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“Where Did the Productivity Growth Go?
Inflation Dynamics and the Distribution of Income”
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Starting from the standard Gordon inflation model, which explains price changes by inertia, demand shocks, and supply shocks but excludes wages, the first part of this paper returns wages to the analysis by developing a model that includes both price and wage equations. The model allows for feedback between the two and captures the effect of changes in trend productivity growth on inflation, nominal wages, and labor’s income share. In dynamic simulations, changes in the productivity growth trend strongly boosted inflation during 1965-79 and slowed it between 1995 and 2005. The paper’s second part links the productivity growth analysis to changes in the income distribution. It finds, using IRS data, that only the top decile experienced real wage and salary income growth equal to or above average economywide productivity growth. And increasing inequality *within* the top decile was as important a source of growing inequality as the gap between the top and bottom deciles.

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