

Yasuyuki Osumi *Editor*

Structural Change, Market Concentration, and Inequality

A Multi-sector Analysis

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Preface

In recent decades, there have been widespread phenomena of the income inequalities and the decrease in labor share in the advanced countries. This volume aims at clarifying the mechanism of widening income inequality and labor share declining in macroeconomics, growth, technology, and labor market and provides policy implications. The volume covers three research themes. These themes contain the influence of structural change, the advancement of artificial intelligence, and the phenomena of market concentration on inequalities and labor share dynamics in theory and empirics. In this volume, the theoretical topics include the implications of unbalanced growth, economy-wide elasticity of substitution between capital and labor, relatively rising service sectors, superstar firm phenomena, automation, the heterogeneity of capital, increasing returns to scale, and the information and financial service sectors on inequalities and labor share decline. These analyses are based on multifactor, multisector general equilibrium framework, as well as imperfective competitive ones in both goods and labor markets. In addition, the volume covers the relevant empirical data analyses that involve top wealth dynamics in the US Forbes 400, the impact of deepening ICT capital on the labor share in Japanese main industries, and the emergence of increasing returns to scale in Japanese information and financial sectors.

Kobe, Japan
December 2023

Yasuyuki Osumi

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About the Editor

Dr. Yasuyuki Osumi is Professor of Economics at University of Hyogo in Japan and earned his Ph.D. from Kobe University. Throughout his career, he served as Visiting Scholar at esteemed institutions including the University of British Columbia in Canada, the Catholic University of Louvain in Belgium, and the University of York in the UK. His primary research interests lie in macroeconomics, economic growth, technological progress, and income distribution. Dr. Osumi has significantly contributed to the field, co-editing and co-authoring research books such as *Studies in Medium-Run Macroeconomics: Growth, Fluctuations, Unemployment, Inequality and Policy*, published by World Scientific, and *Technological Progress, Income Distribution, and Unemployment: Theory and Empirics*, published by Springer.

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Chapter 1

Introduction



Yasuyuki Osumi

Abstract In recent decades, there have been widespread global phenomena of inequalities of income and wealth and the decrease in labor share in the advanced countries and emerging economies since 1980s. This implies that stability of labor share as one of Kaldor's stylized facts in economic growth has been challenged. In the broadly sense, existing standard macroeconomic models, with implications for the production function, inequality, and macroeconomic dynamics, based on these stylized facts, cannot explain the changes of movement of income inequalities and labor share declining over the past 40 years. Many possible but not exclusive explanations have been presented. This volume focuses on three specific themes, which are structural change, artificial intelligence, and market concentration, and analyzes the implications of these themes on income inequalities and labor share declining.

In recent decades, there have been widespread global phenomena of inequalities of income and wealth and the decrease in labor share in the advanced countries and emerging economies since 1980s (Elsby et al., 2013; Karabarbounis & Neiman, 2014; Piketty, 2014). This implies that stability of labor share as one of Kaldor (1961) stylized facts in economic growth has been challenged. In the broadly sense, existing standard macroeconomic models, with implications for the production function, inequality, and macroeconomic dynamics, based on these stylized facts, cannot explain the changes of movement of income inequalities and labor share declining over the past 40 years.¹ Many possible but not exclusive explanations have been presented.

¹ Eggertsson et al. (2021) refer to the recent new facts as Piketty's fact. They compare Kaldor's with Piketty's facts and present alternative models based on Piketty's fact. See Eggertsson et al. (2021).

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1.1 Literature Review

A dozen of possible explanations for income inequalities and labor share declining are provided as follows.² Capital-augmenting technological change and the mechanization of production (Acemoglu & Restrepo, 2018, 2022; Blanchard, 1997; Grossman et al., 2017), a decline in the relative price of capital and elasticity of substitution (Eden & Gaggl, 2018; Hubmer, 2023; Hubmer & Restrepo, 2021; Karabarbounis & Neiman, 2014), capital accumulation (Piketty, 2014; Piketty & Zucman, 2014), capital composition distinguishing between traditional capital and information and communication (ICT) capital (Berg et al., 2018; Eden & Gaggl, 2019), globalization (Elsby et al., 2013; Harrison, 2002), and a decline in the bargaining power of labor (Blanchard & Giavazzi, 2003; Stansbury & Summers, 2020).

Besides, an increase in the cost of housing (Rognlie (2015), a rise in industry concentration and market power (Autor et al., 2020; De Loecker et al., 2020; Barkai, 2020; Baqaee & Farhi, 2020a; Eggertsson et al., 2021), a rise of “superstar” firms (Autor et al., 2020; Kehrig & Vincent, 2021), intellectual property products (IPP), (Koh et al., 2020), structural change (Alvarez-Cuadrado et al., 2018; Comin et al., 2021; Hubmer, 2021; Fukao & Perugini, 2021), and increasing return to scale (Lashkari et al., 2023; Wang & Wright, 2020; Baqaee & Farhi, 2020b, De Loecker et al., 2020).

In this volume, we categorize the chapters into three specific themes. These three themes focus on the implications of structural changes, artificial intelligence, and market concentration on income inequalities and labor share declining. The chapters discuss three related, but not distinct, topics of income inequalities and labor share declining. First, we deal with structural changes that include the phenomena of rising service sectors and declining manufacturing sectors in Chap. 2, the wealth concentration in the upper tail particularly in the information and financial industries in the U.S. economy in Chap. 3, and the superstar firm, reallocation of industrial sectors in the multisector dynamics in Chap. 4. Second, there are artificial intelligence that contains heterogenous capital and labor that are not only traditional capital and robot capital but also skilled labor and unskilled labor in Chap. 5, heterogenous capital and task-based growth model in Chap. 6, and the estimation of the effect of ICT capital on labor share in Japanese industries in Chap. 7. Third, the topics cover market concentration that involves automation and goods and labor markets in Chap. 8, information goods and increasing returns to scale in Chap. 9, and finally, the empirical investigation of increasing returns to scale in Japanese financial and information service sectors in Chap. 10.

Most chapters are based on the frameworks of multifactor, multisector general equilibrium model, task-based growth model, goods market and labor market imperfective competitive models. In addition, the chapters cover the relevant empirical

² See also the following survey of the topics of income inequalities and labor share declining: IMF (2017), OECD (2018), McKinsey Global Institute (2019), Agrawal et al. (2019), Cetto et al. (2019), Dao et al. (2019), Barkai (2020), Aum and Shin (2020), Gutierrez and Piton (2020), Grossman and Oberfield (2022), Karabarbounis (2023). For wealth inequality, see Hubmer et al. (2020).

data analyses that involve top wealth dynamics in the U.S. economy, the deepening ICT capital in Japanese main industries and the emergence of increasing returns to scale in Japanese information and financial sectors.

1.2 Part I Structural Change and Inequalities

Chapter 2, by Yasuyuki Osumi, is entitled “Structural Change, Service Sector Features, and Aggregate Elasticity of Substitution.” This chapter analyzes the behaviors of endogenous economy-wide elasticity of substitution that can influence growth and distribution and examines the possibility of labor share declining, focusing on some relevant features of service sector. Economies of scale in the production function can be shown as one of the significant features of the service sector, for instance, financial and information and communication service sectors. In contrast, features of the manufacturing sector are dealt with the constant return to scale in the production function. To capture these heterogeneous features, this chapter develops a two-sector general equilibrium model in the monopolistic competitive framework. The analysis shows that not only factor substitutability and commodity substitutability in the demand for goods, but also the property of economy of scale and its heterogeneity in the economy of scale in each sector are likely to make the aggregate elasticity of substitution enlarge and fluctuate. It implies that labor share can decline when rising service sectors and declining manufacturing sectors occur. Because higher elasticity of substitution between capital and labor in a macroeconomy has the possibility of being larger than unity, this can lead to a declining aggregate labor share.

Chapter 3, by Atsushi Miyake and Yasuyuki Osumi, is entitled “Structural Change and Evolution of Top Wealth: The American Forbes 400 list, 1990–2020.” Wealth distribution in the U.S. economy has been biased since late of twentieth century. This chapter analyzes wealth distribution by focusing on the Forbes 400 data from 1990 to 2020. They consider not only wealth concentration but also the source of wealth from data sources. The findings are as follows. First, the number of the richest members who made their wealth by themselves is increasing. Second, wealth-generating business has changed. E-commerce, digital media, and asset management business are more profitable in the twenty-first century. Third, the value of assets of the richest members in the retail trade industry grows fastest in the U.S. economy on average.

Chapter 4, by Harutaka Takahashi, is entitled “Toward A Theory of the Labor Share’s Fall: A Dynamic Model of the “Superstar Firm.” This chapter provides a multiple-firm optimal growth model as a benchmark model that provides a solid theoretical foundation for the superstar firm theory. One of the key findings in the new facts about a declining in the labor share is that the decline in the labor share is primarily driven by reallocation among firms, rather than the decline in the weighted average labor share within firms (between-firm effect). On the other hand, at the industry level, the aggregate macro labor share is mainly affected by within-industry effects (the movement of the labor share in each industry). Autor et al. (2020) propose

the “superstar” firm theory. That is, the aggregate labor share of an industry tends to decline as the most productive firms with the lowest labor share, called “superstar” firms, increasingly dominate the industry. However, their theory is analyzed within the framework of statics. This chapter provides the multi-firm optimal growth model that was intensively investigated by J. Scheinkman and L. McKenzie, under the title “Turnpike theory for multisector optimal growth model.” The results show that the superstar firm in each industry, which has the highest TFP rate, tends to dominate that industry and thus reduces the labor share, and show that when the same phenomenon occurs in each industry, the aggregate labor share will decline.

1.3 Part II Artificial Intelligence and Labor Share

Chapter 5, by Yasuyuki Osumi, is entitled “Robotics, Skill-Biased Technology and Labor Shares: A Four-Factor Case.” This chapter compares the effects of the robot capital technology and skill-biased technological progress on wage inequality and labor shares in both the short- and long-run, by focusing on a four-factor nested production function that has two heterogeneous capitals, which are robot capital and traditional capital, and two heterogeneous labors, which are skilled labor and unskilled labor. The main results show that in some relevant conditions, which are capital-skill complementarity and factor substitutability between robot capital and unskilled labor, in the short-run, both robot capital technology and skill-biased technical change can increase wage inequality and decrease aggregate labor share. However, even in the long-run equilibrium, the outcomes of both biased technical changes, which can lead to increasing wage inequality and decreasing aggregate labor share, are likely to be robust. However, if robot technology cannot continue infinity in the long-run balanced growth equilibrium, skill-biased technical progress may provide more wage inequalities and labor share declining in the long-run.

Chapter 6, by Kazunobu Muro, is entitled “Automation, Tasks, and Labor Share.” This chapter examines the effect of automation on economic growth and labor share, by distinguishing between traditional capital and automation capital in a task-based framework. The study shows that labor share is determined not only by a new task minus the automation threshold, but also by the elasticity of output with respect to labor in technologically non-automated tasks. In this setting, the aggregate CES production function is derived under the productivity specification, and moreover, the non-arbitrage condition between the two types of capital results in the aggregate Cobb–Douglas production function. In addition, automation prevents the marginal product of capital from diminishing and gives rise to sustainable growth. Extending a dynamic general equilibrium model, along the balanced growth path (BGP), the study shows that labor share depends on the ratio of traditional capital to automated capital, but not on the elasticity of substitution between automated capital and labor. However, a decrease in the ratio of traditional capital to automated capital can decrease labor share. This result supports the pessimistic view of Keynes and Leontief.

Chapter 7, by Kazuyuki Inagaki, is entitled “Impact of ICT capital on labor share: Evidence from Japan.” This chapter examines the empirical determinants of the labor share of income in Japan. The novelty of this empirical analysis is that it estimates the impacts of ICT and non-ICT capital intensities separately. This approach is motivated by the fact that, since the 1990s, the growth rate of ICT capital stock has been considerably higher than the growth rate of non-ICT capital stock (or traditional capital stock). Using a panel of 97 sectors in Japan for the period 1994–2015, this chapter shows that the deepening of ICT capital has a negative impact on the labor share. Furthermore, this negative impact is amplified after the 2000s, suggesting that the recent technological development significantly contributes to the reduction of the labor share in Japan.

1.4 Part III Market Concentration and Inequality

Chapter 8, by Kazunobu Muro, is entitled “Automation, Goods and Labor Markets Imperfections, and Labor Share.” This chapter analyzes the hypotheses that the decline in the labor share coincides with goods market concentration and the decline in the bargaining power of labor union, incorporating automation capital as well as traditional capital into the model with goods and labor market imperfections. This chapter shows that the labor share is an increasing and concave function with a degree of goods market competition. This implies that goods market concentration associated with the rising markup over cost decreases the labor share. With the low bargaining power of labor union, the labor share in the automation model is lower than that without automation for a valid degree of goods market competition, which implies that automation decreases the labor share. The labor share is an increasing function with the bargaining power of labor union. Moreover, the labor share in the automation model is a concave function with the bargaining power of labor. When automation capital exists, the decline in the bargaining power of labor decreases the labor share remarkably.

Chapter 9, by Atsushi Miyake, is entitled “Increasing Returns to Scale and Declining Labor Share in the Information Economy.” Information plays an important role in the recent economy and the information sector is hugely expanding. In addition, the phenomenon of declining labor share is observed in recent decades worldwide. This chapter develops a model in which the economy uses the information as a factor of production. Whereas the final goods sector is constant returns to scale, the increasing returns to scale prevails in the information sector. There are two situations in the economy, poverty trap and permanent growth. If the economy sustains permanent growth, then the labor share continues to decrease as the economy grows.

Chapter 10, by Atsushi Miyake and Yasuyuki Osumi, is entitled “Firm Size, Rate of Return on Capital, and Increasing Returns to Scale—The Japanese Financial and Information Communication Service Sectors—.” Parallel to the increasing income

inequalities in OECD countries, a few large firms have become mega giants, generating superstar firms, particularly in the financial and information communication service sectors. This implies that increasing returns to scale can produce this winner-take-most phenomenon in these service sectors. This chapter empirically analyzes the hypothesis that these industries show increasing returns to scale by investigating the correlation between firm size and the rate of return on capital in Japanese main industries. This chapter focuses on Japanese service sectors including banking and information and communication service industries as well as some Japanese manufacturing sectors. The results show a positive relationship between firm size and the rate of return on capital in most service sectors. Thus, economies of scale are most likely to prevail in these service sectors even in Japanese economy, which suffered a prolonged stagnation. Conversely, in the Japanese manufacturing sectors, such as transportation equipment and electrical machinery, equipment, and supplies, the trend in the rate of return on capital by firm size can synchronize. Thus, this finding suggests that these manufacturing sectors are characterized by constant returns to scale.

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