To what extent do UK companies share their profits with employees? **Brian Bell**, **Pawel Bukowski** and **Stephen Machin** find that rent-sharing is on a much smaller scale today than during the 1980s and 1990s – and that the decline coincides with a rise in firms' product market power alongside a fall in workers' bargaining power.

Workers' falling share of firms' profits

Stagnating real wages and falling labour shares across developed economies have stimulated a renewed interest in the question of how, and to what extent, corporate rents are shared with labour. Nicholas Kaldor's (1957) long-held stylised fact that the fraction of national income going to labour is fixed has been questioned – for example, by Karabarbounis and Neiman (2013), who show that the global labour share has dropped from 65% in 1980 to 59% today.

Over the same period, US labour productivity has grown by 90% but the median real wage only by a paltry 10%. This has rekindled debates about whether growth benefits workers, which date from as far back as David Ricardo to the highly influential contemporary work of Thomas Piketty.

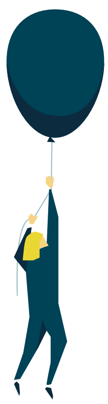
In response to these developments, researchers have again turned their attention to firms and their wage-setting processes. Building on the seminal work of Michal Kalecki (1938), CEP's former director John Van Reenen and co-authors have recently reconnected the distribution of income with the behaviour of firms and their market power (Autor et al, 2017).

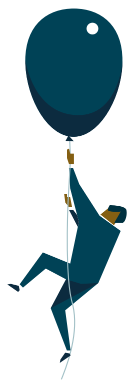
The question is: how does the power structure in product and labour markets translate into wage stagnation and a lower labour share? A classic argument says that workers lose bargaining power. This might affect 'rent-sharing' – that is, workers' ability to claim a portion of firms' profits.

Knowing how rent-sharing has evolved over time can therefore help us to understand changes in the position of workers within companies and shed light on the mechanisms behind the fall in the labour share. But the reality is that little is known about long-run changes in rent-sharing, in part owing to a lack of data.

Our new study aims to redress this by looking at the long-run evolution of rent-sharing among UK-domiciled

Rent-sharing has fallen since the early 2000s in the EU and since the 1970s and 1980s in the United States





companies. It features the compilation of a comprehensive and consistent panel of the top 300 companies (by market capitalisation) listed on the London Stock Exchange between 1983 and 2016.

The sample includes well-known UK companies, such as BP, British American Tobacco, G4S and Tesco, which have played an important role in the economy throughout the last few decades. It also covers all sectors of the economy, which is crucial given the dramatic shift from manufacturing to services in the UK since the 1980s.

The prime empirical focus of our study is to examine rent-sharing, and its variation over time, by estimating the elasticity of firm-level average wages with respect to firms' profits per employee, after accounting for all time-invariant firm characteristics and outside-firm forces shaping wages (for example, the unemployment rate, industry-level wages and other common effects over time). The profit-pay link may work in both directions, for example, when companies use 'efficiency wages'. We deal with the potential endogeneity by instrumenting firm-level profits with their lags or industry-average profits.

The first result to emerge is a positive and statistically significant rent-sharing parameter. Estimating over the whole sample, this rent-sharing elasticity is fairly modest in magnitude: a 1% increase in profits implies an increase of around 0.01% in wages.

The second, more novel result concerns the time series evolution of rent-sharing: there is a substantial fall in the long-run elasticity from 0.043% in the period 1983-2000 to 0.012% in the period 2001-16.

The finding of a significantly reduced rent-sharing parameter proves robust to various specification checks and alternative definitions of the sample. Moreover, the same result emerges for a panel of UK manufacturing companies, which provides data on domestic operations only.

In addition, industry-level data for the United States and for nine countries of the European Union (EU) show the same pattern. Consistent with the firm analysis, there is strongly falling rent-sharing for almost all countries: it dates from the early 2000s in the EU and from the 1970s and 1980s in the United States.

The elasticities might appear small, but one should keep in mind that profits can be extremely volatile, so even a small elasticity might have significant implications for wages.

To illustrate this, Figure 1 shows a rent-sharing-induced wage change

Figure 1:

The rent-sharing-induced wage change (%) caused by the rise of profits per employee by one standard deviation

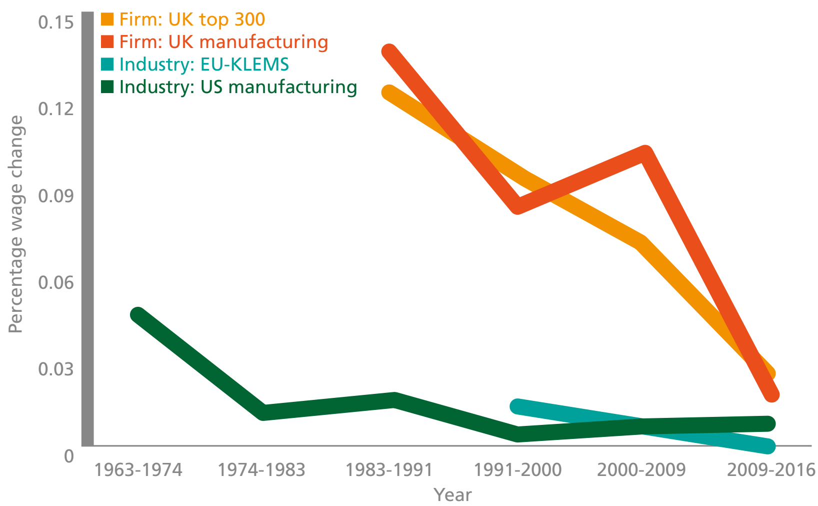
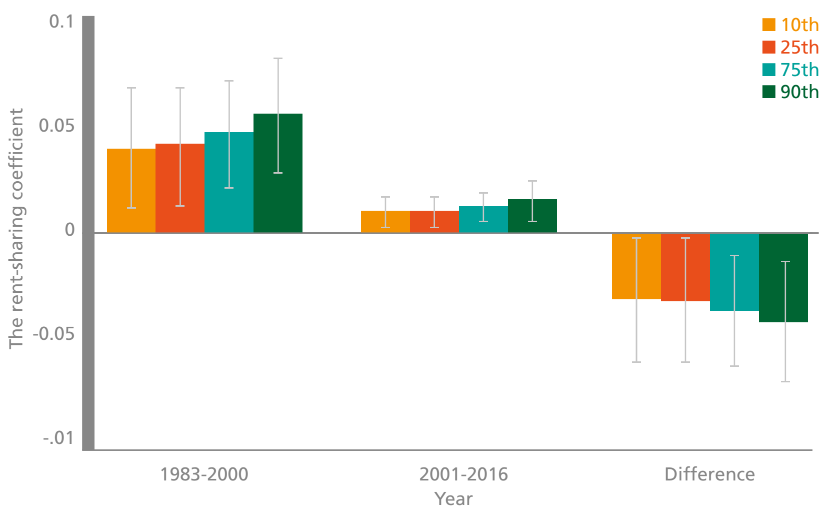


Figure 2:

Estimates of rent-sharing elasticity conditional on the percentile of firms' market power (measured by market share)



The fall in rent-sharing has been more pronounced among companies that enjoy monopolistic mark-ups caused by the rise of profits per employee by one standard deviation. For example, in our main sample (top 300, orange line), between 1983 and 1991, more profitable companies paid on average 12.2% higher wages only because of rent-sharing, compared with less profitable companies. After 2009, the gap narrowed to merely 2.6%, implying that companies shared profits with workers to a much lesser extent. Although the industry-level estimates are lower because they correspond to wage gaps between industries, they consistently show a sizeable fall in rent-sharing.

As mentioned above, recent research shows that the aggregate fall in the labour share is driven by companies with high market power (Autor et al, 2017). It is therefore natural to ask whether these companies are also responsible for the fall in rent-sharing.

Figure 2 shows the estimates of rent-sharing elasticity to be conditional on the percentile of firms' market power (measured by market share). On average, companies with higher market power share more of their rents than companies with low power. But the positive association between market power and rent-sharing is significantly weaker in the period 2001-16 compared with1983-2001. In other words, the fall in rent-sharing has been more pronounced among the companies that enjoy monopolistic mark-ups.

These findings have implications for debates about the future of work. A decline in rent-sharing contributes to a shift of income from labour to capital, and may encourage calls for a bigger role for redistributive policies.

It also suggests a fundamental change in the competitiveness of the labour market. A weaker bargaining position for workers might be a result of technological change ('robocalypse'), higher labour mobility and institutional change (for example, the decline of unions).

Finally, companies with higher market power experience relatively larger falls in rent-sharing, suggesting that competition policies should also be analysed from a labour market perspective. As these companies are increasingly global, with many having value chains connected across countries, one might expect these trends to become worldwide phenomena.

A decline in rent-sharing implies growing income inequalities and may encourage calls for more redistributive policies

This article summarises 'Rent Sharing and Inclusive Growth' by Brian Bell, Pawel Bukowski and Stephen Machin, CEP Discussion Paper No 1584 (http://cep.lse.ac.uk/pubs/download/dp1584.pdf).

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Further reading

David Autor, David Dorn, Lawrence Katz, Christina Patterson and John Van Reenen (2017) 'The Fall of the Labor Share and the Rise of Superstar Firms', CEP Discussion Paper No. 1482 (http://cep.lse.ac.uk/pubs/download/dp1482.pdf).

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Loukas Karabarbounis and Brent Neiman (2013) 'The Global Decline of the Labor Share', *Quarterly Journal of Economics* 129(1): 61-103.