Discussion of "International Diversification, Reallocation, and the Labor Share" by David, Ranciere and Zeke

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One-slide summary

1. Aggregate labor share has declined in the US and other developed countries. But firm-level labor share is increasing.
2. Model with risk-averse firm owners: quantity and price of firm-specific risk drives labor share.
   - Predicts within-firm increases and reallocation towards low-labor-share firms.
3. Additional predictions confirmed in Compustat data:
   - Risky firms have lower labor share.
   - Firms with foreign equity are more responsive to risk.

Outline

1. Intuition for the main mechanism
2. Are public firms representative of the economy?
3. Can we replicate the results in Hungary?

Risk-adjusted profit maximization

$$\max_L \mathsf{E}[AF(K,L) - wL]$$

vs

$$\max_L \mathsf{E}[\Lambda[AF(K,L) - wL]]$$

Intuition

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Firm is a *leveraged* portfolio with a risky asset Q and a safe liability L.

Key assumption: labor is less risky than capital.

Optimal leverage depends on risk-return tradeoff: higher risk means lower leverage.

Glossary

labor
inputs decided before uncertainty is resolved

labor share
leverage ratio

low-labor-share firm
high excess-return portfolio

Are public firms representative of the economy?

Volatility trends differ for public and private firms (Comin and Philippon 2006 vs Davis et al 2007)

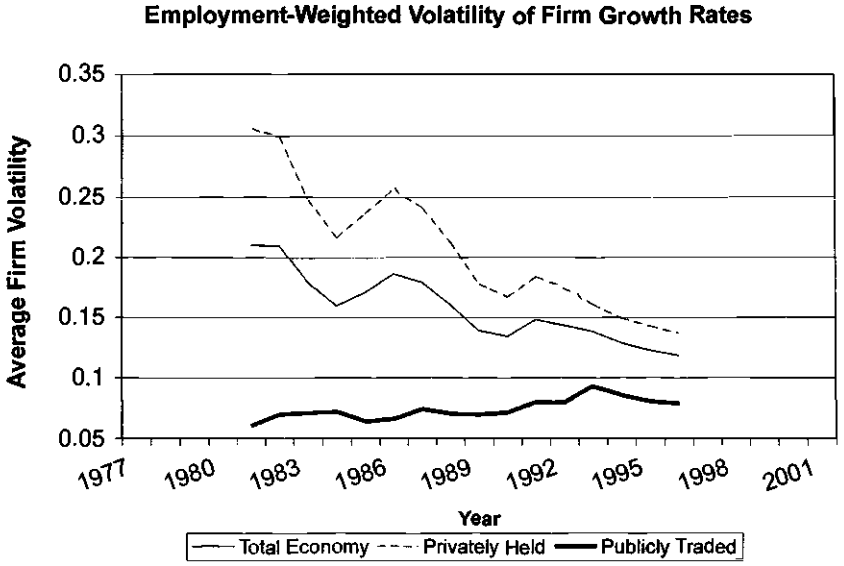

Figure 1: Davis et al 2007 (Figure 2.5)

Can we replicate the results in Hungary?

Data from Hungary

Universe of corporations, 1989-2019: 870k businesses, of which 99% are private.

Labor share: personnel costs / value added (as in paper)

Firm beta: 2-year growth rate of log sales on log aggregate growth (unlike in paper)

Higher beta firms have lower labor share

Beta portfolio	Mean labor share
0	0.619
1	0.589
2	0.523
3	0.457
4	0.456

Bigger firms have lower labor share

Size portfolio	Mean labor share
0	0.785
1	0.725
2	0.665
3	0.582
4	0.508

Except for largest firms, labor share is driven by size, not beta

Beta	Size 0	Size 1	Size 2	Size 3	Size 4
0	0.772	0.702	0.640	0.527	0.621
1	0.786	0.732	0.664	0.596	0.587
2	0.788	0.741	0.680	0.594	0.519
3	0.775	0.723	0.663	0.574	0.449
4	0.787	0.720	0.661	0.580	0.441

Conclusion

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Great to bring in asset pricing and portfolio choice in production problems.

Helps reinterpret real metrics (markup, labor share) as financial (risk premium, leverage).

But: finance and risk of private firms very different from those of public firms.

Smaller points

What if markets are incomplete? Λ_{it} rather than Λ_t

Cattaneo et al (2023) "On Binscatter": cannot do covariate adjustment before binscatter