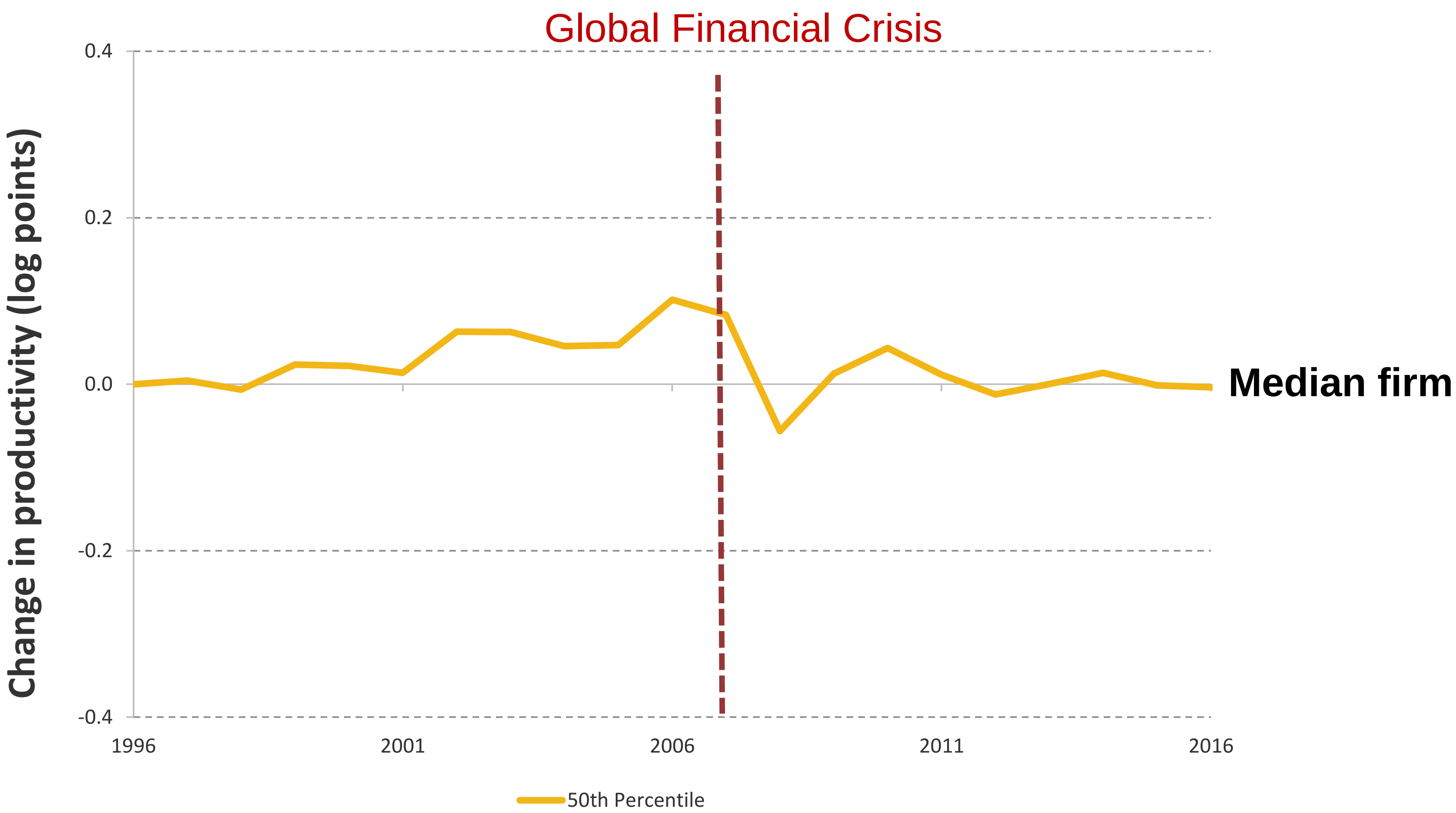
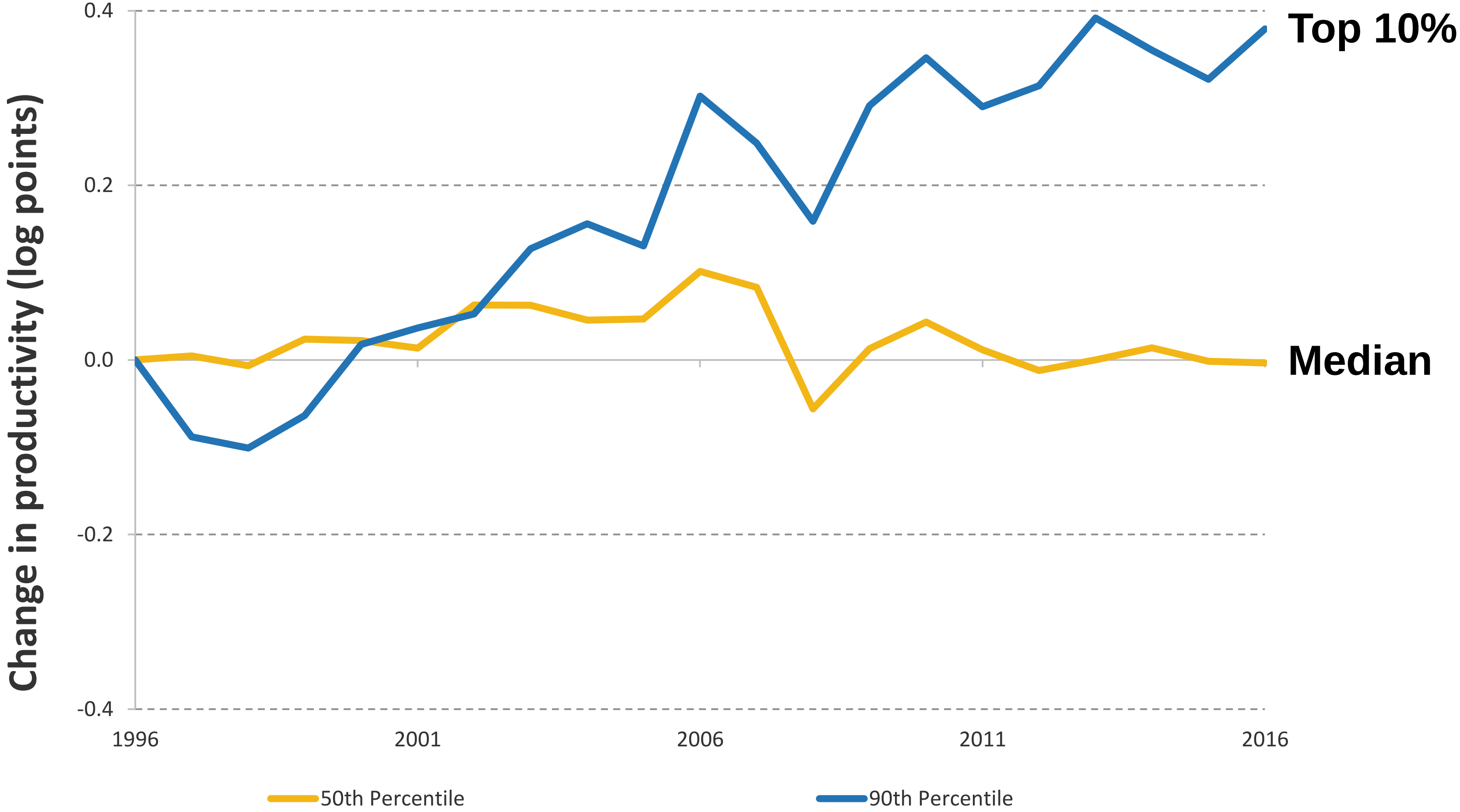
Productivity growth since 1996: Stagnation after Financial Crisis clear for median firm



Notes: Historical ORBIS, ln(value added/employee), quantiles weighted by firm employment; values indexed to zero in 1996; Changes in log points, so 0.05 = about 5% growth; 0.4 = ($e^{0.04}$ - 1)*100 = 50%

"The Best pull away from the Rest": Superstar Firms have strong productivity growth



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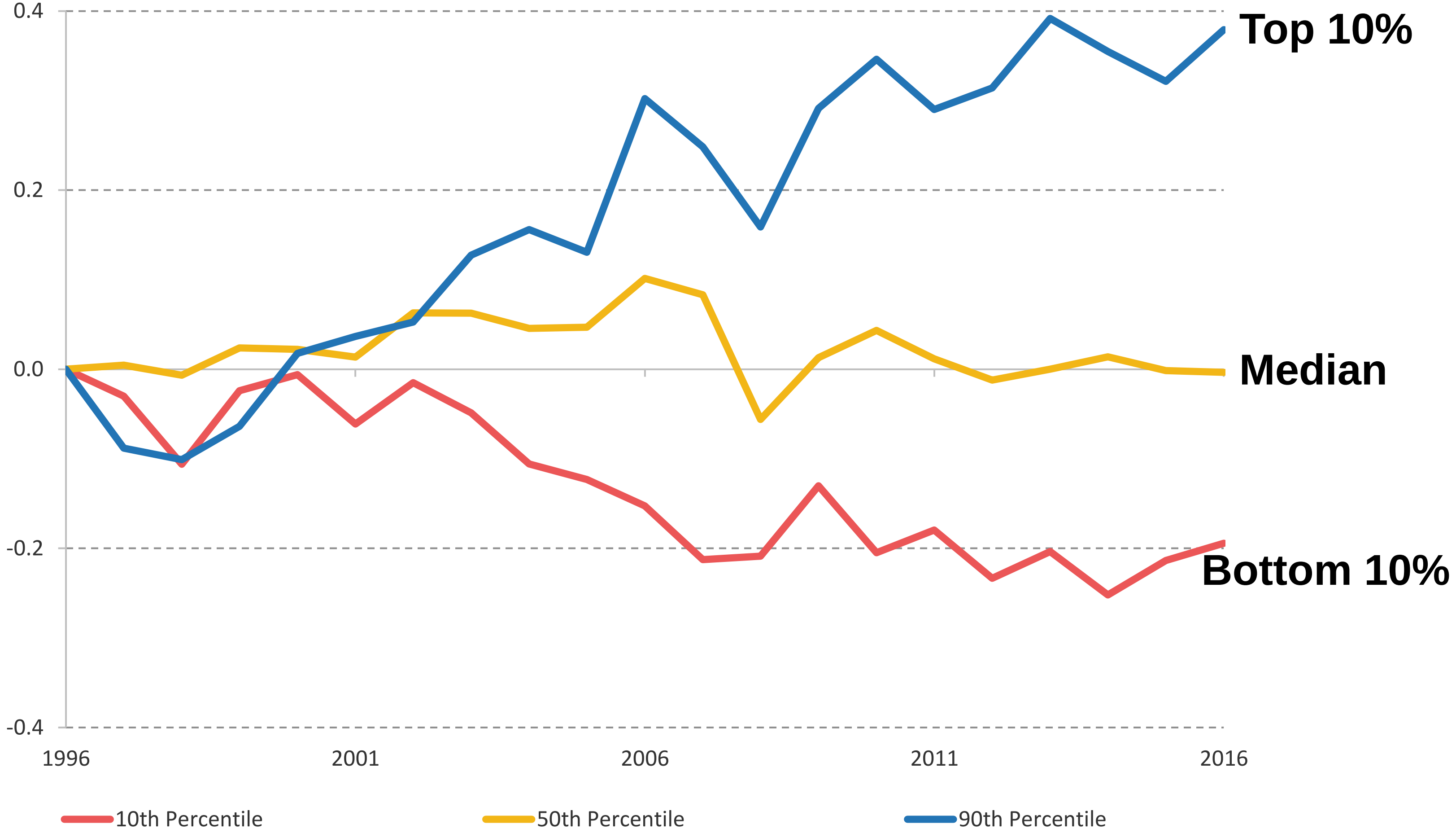
And poor productivity performance at the bottom of the distribution



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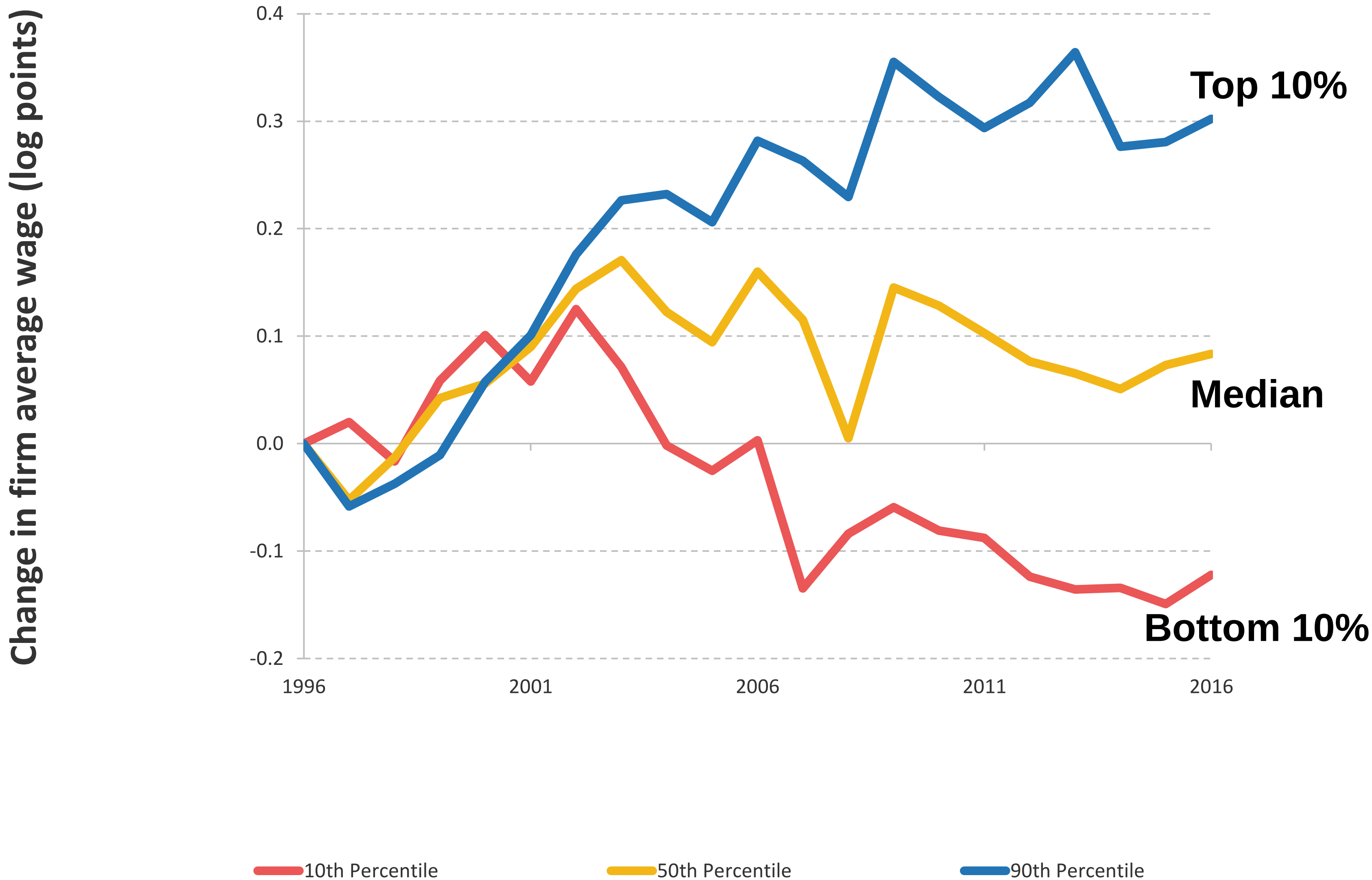
But what about Wages in these Firms?

Average Wages by firm have become increasingly dispersed, (like productivity)



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Comparing UK trends with US

Indicator	*UK*	*US*
Aggregate Productivity Growth	Slowdown since GFC	
Productivity Dispersion	Increase	
Aggregate Wage Growth	Slowdown since GFC	
Wage Dispersion	Increase	

Notes: GFC = Global Financial Crisis

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Aggregate Mark Up		
Mark Up Dispersion		
Aggregate Labour Share		
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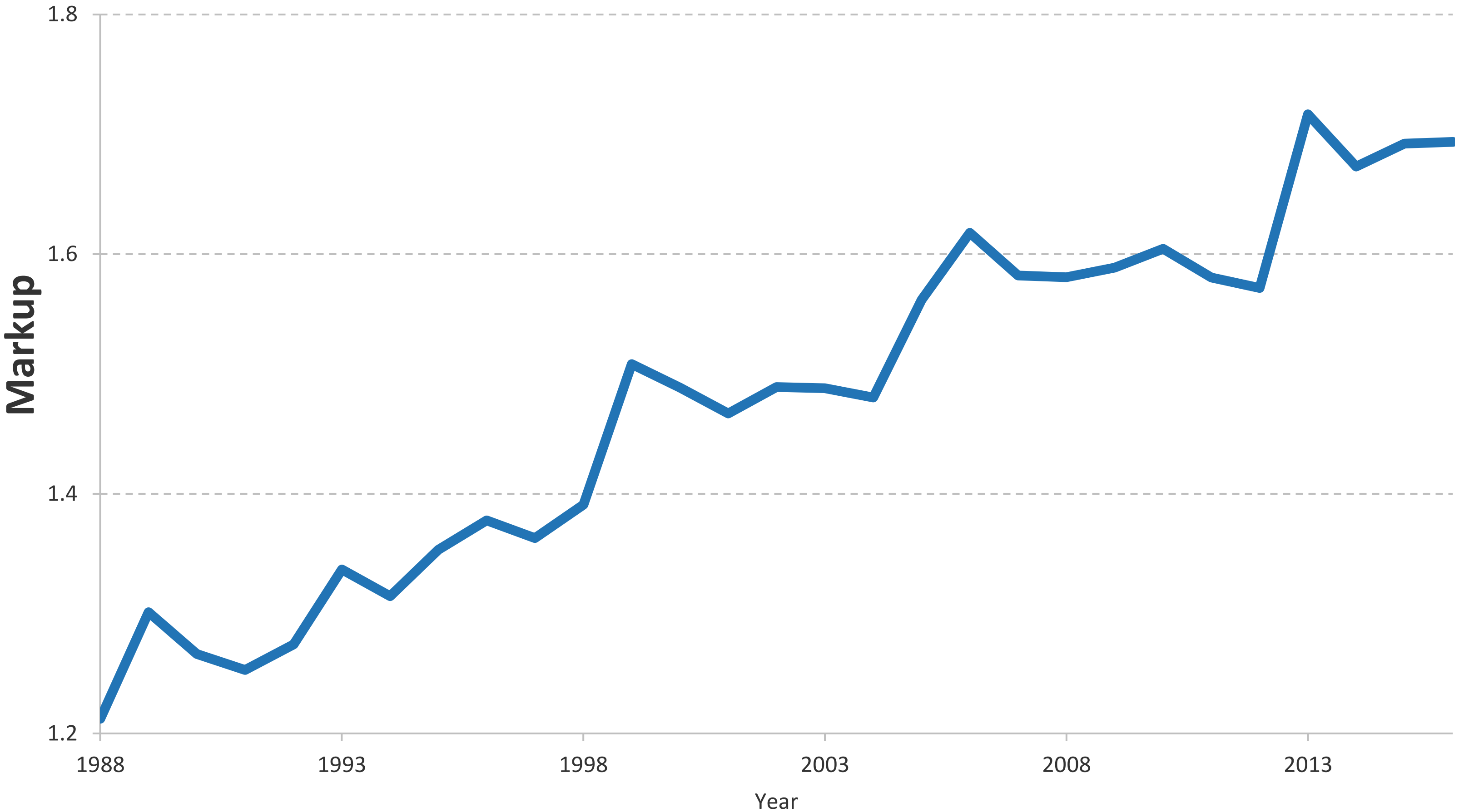
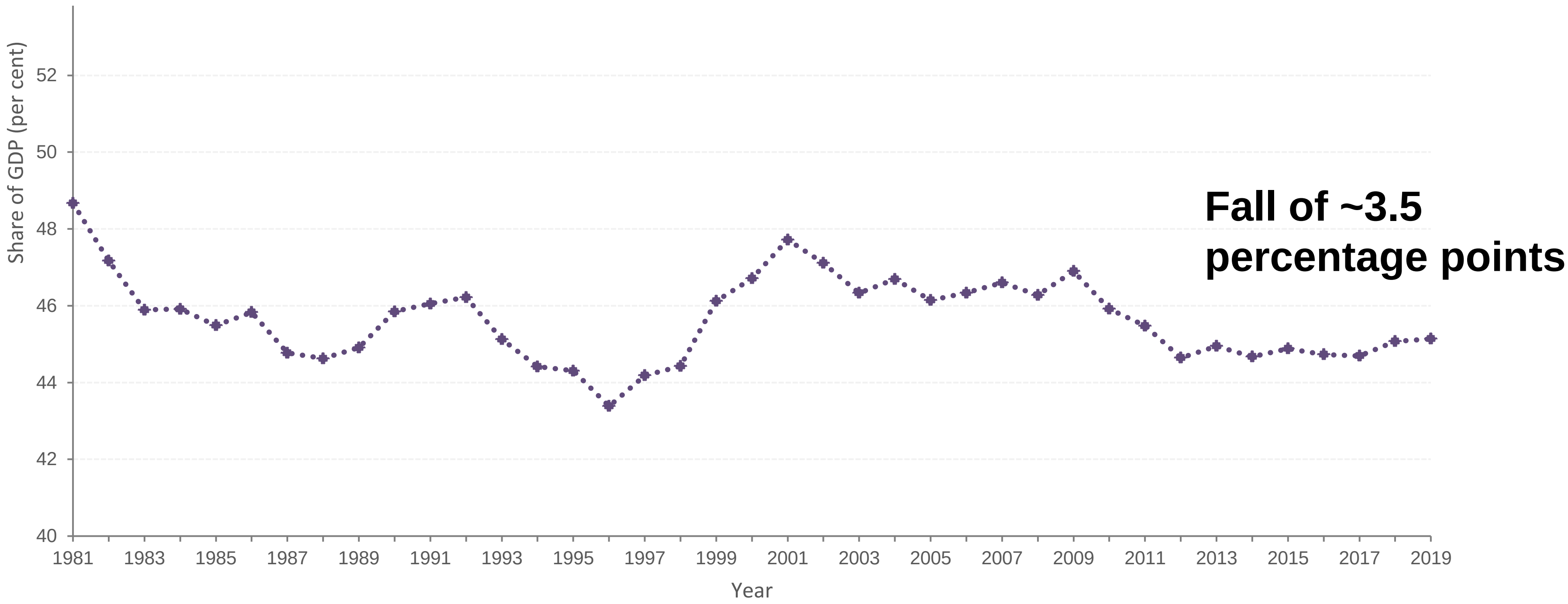
Aggregate markups (Prices/marginal cost) have also been increasing, 1988-2016



Notes: Worldscope (publicly listed firms), estimate of price/marginal costs using COGS/Sales and calibrated elasticity of output to variable costs of 0.85. Trends in markups of all firms (since 1996) looks broadly similar

UK Wage Share of GDP falls, 1981-2019 (smaller than US though)



Source: Teichgraeber and Van Reenen (2021) using ONS and OECD data.

Note: Wages and adjusted mixed income over GDP (excluding non-wage benefits of employees)

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Aggregate Mark Up	Increase	✓
Mark Up Dispersion	Increase	✓
Aggregate Labour Share	Decrease	✓
Labour Share Dispersion	Increase	✓
Average firm size	Increase	✓
Firm size (Concentration)	Increase	✓
Share of start-up activity	Decrease	✓

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OUTLINE OF TALK

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Firm level findings

$\boxed{\textbf{Explanations}}$

Policy

Three broad types of explanation

1. **Institutions**
   - Weaker enforcement of competition policy allowing superstar firms more market power
2. **Technology**
   - Network effects in digital industries: “Google effects”
   - Increased fixed costs/Intangible Capital (e.g. software): “Tesco effects”
   - Slower technology diffusion from superstar leaders to followers
3. **Globalization**
   - Reallocation effects (via product markets)
   - Multinational Global Value Chains (via input markets)

Assessment

- Striking similarity between UK and US
  - Suggests some **common factors** like technology rather than **purely** country-specific institutional explanations (like weakening competition enforcement in US)

- Labour Share falls less in UK than US, despite upward trend in price-cost mark up in both countries
  - Offset by fall in monopsony power in UK? 1999 introduction and uprating of the **minimum wage** (Draca, Machin & Van Reenen, 2011) whereas real value fell in US

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   - **Raising productivity** through long-term investments in innovation, skills & infrastructure. Address policy ADD

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3. **Labour market institutions** have been important countervailing force in UK (Minimum Wages)

   - Improving labour market regulation (e.g. in Gig economy)

Thanks!