The Large Firm Pay Premium Redux

Nicholas Bloom (Stanford)
Fatih Guvenen (Minnesota)
Brian Lucking (Stanford)
Ben Smith (UCLA)
Jae Song (Social Security Administration)
Till von Wachter (UCLA)

NBER, October 2018
A very old topic - data goes back to 1905

### TABLE I.—Mean Daily Wages of Italian Women According to Their Ages and the Sizes of the Establishments in Which They Were at Work

<table>
<thead>
<tr>
<th>Age of Employees</th>
<th>Mean Daily Wages Received in Establishments with</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Less than 20 Employees</td>
</tr>
<tr>
<td>15–20</td>
<td>.87</td>
</tr>
<tr>
<td>20–35</td>
<td>1.09</td>
</tr>
<tr>
<td>35–55</td>
<td>1.05</td>
</tr>
<tr>
<td>Above 55</td>
<td>.92</td>
</tr>
</tbody>
</table>

"Il progresso dell’Economia politica dipenderà pel futuro in gran parte dalla ricerca di leggi empiriche, ricavate dalla statistica, e che si paragoneranno poi colle leggi teoriche note, o che ne faranno conoscere di nuove." **Pareto.**
Many papers over the decades also similar findings of a large firm pay premium – e.g.

Slichter (1950)

Lester (1967)

Brown and Medoff (1989)

Oi and Idson (1999)
Our Large Firm Wage Premium (LFWP) Paper

Use two massive datasets – SSA data on all W2 pay slips since 1978 and Census data on all firms since 1976, finding:

1. LFWP falls by about 50%, mainly due to falling large firm AKM Fixed-Effect (not due to less worker sorting)

2. Appears to particularly impact lower paid/educated workers

3. Associated with two industry factors in particular:
   • Shrinking manufacturing (which has a high LFWP)
   • Growth of low paying service sector (e.g. big-box retail)
Outline

1) Data (SSA and Census Data)

2) SSA results

3) Census Data

4) Implications for inequality
Social Security Administration (SSA) data is the Master Earnings File (MEF)

Universe of all W-2s from 1978 to 2013 (about 100m per year)

For each job: SSN, EIN and total compensation:
“Total compensation includes: wages, salaries, tips, restricted stock grants, exercised stock options, severance payments, & all other types of income considered remuneration for labor services by the IRS.”
## Example W2

### W-2 Wage and Tax Statement

<table>
<thead>
<tr>
<th>Field</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>22222</td>
<td>Void [ ]</td>
</tr>
<tr>
<td>000-00-0000</td>
<td>Employee’s social security number</td>
</tr>
<tr>
<td>999-99-9999</td>
<td>Employer identification number (EIN)</td>
</tr>
<tr>
<td>1,000,000</td>
<td>Wages, tips, other compensation</td>
</tr>
<tr>
<td>c</td>
<td>Employer’s name, address, and ZIP code</td>
</tr>
<tr>
<td>d</td>
<td>Control number</td>
</tr>
<tr>
<td>e</td>
<td>Employee’s first name and initial</td>
</tr>
<tr>
<td>f</td>
<td>Employee’s address and ZIP code</td>
</tr>
<tr>
<td>g</td>
<td>State</td>
</tr>
<tr>
<td>h</td>
<td>Employer’s state ID number</td>
</tr>
<tr>
<td>i</td>
<td>State wages, tips, etc.</td>
</tr>
<tr>
<td>j</td>
<td>State income tax</td>
</tr>
<tr>
<td>k</td>
<td>Local wages, tips, etc.</td>
</tr>
<tr>
<td>l</td>
<td>Local income tax</td>
</tr>
<tr>
<td>m</td>
<td>Locality name</td>
</tr>
</tbody>
</table>

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Department of the Treasury—Internal Revenue Service

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Cat. No. 10134D
What is an **EIN** (Employer Identification Number)?

Any firm with an employee (so issues a W-2) must have an EIN.

Bureau of Labor Statistics uses the EIN as its definition of a firm.

Many organizations have one (e.g. Facebook, Walmart Stores).

Others have many, e.g.

- Stanford has 4 EINs (1 for the university, 1 for each hospital and 1 for the bookstore).
- The 6165 public companies in D&B have 19,969 EINs.
Individual earnings percentiles
(10%=$10k, 50%=$40k, 90%=$100k, 99%=$350k)
Firm size percentiles: unweighted & emp weighted

Unweighted, Median = 3 employees

Employee weighted, Median = 1000 employees
Census data is Longitudinal Business Database

Contains all establishments from 1976 to 2015

Census groups into firms based on ownership and control

Industry defined by largest employment across establishments

Earnings data from the IRS, so similar W2 definition as SSA
Outline

1) SSA Data

2) SSA Results

3) Census Results

4) Implications for inequality
LFWP measured by yearly regression coefficient of log(earnings) on log(size) - falls by ≈50% since 1970s
Increase in earnings from 100 to 10,000 person firm

Pay increase moving from 100 to 10,000 employee firm, %

- 1980-1984: 47%
- 1985-1989: 44%
- 1990-1994: 41%
- 1995-1999: 31%
- 2000-2004: 27%
- 2005-2009: 22%
- 2010-2013: 20%
Analysis with the Abowd, Kramarz and Margolis (1999) and Card, Henning and Kline (2013) Model

Statistical Model for Individual Log Annual Earnings

\[ y_{ijt} = \alpha_i + \psi_j + X_{ijt} \beta + \epsilon_{ijt} \]

- Fixed worker component \( \alpha \) (e.g. education, innate ability, etc.)
- Fixed firm component \( \Psi \) (e.g. rent sharing, efficiency wages, etc.)
- Time varying worker characteristics \( X \) (here age and age squared)

Estimate Separately in 7-Year Intervals from 1980 to 2013

- 1980-1986 (first): 5.2m firms, 65m workers, 332m worker years
- 2007-2013 (last): 5.2m firms, 81m workers, 414m worker-year

Details in Song et al. (forthcoming 2019)
AKM regression equation: $y_{it} = \alpha_i + \psi_{j(i,t)} + x'_{it}/\beta + r_{it}$

1980-1986

Firm size groups: 1=1-10, 2=10-50, 3=50-250, 4=250-1K, 5=1-2.5K, 6=2.5-10K, 7=10-15K, 8=15K+
AKM regression equation: $y_{it} = \alpha_i + \psi_j(i,t) + x_{it}'\beta + r_{it}$
Almost 90% of the decline in the large firm wage premium comes from the fall in the firm effect.
Fall in LFWP more for lower end workers: earnings

Figure 3. Relationship Between Firm Size and AKM Match Component by WFE Quartile
Fall in LFWP more for lower end workers: education

**Figure:** LFWP for Two Education Groups, Relative to Firm Size 100 or Less

High-School or Less

College or More

Outline

1) SSA Data

2) SSA result

3) Census results

4) Implications for inequality
Census data similar 44% drop in LFWP

Notes: Obtained from firm-level data in the US Census Longitudinal Business Database. Results from annual employment-weighted regressions. The Y-axis represents the increase in log(firm mean wage) associated with a given increase in log(firm employment). Regressions run for each year with firm-employment weights.
Composition accounts for $\approx \frac{1}{4}$ of the LFWP drop

Notes: Obtained from firm-level data in the US Census Longitudinal Business Database. The solid line shows estimated from annual employment-weighted regressions. The dotted line shows estimates from regressions weighted by employment*(industry employment in 1976/industry employment in year t).
Composition change reflects mainly the shrinkage of manufacturing, which has a high LFWP.

Notes: Obtained from firm-level data in the US Census Longitudinal Business Database. Results from employment-weighed regressions using data from 1980. LFWP defined as regression coefficient of log(mean wages) on log(firm employment) by industry and year.
Industry characteristic changes also matter: low pay industries (e.g. retail & admin) now have larger firms

Notes:
Obtained from firm-level data in the US Census Longitudinal Business Database. The fitted lines are weighted by industry employment shares.
Controlling for industry composition and characteristics accounts ≈2/3 of the fall in LFWP

Notes: From US Census Longitudinal Business Database. The black line shows the benchmark regression estimates from annual employment-weighted regressions. The red line adds industry fixed effects. The Y-axis represents the coefficient from regressing log(average wage) on log(firm employment) by year.
Remaining 1/3 due to drops of LFWP within individual industries – in particular Retail

Notes: From US Census Longitudinal Business Database. Results from regressions of log(average wages) on log(firm employment) by industry and year. Industry line thickness scaled to average employment share from 1978 to 2015.
Summary

1. LFWP falls by about 50%, mainly due to falling large firm AKM Fixed-Effect (not due to less worker sorting)

2. Appears to particularly impact lower paid/educated workers

3. Associated with two industry factors in particular:
   • Shrinking manufacturing (which has a high LFWP)
   • Expansion of low paying service sector (e.g. big box retail)
Outline

1) SSA Data

2) SSA result

3) Census results

4) Implications for inequality
Two offsetting impacts on inequality

(1) Large firms pay more, so reducing the LFWP reduces **between firm** inequality

(2) LFWP falling faster for lower-end workers, increasing **within firm** inequality
Firms $100 \leq \text{employees} < 1k$, percentiles since 1981

Source: “Firming up inequality” (2019), Song, Price, Guvenen, Bloom and von Wachter
Firms 10k≤employees, percentiles since 1981

Source: “Firming up inequality” (2019), Song, Price, Guvenen, Bloom and von Wachter
Summing up: LFWP falling from above at the bottom

Notes: Large firms 10k+ employees, small firms 100-999 employees. Source: Song et al. (2019)
Find that the net impact of decline in the LFWP probably relatively small

The fall in LFWP reduces between firm size class inequality

This fall in between firm size class inequality from the falling large firm AKM firm-effect

Within firm size class inequality rising from more sorting & segregation (Song et al. 2019)

<table>
<thead>
<tr>
<th>Panel A: Between-/Within-Firm Size Class Variance Decomposition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interval 1</td>
</tr>
<tr>
<td>(1)</td>
</tr>
<tr>
<td>Total Variance</td>
</tr>
<tr>
<td>Between Variance</td>
</tr>
<tr>
<td>Within Variance</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel B: AKM Components of Between-Firm Size Class Variance</th>
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</thead>
<tbody>
<tr>
<td>Var Worker Effect</td>
</tr>
<tr>
<td>Var Firm Effect</td>
</tr>
<tr>
<td>Cov Worker-Firm Effect</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel C: AKM Components of Within-Firm Size Class Variance</th>
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</thead>
<tbody>
<tr>
<td>Var Worker Effect</td>
</tr>
<tr>
<td>Var Firm Effect</td>
</tr>
<tr>
<td>Cov Worker-Firm Effect</td>
</tr>
<tr>
<td>N (millions)</td>
</tr>
</tbody>
</table>

Table 3—Between-/Within-Firm Size Class Variance Decomposition

Notes: Firms are groups into 5 classes based on the size of their workforce: 1 to 20, 21 to 100, 101 to 1000, 1001 to 10000, and over 10000.
Conclusions

1. US large-firm wage premium (LFWP) has been falling for over 30 years, and now about half of its value in 1980.

2. Appears to due to large firms are cutting their pay premium.

3. Fall in LFWP particularly for lower education employees.

4. Declining manufacturing and expanding services (e.g. big-box retail) appears to account for much of this.
Back Up
The disappearing large-firm wage premium seems to come from a falling large-firm AKM fixed-effect – in other words, large-firms no longer pay “extra”
In numbers, almost 90% of the drop is from the decline in the firm effect.

<table>
<thead>
<tr>
<th>Interval 1: 1980-86</th>
<th>Dependent Variable:</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Log Earnings (1)</td>
</tr>
<tr>
<td>0.080</td>
<td>0.016</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Interval 5: 2007-13</th>
<th>Dependent Variable:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Log Earnings (1)</td>
</tr>
<tr>
<td>0.039</td>
<td>0.019</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Change Share (Percent)</th>
<th>-0.041</th>
<th>0.003</th>
<th>-0.036</th>
<th>-0.008</th>
<th>0.000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share (Percent)</td>
<td>-</td>
<td>(-7.5)</td>
<td>(86.8)</td>
<td>(20.2)</td>
<td>(0.5)</td>
</tr>
</tbody>
</table>

**Table 1—Change in LFWP Regression Coefficients by AKM Components**
The firm size and earnings correlation: 1978-2013