

## **MaCurdy meets McFadden**

**David Berger, Kyle Herkenhoff, Jaehun Jeong, and Simon Mongey**

*Abstract :*

We study labor market power with worker heterogeneity. Workers with MaCurdy (1981) preferences and heterogeneous wealth choose which firm to work at and how many hours to supply. Firms set wages understanding that wealthier workers are less sensitive to pay, giving their employers more market power. High-productivity firms endogenously attract these less elastic workers, generating wider markdowns at the top. The model matches matched employer-employee wage decompositions, cross-sectional patterns of labor supply elasticities across workers and firms, and quasi-experimental estimates of how unearned income affects earnings. In preliminary calibrations, worker wealth composition accounts for roughly 30 percent of cross-firm variation in markdowns. Progressive taxation amplifies market power by reducing workers' responsiveness to wages, weakening sorting, and lowering output, with roughly half the loss operating through a reallocation channel absent from standard models of optimal taxation.