RESEARCH BRIEF

Markups, Labor Market Inequality and the Nature of Work

Based on BFI Working Paper No. 2020-09, "Markups, Labor Market Inequality and the Nature of Work," by Greg Kaplan, professor, UChicago's Kenneth C. Griffin Department of Economics; and Piotr Zoch, UChicago economics PhD student.

KEY TAKEAWAYS

- ✓ Economists and policymakers have long considered labor to represent a single type of worker, associated with production or blue-collar work
- ✓ However, this research reveals that as much as one-third of labor is akin to expansionary work, or tasks that increase product mix or market share, for example
- ✓ This distinction matters because these two occupation groups do not share equally when, for example, markups occur and income distribution changes

Odds are, when you think of workers in a modern industrialized economy, you imagine all kinds of jobs, from those on factory floors and farms, to those in sales, marketing, and business development. You might also imagine that, over time, the percentage of people working in so-called blue-collar jobs, while still the majority, has decreased relative to white-collar workers.

Your presumptions are not only spot on, but they are closer to the mark than how most economic models view labor in the economy. At least until now. With the publication of their paper, "Markups, Labor Market Inequality and the Nature of Work," UChicago's Greg Kaplan and Piotr Zoch offer a more nuanced—and accurate—description of laborers that accounts for the type of work they do. While the bulk of the labor market conforms to the idea of workers making existing products for existing markets, up to about one-third of workers are employed in developing new products, getting products to market and expanding market share, among other tasks not directly involved in production.

This distinction matters. Economic models are the foundation for how economists and policymakers understand the way the economy works and how it responds to changes in policy.

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Figure 1 · Expansionary workers have gained in wages...

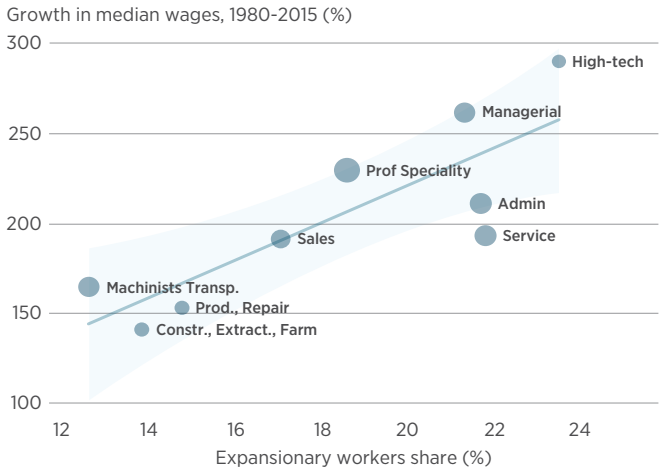
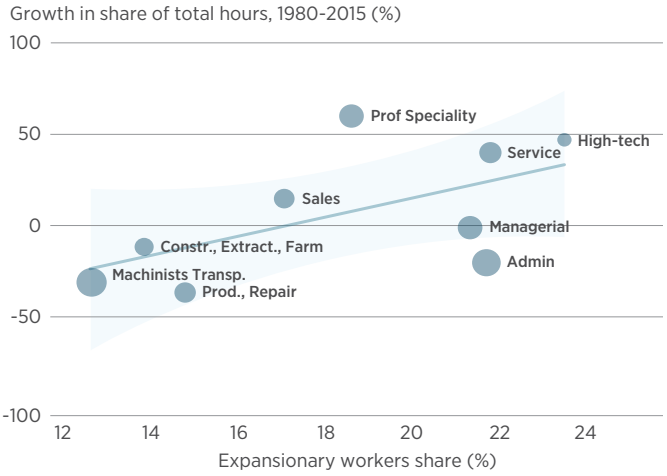


Figure 2 · ...and in hours, over production workers



But when these models treat all labor as essentially similar, they miss key differences in how various occupations experience swings in the economy. Kaplan and Zoch describe these differences and show how various occupations may respond differently to policy changes. Likewise, this more nuanced understanding of the labor market not only benefits economists and their models, but also policymakers charged with setting optimal policies.

Do rising markups lift all boats?

Before describing the authors' theoretical and empirical analyses of the two types of labor (we'll call them production and expansionary workers), let's review the meaning of markups and why they matter to economists and policymakers. Markups are simply the difference between the marginal cost that businesses pay for production inputs (or how much the next set of inputs will cost to keep producing the same item), and the price of the final good paid by consumers.

For macroeconomists, who focus on the aggregate economy, markups are a measure of an economy's competitive forces. In the long-run, an increase in markups is typically associated with a decline in competition and vice-versa. Thus markups are a useful yardstick for economists to understand the impact of industrial and trade policies on the economy.

In the short run, markups are also the main channel through which demand shocks (an event that suddenly increases or decreases demand) and monetary policy affect the economy in most macroeconomic models. For example, when the Federal Reserve increases interest rates, the contractionary force experienced by the economy, is driven in part by an increase in markups.

And this is where the authors make an important contribution: they develop a framework for understanding the effects of a change in markups on the distribution of income among workers, and hence for understanding how monetary policy ripples through the economy differently for different workers. To do this, they draw a distinction between production and expansionary workers, and they offer a new view on how and why wage and employment growth differs for different occupations.

With this as background, let's briefly review the authors' theoretical and empirical analysis of production and expansionary labor. In the first case, the authors use a model for production that reveals the following two theorems:

1. Whether an increase in markups leads to an increase or decrease in the labor share depends on the share of expansionary workers in the economy. For example, if all workers performed production activities, then a higher markup leads to a decrease in labor's share of income. However, if enough workers perform expansionary activities, then a higher markup can lead to an increase in the labor share. For economists and policymakers, this means that to understand

the impact of markups they have to know the makeup of the labor force.

2. Regardless of the impact of a change in the markup on labors' total income share, movements in markups always move income back and forth between production workers and expansionary workers. In particular, an increase in markups tends to shift income away from occupations that perform production activities and toward occupations that perform expansionary activities.

The authors then take this theoretical idea (that some workers lose while others gain following markups), and use it to interpret the post-war US labor labor market experience. They address such questions as how much of the US labor force performs production vs expansionary activities, and how has this mix changed over time?

On the first question, the authors find that between 20 and 35 percent of US labor income is paid for expansionary activities, with the remainder paid for traditional production activities. This is a significant finding, especially given that the existing economics literature—and, thus, the practicing models used by economists and policymakers—puts this number at 0. Also, the fraction of expansionary workers has been increasing since 1970.

How to distinguish between production and expansionary workers? Although almost all occupations peform a mix of the two activites, the authors offer the following broad groupings based on which occupations are more productive vs. expansionary in nature.

> Regardless of the impact on workers' total income when markups change, they always move income back and forth between these two types of workers. In particular, an increase in markups tends to shift income away from production workers and toward expansionary workers.

Production Occupations: those who make existing products

- Construction
- Extractive (e.g., natural resources)
- Production (e.g., manufacturing)
- Farming

Expansionary Occupation: those who generate revenue by expanding into new products and markets

- Managerial
- High-tech
- Administrative
- Service

Hybrid Workers: Those who exhibit both traits

- Professional specialties (e.g., law, medicine, academia, and sales)

As readers may intuit, the more expansionary occupations are more closely aligned with what is typically considered to be white-collar workers, while the more production occupations represent typical blue-collar work. However, it is important to note that these occupations are not grouped by income. Low-wage workers are just as likely to fall into the expansionary group, for example, and high-wage workers, especially among skilled labor, can exist within the production group. That said, as the figures in this Research Brief indicate, the authors find a strong positive correlation between expansionary workers and both wage growth and hours growth since 1980.

Conclusion

Economists have long made assumptions about the effects of markups on the economy without a full understanding of how those markups affect different types of occupations. This gap in knowledge has almost certainly hampered economists' and policymakers' ability to predict likely outcomes to various policy options. This paper addresses that gap by identifying distinct types of labor that, depending on their mix,

CLOSING TAKEAWAY

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alter the impact of policy decisions that change markups.

The authors differentiate between two uses of labor in modern economies: for production and expansion, and they demonstrate that some occupations exhibit more or less traits of each. This distinction matters because, for example, those occupations with an expansionary focus are those whose relative income share rises during a markup-induced rise in overall labor share. All workers, in other words, do not benefit equally (or experience similar declines).

The authors do not explore the policy implications for their findings, which is the subject of a forthcoming paper, but this work should give pause to central bankers concerned about the distributional effects of monetary policy, and to policymakers interested in the long-run income trends of traditional blue-collar and white-collar workers. More to come.

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