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Labor Income Share, Imperfect Competition and the Capital-Labor Substitution

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ABSTRACT

Under the assumptions of a Cobb-Douglas production function and perfect competition, the labor income share is expected to be constant. In this paper we relax these assumptions and search for how much the labor income share variation in Turkey during the period 1987-2011 can be explained by an elasticity of substitution and how much by non-perfect competition. For this, we estimate the degree of imperfect competition in the product market and the elasticity of substitution under imperfect competition. The degree of imperfect competition is measured through a time series estimation of the price markup following the dual approach. It indicates that the elasticity of substitution is below one in Turkey. We also find out that the price markup drives the elasticity of substitution away from one downwards. From these empirical results we characterize the Turkish labor market and its aggregate technologies.

KEYWORDS Labor Share; Elasticity of Substitution; Imperfect Competition

JEL E1, E12, E2