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The Elusive Explanation for the Declining Labor Share

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Abstract

A vast literature seeks to measure and explain the apparent decline in the labor share in national income that has occurred in recent times in the United States and elsewhere. The culprits include technological change, increased globalization and the rise of China, the enhanced exercise of market power by large firms in concentrated product markets, the decline in unionization rates and the erosion in the bargaining power of workers in labor markets, and the changing composition of the workforce due to a slowdown in population growth and a rise in educational attaintment. We review this literature, with special emphasis on the pitfalls associated with using cross-sectional data to assess this phenomenon and the reasons why the body of papers collectively explains the phenomenon many times over.

1. INTRODUCTION

From the earliest days of the discipline, economists have fixated on the labor share in national income. Already in *The Wealth of Nations*, Adam Smith (1776, p. 155) noted that aggregate output could be decomposed into shares that accrue to the various "original sources," one of these being labor, and that the distribution of "the whole annual produce" to wages, rents, and profits was closely associated with inequality in a society's standards of living. Kuznets et al. (1941), Brown & Hart (1952), Johnson (1954), and others made early efforts to classify income according to the "functions performed by the recipients" (Kuznets et al. 1941, p. 80), corroborating what Keynes (1939, p. 48) had called "one of the most surprising, yet best-established, facts in the whole range of economic statistics," namely the "stability of the proportion of the national dividend accruing to labour, irrespective apparently of the level of output as a whole and of the phase of the trade cycle." Kaldor (1961) famously tagged the constancy of the labor share as the first of his stylized facts about economic growth.

Fascination with the labor share has hardly faded with time; on the contrary, it seems to have exploded of late. This explosion reflects what many believe to have been a significant decline in the labor share after more than a century of stability. Literally thousands of papers have appeared to discuss the timing, magnitude, and geographic scope of this apparent drop. As many papers, or even more, have proposed explanations for the seeming break with history. A search of the Google Scholar website for the joint appearance of the phrase "labor share" and the word "decline" generates a list of more than 12,000 books, articles, and papers written in the last decade alone.

Obviously, we cannot recount the contributions of more than 12,000 authors in a short review. Our goal is more limited. We will briefly explore why so much effort has gone into measurement and why that effort has yielded such a wide range of conclusions. Then we will turn our attention to the many proposed explanations for the recent history. We aim to highlight the commonalities across these stories and to understand why, collectively, they have explained the phenomenon many times over. A common theme in what follows will be the distinction between partial and general equilibrium or, what amounts to the same, the different information contained in cross-section and time-series analyses. Cross-section regressions (e.g., across industries, regions, or countries) are appealing due to their relatively gentle requirements for identification. But, inevitably, these regressions hold constant economy-wide variables such as the average wage rate, the interest rate, the state of technology, and the amount of human capital embodied in the workforce. All of these variables evolve endogenously in a dynamic equilibrium, complicating the task of using the cross-section to shed light on the historical episode. Yet, time-series data analysis brings nearly insuperable questions of identification in the light of pervasive simultaneity. Furthermore, many of the studies that we review focus on proximate causes for the decline in the labor share rather than the fundamental causes that are of primary interest. While the former may be easier to identify, many of them likely reflect similar underlying causes. Finally, in an evolving economy in which the labor share responds to many forces—some exerting downward pressures and others possibly exerting upward pressures—publication bias might draw disproportionate attention to the former while neglecting the latter. We conclude that, after more than 12,000 research projects, we still do not have a firm grip on why the labor share in national income has fallen and whether that decline is likely to be temporary, permanent, ongoing, leveling out, or reversed.

Our review—which of necessity is highly selective (and we apologize to the many authors of fine scholarship that we could not cover)—is organized as follows. In the next section, we discuss some of the measurement issues that give rise to ambiguity in the term "the labor share" and to different opinions about what facts need to be explained. Section 3 highlights some potential pitfalls that readers should bear in mind when evaluating the evidence for certain mechanisms, and in particular the difficulty inherent in explaining macroeconomic events using cross-regional

or cross-firm data. Sections 4–8 constitute the main body of our review, covering the various explanations that have been offered for the declining labor share, namely factor-biased technical change (Section 4), globalization and the rise of China (Section 5), increased exercise of product market power by large firms (Section 6), declining worker power in labor relations (Section 7), and changes in the composition of the workforce due to population aging and to gains in educational attainment (Section 8). In Section 9, we ask whether the decline in the labor share is likely to continue and argue that various stabilizing forces in the economy render that outcome unlikely. Finally, we conclude in Section 10 by offering our understanding of why the various explanations that have been offered for the decline in the labor share, taken together, account for a multiple of the measured fall.

2. MEASURING THE DECLINE IN THE LABOR SHARE

Figure 1 shows three popular measures of the labor share in the United States. The Bureau of Labor Statistics (BLS) headline series for the labor share of the nonfarm business sector is the only official series and the most commonly used. This series measures labor compensation plus an estimate of the labor income of self proprietors as a share of gross value added. It gives a clear impression that after decades of stability, or perhaps a modest decline since the late 1940s, the labor share has fallen sharply since 2000, stabilizing in the last decade. In all, this measure shows a decline of about 8 percentage points from its peak in the 1950s. Some researchers prefer measures of the labor share in the corporate sector, because they avoid the ambiguity of proprietors' income that we discuss briefly in Section 2.3 below. The figure shows labor compensation in the nonfinancial sector as shares of gross value added and net value added (which deducts depreciation

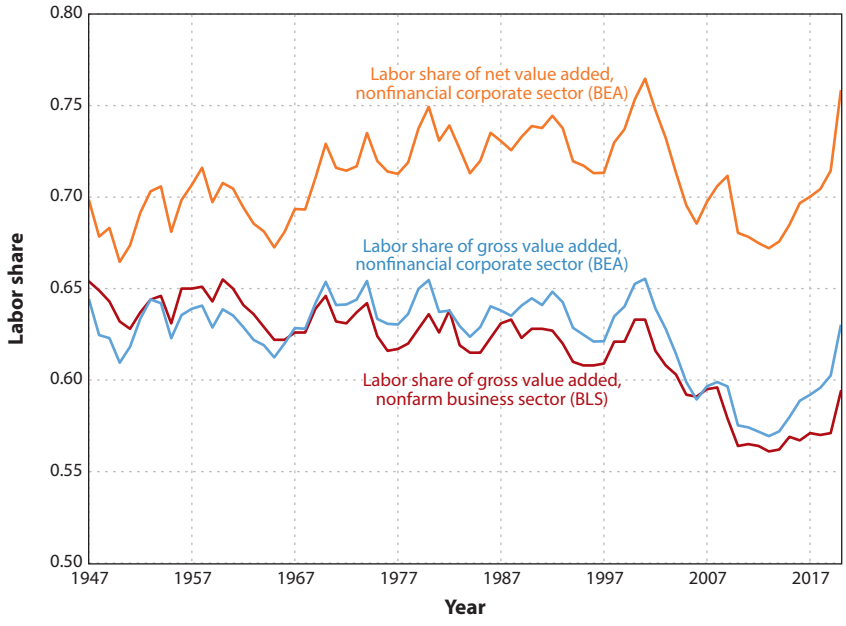

Figure 1

Alternative measures of the labor share in the United States. Data from the BEA national income and product account (NIPA) data set (at **https://apps.bea.gov/iTable/index_nipa.cfm**) and the BLS major sector productivity and costs data set (at **https://www.bls.gov/lpc/data.htm**). Abbreviations: BEA, Bureau of Economic Analysis; BLS, Bureau of Labor Statistics.

from the gross measure). Both series show a decline of 6–7 percentage points from the 1980s to the 2010s. The gross labor share was relatively stable through 2000 but then declined to a level below its historical range. In contrast, as noted by Bridgman (2018) and Rognlie (2015), the net labor share had been rising between 1940 and 1980, so the recent lower level is not without precedent. All three series show a modest increase over the last few years, together with a sharp spike in 2020, although it is of course not yet clear whether this recent history represents a durable rebound or a repeat of the temporary surge during the Great Depression. Another observation that has been emphasized by Karabarbounis & Neiman (2014) is that, over the last few decades, measured labor shares have been declining steadily around the world, with a fall in the global labor share of roughly 5 percentage points since 1975. However, this conclusion remains controversial (Gutiérrez & Piton 2020).

The lack of consensus about what patterns in the data demand explanation reflects an underlying ambiguity in the term "*the* labor share." Many of the definitional and measurement challenges are long-standing, and indeed Kuznets et al. (1941, chap. 3; 1959) and Kravis (1962) discussed them at some length. Clearly, any definition of the labor share in national income must divide some measure of workers' income by some measure of aggregate income. However, researchers diverge on what they believe should be included in the numerator and what they think belongs in the denominator. To some extent, this divergence reflects their different motivations for measuring the labor share: Is it meant to capture the relative well-being of those in the working class compared to those who earn their incomes primarily from asset or land ownership? Or is it meant to be used to gauge aggregate productivity gains, as in standard growth-accounting exercises?[1]

2.1. Gross Versus Net Income

National income can be measured gross or net, the difference being depreciation of the capital stock or the natural environment. To the extent that average depreciation rates trend over time—say because the composition of the capital stock shifts from more physical to more intangible capital or because society depletes its natural resource base at a faster rate—dividing wage income by gross income will tell a different story about the evolution of the labor share than dividing it by net income.

The debate over which is the correct measure of an economy's output has a long history, which is nicely reviewed by Hulten (1992). Hulten cites Solow (1957) and Denison (1962) as early proponents of using net income in growth accounting, whereas Jorgenson & Griliches (1967, 1972) advocated for the use of gross income. Hulten himself offers a balanced perspective, arguing that both measures are useful for different purposes. Net income may be more closely associated with aggregate welfare inasmuch as consumption of capital or natural resources at an accelerated rate merely trades future consumption for current consumption. Weitzman (1976) formalized this idea by linking net income to the Hamiltonian in a representative agent's dynamic optimization problem.[2] On the other hand, gross income may be more appropriate for measuring technological progress, if improvements in total factor productivity (TFP) tend to augment output gross of depreciation.

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[1] Cobb & Douglas (1928) proposed their well-known aggregate production function in part because it could capture well the constancy of factor shares at the time. Solow (1957) adopted this specification of aggregate technology to measure technological progress as a residual, after multiplying changes in factor endowments by the measured factor shares. In this sense, measured factor shares have played a critical role in our understanding of the evolution of technology.

[2] Barro (2019) offers a more recent treatment.

With regard to the measurement of the labor share in national income, the distinction between gross and net income has taken on an increased importance in recent times. The economy has been shifting toward greater use of types of capital that have relatively high depreciation rates, such as information and communications technology (ICT) equipment and various forms of intellectual property (IP). Whereas Karabarbounis & Neiman (2014) assert that the shares of wages in both gross and net income have been trending downward since 1975, Bridgman (2018) argues that the labor share in net income still lies within a range of values observed over a longer time horizon. The same is not true, he claims, for the share in gross income, which is at an all-time low.[3] Rognlie (2015) focuses more narrowly on the corporate, nonfinancial sector (for reasons to be explained below) and similarly finds that the current share of wages in net income falls within the historical range. Bridgman and Rognlie both argue, following Weitzman (1976) and Barro (2019), that the labor share in net income is a more relevant construct if we are interested in the well-being of workers and the extent of inequality in society.

2.2. Treatment of Intellectual Property

The Bureau of Economic Analysis (BEA) previously classified computer software and other IP products as nondurable intermediate inputs, but it recently recategorized them as durable capital. As Koh et al. (2020) argue, this reclassification means that spending on IP products no longer reduces value added but is instead included in national income, like other long-term investments. As a consequence, wages comprise a smaller fraction of the new measure of value added compared to the old. Moreover, the rising share of IP investment in GDP means that the gap between the labor share computed with the alternative methodologies has been growing over time. When Koh et al. (2020) construct a series for the labor share using the now-obsolete accounting practices, they find that the current fraction, while still rather low, falls well within the range of shares observed in the last century.

Atkeson (2020) takes a different approach to the same problem. Using data for the corporate sector, he computes payments to capital as the sum of payouts to investors and corporate taxes. This method treats all investments as current expenses, in keeping with the suggestion by Barro (2019). His measures of capital income are immune to the recent BEA changes in accounting practices, because payouts to investors are the same no matter whether IP is regarded as an intermediate or a capital good. When he computes the labor share as the fraction of wages in the combined payments to labor and capital, he finds, like Koh and colleagues, that the current level is low compared to what it was in the 1970s and 1980s but not outside a longer historical range.

2.3. Treatment of Self-Employment and Entrepreneurial Income

A long-standing question, raised by Kuznets et al. (1941) and others, concerns the proper attribution of income earned by the self-employed. What portion of this entrepreneurial income is a payment for work, and what portion is a return to productive ideas and for bearing risk? That is, should we treat the income of the self-employed as labor income, capital income, or some combination of the two?

Many early researchers equated labor income with employee compensation, thereby excluding self-employment income entirely and implicitly treating it as a return to capital. In a well-known paper, Gollin (2002) showed that this procedure could account for the apparent positive correlation across countries between the labor share in income and the level of per capita income, inasmuch as poor countries typically have significantly higher self-employment rates than

[3] Bridgman (2018) finds that the difference between the evolution of the net and of the gross labor shares holds also for other advanced economies, and in some countries the net share has not fallen at all.

rich countries and the tasks performed by the self-employed there are more like work than entrepreneurship. After adjusting for differences in self-employment rates, he found no systematic relationship in the cross-country pattern of imputed labor shares.[4]

More recently, Elsby et al. (2013) considered a variety of methods to allocate self-employment income between labor and capital. Using these methods, they attribute roughly one-third of the apparent decline in the aggregate labor share in the United States to the particular statistical procedure that the BLS uses to allocate self-employment income, together with the observed decline in the fraction of self-employed time in the total of US hours worked. Another approach taken by some researchers has been to sidestep the problem entirely by focusing only on the corporate sector when measuring income shares. Gomme & Rupert (2004) and Karabarbounis & Neiman (2014) advocate for this approach. This has the obvious advantage that it requires no arbitrary imputation of proprietors' income. However, as Smith et al. (2021) point out, entrepreneurs have considerable flexibility when classifying their income in the light of the prevailing tax code. Recent changes in the code have created incentives to reclassify income from forms that give favorable treatment to labor income to forms that give favorable treatment to profits, as well as incentives for firms with high labor shares to leave the corporate sector entirely by forming partnerships. They estimate that reclassification alone accounts for a 1.6 percentage point drop in the labor share in the corporate sector.[5]

2.4. Treatment of Owner-Occupied Housing

Real estate constitutes a significant fraction of the capital stock in many countries. For residential housing that is occupied by owners, statistical agencies impute rent as a return to this capital and include the imputed rent as part of national income. While this practice may be justified as a way of putting residential real estate on a similar footing with commercial real estate, as Rognlie (2015) emphasizes, the returns to owner-occupied housing accrue mostly to workers, not capitalists. Like self-employment income, the issue raised by imputing a return to owner-occupied housing can be avoided—at least for the United States—by focusing solely on income shares in the nonfinancial corporate sector.[6]

2.5. Treatment of Factorless Income

Oftentimes, the share of capital is treated as a residual, that is, as 1 minus the labor share. However, efforts can be made to impute the return to capital, which may not make up the entirety of the difference between national income and wage payments. Karabarbounis & Neiman (2019) label the residual as factorless income. Barkai (2020) imputes capital income using a measure of the risky real interest rate to estimate the rental cost of capital.[7] Because the real interest rate spiked in the

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[4] Smith et al. (2019) argue that as much as three-quarters of pass-through business profit ought to be classified as labor income rather than as return to capital, based on the fact that reported profits fall precipitously after owner retirements or premature deaths. Bhandari & McGrattan (2021) propose a contrary view that casts pass-through profits as a return to "sweat equity."

[5] Eisfeldt et al. (2021) identify another source of misclassification of income in the corporate sector that stems from increased use of equity-based compensation, some of which is measured as capital income and the rest as labor income, but only after it vests and is exercised. This practice leads to underestimation of labor compensation during the periods in which the prevalence of this form of compensation is rising.

[6] Gutiérrez & Piton (2020) point out that the practice of excluding imputed rent from incomes in the corporate sector is not universal, so cross-country comparison of labor shares in this sector can be problematic.

[7] However, some critics such as Harper et al. (1989, p. 357) argue that swings in the ex-post real return to capital are too large to be a plausible measure of changes in capital owners' rental income. Harper and colleagues offer

1970s, Barkai finds the imputed capital share to be unusually high at that time and to have fallen since. This means, of course, that with the wage share also falling, the residual has been growing.

But what would account for an expansion in factorless income, and who in society benefits from it? Karabarbounis & Neiman (2019) explore three possibilities. First, the residual might reflect an unmeasured return to capital. Second, it could represent pure profit in the face of increased monopoly power and rising markups. Third, it could simply represent measurement error in the return to owners of capital, considering the difficulties that arise in assessing the appropriate risk premium. They find that none of these interpretations of the residual is fully satisfactory, but that the possibility of measurement error in returns seems closest to the truth.

In sum, there remains considerable controversy about the facts. Some believe that the labor share has fallen precipitously, whereas others see a smaller drop or even that the current levels are not far from their historical values. We have tried to argue that many of these differences reflect alternative notions of the labor share, and that various measures are valuable for different purposes. Moreover, the significant volatility in all of the measures makes it difficult to distinguish medium-run fluctuations from long-run level changes or even ongoing trends.

Nonetheless, there exists a fair amount of consensus that the labor share today—however measured—is well below its level of the 1970s and 1980s, at least in the United States. We will henceforth take such a decline as a fact worthy of an economist's attention.

3. SOME PITFALLS IN EXPLAINING THE DECLINE IN THE LABOR SHARE WITH CROSS-SECTIONAL DATA

Before turning to some of the explanations that researchers have proposed for the decline in the labor share, we highlight some potential pitfalls that the reader should bear in mind when approaching this literature. They invoke in us a healthy skepticism about the evidence that has been proffered in support of many mechanisms.

Most explanations for the decline in the labor share begin with an alleged shock to the relative demand for labor versus capital or to the relative supplies of these factors. Consider a parameter τ that influences relative factor demands. This parameter could represent the occurrence of factor-biased technological progress, such as the one associated with the evolution of IT technologies or the development of robots; or it could index the increased availability of imports of certain types of goods that substitute for domestic production; or it could stand for the accumulation of human capital that is complementary to physical capital; and so on. In any case, let us write the constant-returns-to-scale production function for the representative firm (supposing there is one) as $F(K, L; \tau)$ and the corresponding unit cost curve as $c(r, w; \tau)$, where K and L are inputs of capital and labor, respectively, and r and w are the corresponding factor prices. If we normalize the price of final output to be 1 and let θ denote the labor share, then we have $\theta = wc_w(r, w; \tau)$ and $1 - \theta = rc_r(r, w; \tau)$.

Now suppose that τ changes, which a researcher might offer as a (partial) explanation for the decline in the labor share. Differentiating with respect to τ, and recognizing the linear homogeneity of $c(\cdot)$, we find that

$$\frac{d \ln \frac{\theta}{1-\theta}}{d\tau} = \frac{\partial \ln \frac{c_w}{c_r}}{\partial \tau} + (\sigma - 1)\frac{d \ln \frac{r}{w}}{d\tau}, \qquad 1.$$

four alternatives for measuring the rental price of capital and conclude that using market interest rates is the least attractive of these.

where $\sigma \equiv \frac{c c_{rw}}{c_r c_w}$ is the elasticity of substitution between capital and labor in the firm's production technology. Equation 1 expresses the proportional change in the ratio of factor shares as the sum of two components. The first component reflects the deviation of the shock from Hicks neutrality; if the shock is not Hicks neutral, then it will tilt demand in favor of one factor or the other at given factor prices. The second term represents the response of the factor shares to the equilibrium adjustment in relative factor prices that ensues from the shock. With a Cobb-Douglas technology, changes in relative factor prices do not affect factor shares. Otherwise, the full effect on factor shares includes a component that depends on the equilibrium adjustment of r/w.

Many researchers use cross-sectional or panel regressions to validate their explanation for the decline in the labor share. Suppose, for example, that different firms or different regions experience the shock somewhat differently. Let $d\tau_i$ represent the measure of the shock that affects firm or region i. Then the researcher might run the cross-sectional regression,

$$d \ln \frac{\theta_i}{1-\theta_i} = \alpha + \beta d\tau_i + \varepsilon_i, \qquad 2.$$

possibly with some controls to account for other explanations. The researcher might estimate the coefficient on $d\tau_i$ as $\hat{\beta} < 0$, which would be interpreted as evidence in favor of the proffered explanation if, on average, $d\tau_i > 0$.

If the coefficients of the regression in Equation 2 are credibly identified, the estimates would in fact reveal how local technology shocks alter the relative demands for the two factors at given factor prices. Such results can serve as a useful diagnostic for a mechanism and may provide information that can guide the search for explanations for a decline in the labor share. However, the results from the cross-sectional regression do not answer the question of interest, namely, how the shock has affected the functional distribution of income over time and in the aggregate. As Nakamura & Steinsson (2018) have argued, estimates of macroeconomic effects that use cross-regional or cross-firm data neglect the general-equilibrium adjustments that affect all units similarly. In our context, a cross-sectional regression of factor shares would absorb the widespread effect of relative factor prices on input choices into the constant term α.

Consider, for example, a technology shock τ that is Harrod neutral, which Uzawa (1961) showed can be represented by a purely labor-augmenting technical change: $c(r, w; \tau) = \tilde{c}(r, we^{-\tau})$. Then we have $\partial \ln \left(\frac{w c_w}{r c_r}\right)/\partial\tau = \sigma - 1$.[8] If $\sigma < 1$, a technological improvement of this sort reduces the labor share at constant factor prices, whereas if $\sigma > 1$, the labor share rises with τ. Normalize the initial level of technology in all firms or regions to 1 and suppose that they experience idiosyncratic shocks, $d\tau_i$. Then a cross-section regression of firms' or regions' labor shares on local technology indicators might appear to confirm that positive (negative) shocks explain the declining labor share when $\sigma < 1$ ($\sigma > 1$). However, this interpretation neglects the factor-price adjustments set in motion by the technology shock. In a setting in which the supply of capital is perfectly elastic in the long run, with a constant real return equal to the subjective discount rate, perhaps adjusted for steady-state growth, the quantity of capital adjusts until r returns to its initial level and the wage absorbs the productivity increase. In the case of Harrod neutrality, the wage rises by a factor of e^{τ}. Therefore, we have $d \ln \frac{r}{w} = -d\tau$, and so the resulting factor-price adjustments exactly offset the direct effect of the technological change, leaving average factor shares at their original levels. In fact, Harrod-neutral technical change is defined as technical change that,

[8] Using the homogeneity of the cost function, the elasticity of substitution can be expressed as

$$\sigma - 1 = \frac{\partial \ln \frac{r c_r(r,w;\tau)}{w c_w(r,w;\tau)}}{\partial \ln w/r} = \frac{\partial \ln \frac{c_r(1,\omega;\tau)}{\omega c_w(1,\omega;\tau)}}{\partial \ln \omega} = \frac{\partial \ln \frac{\tilde{c}_r(1,\omega e^{-\tau})}{\omega e^{-\tau} \tilde{c}_w(1,\omega e^{-\tau})}}{\partial \ln \omega} = -\frac{\partial \ln \frac{\tilde{c}_r(1,\omega e^{-\tau})}{\tilde{c}_w(1,\omega e^{-\tau})}}{\partial \tau}.$$

at the same real interest rate, leaves factor shares unchanged. Purely Harrod-neutral technological progress cannot explain a long-run change in the distribution of income. In contrast to estimates from cross-sectional regressions, which reveal deviations from Hicks neutrality, movements in aggregate factor shares can only be explained by shocks that deviate from Harrod neutrality.

What determines the magnitude of the general equilibrium response? Consider a more general technology shock in a setting in which the supply of capital is perfectly elastic in the long run. Differentiating the zero-profit condition $c(r, w; \tau) = 1$ with $dr = 0$ gives the equilibrium change in the wage rate in this case, $d \ln w = -\frac{1}{\theta} c_\tau d\tau$. Then substituting for the changes in the factor prices in Equation 1 gives the full general-equilibrium response of the relative factor shares,

$$\frac{d \ln \frac{\theta}{1-\theta}}{d\tau} = \frac{\partial \ln \frac{c_w}{c_r}}{\partial \tau} + \frac{\sigma - 1}{\theta} c_\tau. \qquad 3.$$

Equation 3 decomposes the long-run change in the ratio of factor shares into a direct component reflecting shifts in factor demands at given factor prices and a component that reflects the wage adjustment. In general, the two might offset one another (as with Harrod neutrality) or reinforce one another. We see that the elasticity of substitution is a crucial parameter in this; for any given shift in c_r/c_w, the induced movement of wages will offset or reinforce the impact effect according to the sign of $\sigma - 1$.[9]

Wage adjustments are not the only endogenous responses to technology shocks that may impact the labor share. A shock may induce equilibrium responses in other economy-wide economic variables as well. A spurt of automation, for example, even if it is felt in some industries more than in others, may induce an economy-wide increase in the skill premium if there is a capital-skill complementarity. This could induce a change in the relative supply of skilled workers, which could alter factor shares in all industries, as outlined by Grossman et al. (2017, 2021); or it may induce directed technical change, along the lines described by Acemoglu (2003), that produces new technologies available to all industries regardless of whether they are subject to the initial impulse. We discuss these channels in greater detail in Section 9 below.

4. TECHNICAL CHANGE

Many researchers ascribe the decline in the labor share to some form of biased technical change. In this category of explanations, we include all technological trends that may have reduced firms' demand for labor relative to capital. Some researchers point to a decline in the relative price of capital, which may have induced greater use of capital in general. Others implicate forms of technical change that may have made certain types of capital more productive, such as improvements in ICT.[10] Still others highlight the development of new types of capital (e.g., robots) that may substitute closely for labor, in contrast to older forms (e.g., equipment or structures) that might complement labor.

[9]The elasticity of substitution between capital and labor figures prominently in the literature on the labor share. Many qualitative results on the response to various shocks hinge on whether the elasticity exceeds, equals, or falls short of unity. All quantitative exercises explaining the decline of the labor share rely on estimates of σ. However, this parameter is notoriously difficult to estimate due to the simultaneous determination of relative factor inputs and their relative prices. Readers are referred to **Supplemental Appendix A** for a critical discussion of the methodological issues that arise in estimating the elasticity of substitution.

Supplemental Material >

[10]It may be tempting to surmise that technological progress cannot be the explanation for the drop in the labor share, because TFP growth was much faster in the 1950s and 1960s compared to today, at a time when the labor share was higher than now. However, Aghion et al. (2019) and De Ridder (2020) show that a one-time improvement in ICT can generate a subsequent slowdown in productivity growth.

Various authors refer to automation to describe many of the technological processes that they have in mind. We take issue with this terminology inasmuch as it sometimes is used to mean that firms use more machines and other times to mean that they adopt new and different technologies. The former usage is especially problematic, because firms choose their factor inputs and therefore the use of more machines cannot be a primitive cause of a decline in the labor share. Even the choice of technique can be endogenous in many contexts.

One recurring challenge authors face in attributing declines in the labor share to technological progress is the well-known difficulty of measuring technical change. Most technological improvements occur without leaving a paper trail, leaving researchers since Solow (1957) to treat productivity as a residual. In the context of assessing reasons for changing factor shares, the use of residuals may be especially troublesome. If we observe changes in factor prices and estimate an aggregate elasticity of substitution, we might be able to infer the shifts in relative factor demands that have taken place. But then, how are we to allocate these shifts in relative demand to technological progress versus other potential causes, such as falling trade costs or modifications in preferences?

To partially address this issue, some of the literature has taken advantage of the observation that some (or many?) of the relevant technological improvements are embodied in new capital goods such as computers and robots. In some circumstances, it is possible to associate the extent of technological progress with the decline of the quality-adjusted cost of these particular goods. Thus, it may be easier to attribute causation to embodied technical progress than to disembodied gains that raise the productivity of existing and new capital relative to that of labor. Of course, assessing the relative importance of embodied versus disembodied technical change in recent economic history is itself a vexing problem.

4.1. Investment-Specific Technological Change

Greenwood et al. (1997) argue that the decline in the relative price of equipment in the postwar United States, together with the substantial increase in the equipment-to-output ratio, can be taken as evidence of substantial "investment-specific technological change," that is, advances in know-how that are embodied in new capital goods.

Karabarbounis & Neiman (2014) consider the fall in the relative price of investment goods to be a prime suspect for the decline in the labor share. They use variation in long-run trends in the relative price of investment goods across countries as a proxy for low-frequency variation in the movements of the rental cost of capital. If the economy has zero profits and if local, disembodied capital-augmenting technological progress is orthogonal to shocks to investment prices, then a regression of the change in the labor share on the change in the investment price identifies the aggregate elasticity of substitution between capital and labor. In Karabarbounis & Neiman's (2014) preferred estimate, $\sigma = 1.25$ and the roughly 25% decline in the global relative price of investment accounts for about half of the observed decline in the global labor share.

We see several reasons for caution before accepting this conclusion. First, other things that affect relative factor demand might be correlated with changes in investment prices. For example, many countries import most of their capital; opening up to trade would reduce the cost of capital but may bring about other changes in demand for capital and labor. Second, an exogenous decline in the rental rate of capital can be the cause of a fall in the labor share only if the elasticity of substitution between capital and labor exceeds 1. Indeed, Karabarbounis & Neiman take the positive correlation between changes in labor shares and changes in local investment prices to be prima facie evidence of such an elasticity. However, their estimate of an elasticity greater than 1 is very much at odds with the findings of numerous studies that have attempted to measure this key parameter [see,

for example, the survey by Chirinko (2008) and the more recent work by Chirinko et al. (2011), Herrendorf et al. (2015), Lawrence (2015), and Oberfield & Raval (2021)]. Third, pointing to a fall in investment prices as an explanation for the decline in the labor share after 1980 is difficult to reconcile with the stable labor share between the 1950s and the 1970s, when investment-good prices also fell, albeit not as precipitously as in the subsequent period. Finally, Glover & Short (2020) argue that the estimated relationship between labor shares and rental rates is sensitive to data selection criteria and that long differences in rental rates should reflect changes in the real interest rate along with investment-specific technological progress. When they make either of these adjustments, they find that trends in investment prices and trends in factor shares are uncorrelated.

Heterogeneity of capital can also complicate inference about the effects of investment-specific technical change on factor shares. Hubmer (2020) distinguishes a fall in equipment prices from the relatively stable prices of buildings and structures, considering only the former to be evidence of investment-specific technical change. He finds that industries that used equipment more intensively compared to structures saw larger declines in their labor shares, leading him to conclude like Karabarbounis & Neiman that capital and labor are gross substitutes in producing aggregate output.[11] However, as discussed in Section 3, even if investment-specific technical change reduced the labor share more in sectors with greater exposure to the change, the impact on the aggregate labor share would depend on whether the subsequent increase in the wage offsets or amplifies the initial impulse. This depends on the aggregate elasticity of substitution between capital and labor. Hubmer's (2020) conclusion that investment-specific technical change reduced the labor share requires the assumption that capital and labor are gross substitutes in aggregate production. Hubmer imposes gross substitutability by assuming that equipment and structures combine to form a composite capital good that is separable from labor in the aggregate production function. However, other plausible production functions—such as one that forms a composite of labor and equipment that is then combined with building and structures—would allow for the possibility that labor and capital are complements. The implications of regressing labor shares on the price of equipment to infer whether capital and labor are substitutes or complements become even less clear when we recognize that there are different types of labor and that equipment might complement some (such as skilled labor) while substituting for others (such as unskilled labor).[12]

4.2. The Rise of Superstar Firms

Whereas Karabarbounis & Neiman (2014) and Hubmer (2020) focus on the ubiquitous effects of economy-wide changes in relative prices, recent research has highlighted heterogeneity in the technology shocks experienced by different firms. The adoption of new technologies like automated production methods often imposes substantial fixed costs, as Yeaple (2005) and Bustos (2011) have noted. If so, firms that have a larger scale of output will see greater incentives to adopt. Meanwhile, ICT technologies may be more productive in larger firms if, for example, they enhance the integration and coordination of different units (see Lashkari et al. 2021). The differential adoption of new technologies involving ICT and automated production methods has been seen as one reason for a reallocation of resources toward larger firms and for a rise in concentration in many industries. Autor et al. (2020) refer to this phenomenon as the rise of superstar firms.

[11] Against this, he pits a shift in demand toward labor-intensive goods that reflects income growth in the face of nonhomothetic preferences. This way, he is able to reconcile the relative stability of factor shares before 1980 with the declining labor share thereafter.

[12] Eden & Gaggl (2019) argue that ICT substitutes differently with labor than do other forms of capital. Readers are referred to **Supplemental Appendix A** for further discussion of this point.

Supplemental Material >

Lashkari et al. (2021) note that developments in ICT have fueled productivity growth at the firm and aggregate levels around the globe. They document in French firm-level data a robust within-industry, cross-sectional correlation between scale of production and per-unit demand for computer hardware and software. To rationalize this finding, they posit a firm-level production function in which the marginal product of ICT capital rises with firm size. When the elasticity of substitution between ICT inputs and labor is less than 1, the nonhomotheticity of ICT demand implies that larger firms have lower returns to scale and lower shares of wages in revenues. Then, an improvement in the productivity of ICT inputs or a fall in the price of hardware and software generates conflicting effects on the labor share. On the one hand, returns to scale and the labor share rise in all firms. On the other hand, the market shares of larger firms rise, a compositional effect that operates to reduce the aggregate returns to scale and the aggregate labor share in national income. A calibrated version of Lashkari et al.'s (2021) model suggests that the observed fall in ICT prices can account for about half of the rise in the within-firm component of change in the French labor share between 1995 and 2007 and about half of the fall in the across-firm component of that change; ultimately, however, the decline in ICT costs did not reduce the labor share, as they find that the aggregate elasticity of substitution between capital and labor did not exceed unity.

Compositional effects also feature prominently in the work of Dinlersoz & Wolf (2018) and Autor et al. (2020). Dinlersoz & Wolf (2018) use responses to the Census Bureau's 1991 Survey of Manufacturing Technology to identify plants that have adopted automation technologies. In the cross-section, firms that rely more heavily on such technologies engage a smaller fraction of workers in production but pay higher wages to their production workers. They find that the more automated plants exhibit lower labor shares and that those plants that had made greater investments in automation in the years leading up to the survey saw larger drops in their labor shares over the succeeding 5–10 years. They conclude that larger and more productive plants rely more heavily on automation and have lower production labor shares, and hence expansion by these larger plants contributes to the aggregate decline in the labor share.

Autor et al. (2020) take a step further. They show that industries that have become more concentrated have seen faster TFP growth and a greater increase in patenting. Faster productivity growth in larger firms suggests that these firms benefited disproportionately from recent innovations, perhaps because the adoption of new technologies entails a substantial fixed cost that only these larger firms were willing to incur. In the model Autor and colleagues develop to rationalize their findings, larger firms have a lower labor share because they face less elastic demand and choose a higher markup. Together, these forces imply a falling labor share.[13]

Using establishment-level data for the US manufacturing sector between 1967 and 2012, Kehrig & Vincent (2021) offer a different take on the evidence. They observe that, over this period, the manufacturing labor share rose in the median plant. Meanwhile, resources moved to firms with below-average labor shares. However, compositional forces cannot account for the aggregate decline; instead, they find that the labor share in these low-share firms fell as they grew in size. Indeed, when they decompose the change in the manufacturing labor share into the change in the average share, the faster growth of firms with below-average shares, and the covariance between the two, they find that the (negative) covariance term accounts for the entire decline. Finally, they

[13] Ganapati (2021) also finds that output and productivity grew fastest in industries that experienced the greatest increases in concentration. Unlike Autor et al. (2020), he assumes that fixed costs are capital intensive relative to variable costs. Firms face a menu of choices between fixed and variable costs, and the largest firms opt for higher fixed costs with lower marginal costs, thereby increasing the capital-intensive outlays. By this alternative mechanism, he also generates a decline in the labor share (see also Hsieh & Rossi-Hansberg 2019).

show that firms with higher labor shares tend to have higher prices than other firms, consistent with the idea that demand factors play a role.

4.3. Robot Adoption

Several economists point to the increased adoption of robots as an explanation for the decline in the labor share. Robots are devices that automatically perform complicated and typically repetitive tasks. As such, they oftentimes substitute directly for workers that formerly performed these tasks on the industrial assembly line. Advances in computer-aided design and manufacturing (CAD/CAM), machine sensing, automated guidance, and machine learning have boosted the attractiveness of robots as a substitute for human labor and accelerated their adoption in the 1990s and 2000s.

Acemoglu & Restrepo (2020) and others argue that improvements in robot technologies that spur greater adoption have different implications for labor demand than other forms of capital-deepening or factor-augmenting improvements do. Whereas some forms of capital may complement labor and some technical progress may boost labor productivity, robots directly displace workers from tasks they previously performed. However, there remains an offsetting productivity effect inasmuch as robots induce expansion by the firms and industries that adopt them, and labor demand may rise as workers undertake a different set of tasks.

The association between robot adoption and labor market outcomes has been studied at the firm, industry, and commuting-zone level in a variety of countries. At the firm level, Humlum (2019) finds that robot adopters in Denmark grew both their sales and wage bills, but the former grew more, so that the labor share in revenues fell. Robot adopters reduced their employment of production workers while increasing their employment of technical workers. Acemoglu et al. (2020) find that French firms that adopted robots increased their value added and employment but reduced the share of revenues paid to workers and the share of workers performing production tasks. Bonfiglioli et al. (2020) find a similar pattern among French robot importers; compared to other firms operating in the same industry, robot importers were more productive, made greater sales, hired greater numbers of workers, and employed larger shares of skilled workers. Over time, the importers expanded relative to nonimporters and reduced their labor demand. Using an instrument for adoption that measures the ex-ante prevalence of tasks that can be replaced by robots, these authors argue that, despite the positive correlation in the panel data, exogenous demand shocks associated with robot adoption generate overall job losses with minimal positive effects on sales. The patterns are rather similar in Spain, where Koch et al. (2021) show that larger and more productive firms are more likely to adopt robots. After controlling for nonrandom selection into robot adoption, they find that adopters grew faster and expanded their relative employment, but paid a relatively smaller share of costs to workers, compared to nonadopters.[14]

Using panel data for a sample of industries and countries, Graetz & Michaels (2018) find that industry-country pairs with more intensive use of robots saw greater productivity gains after controlling for a variety of country-specific and industry-specific time-varying factors. They, too, try to identify exogenous shocks to robot demand using information on replaceable tasks. Their results suggest that robots generated a hike in average wages while inducing a shift in employment from low-skill to higher-skilled workers. Although they did not consider the effects on factor shares, their evidence is suggestive in this regard, considering vom Lehn's (2018) and Abdih &

[14]Readers are also referred to the studies using firm-level data for Canada by Dixon et al. (2020) and for China by Cheng et al. (2019).

Danninger's (2017) finding that industries using occupations that performed more routine tasks saw larger declines in their labor shares.[15]

Given the issue of cross-section versus general equilibrium that we discussed in Section 3, estimates of the impact of robot adoption by individual firms may not reveal the aggregate impact of robots due to the potential for induced changes in the wage. As a result, studies that focus on the impact of robot adoption on aggregate outcomes may be more informative. Several studies now investigate the equilibrium impact of robot adoption on local labor markets.

Acemoglu & Restrepo (2020) focus on local labor markets in the United States, adopting the approach developed by Autor et al. (2013) to study the employment and wage effects of the China trade shock. They measure robot exposure at the commuting-zone level by combining data on the local industry composition of employment and on the pattern of robot usage at the industry level in Europe. Their shift-share analysis reveals that commuting zones that were more exposed to robot adoption experienced relative declines in wages and in employment-to-population ratios compared to those that were less exposed. Interestingly, a similar analysis using capital exposure and IT capital exposure—as measured by attribution of national expansion of the capital stock and of IT capital to commuting zones according to industry composition—reveals opposite patterns for employment and wages. This evidence supports the authors' view that robots enter the production function differently from other forms of capital. Unfortunately, a lack of data on factor shares across commuting zones prevents the authors from studying the labor share explicitly.

However, data on factor shares are available for local labor markets in Germany. Using these data, Dauth et al. (2021) found no adverse effect of robot exposure on total local employment, but localities with more exposure saw relatively slower growth in manufacturing jobs and relatively faster growth in service-sector jobs. The displacement effect and reallocation effect combined to imply that more exposed markets experienced a relative decline in their labor share. Dauth and colleagues' findings also point to a complementarity between robots and skills, in that firms that adopted robots shifted to relatively higher-paying occupations, to occupations that perform less-routine tasks, and to workers with greater education.

The idea that robots are good substitutes for low-skilled labor does not necessarily imply that robots substitute with labor differently compared to earlier types of capital. As Acemoglu & Restrepo (2018) point out, it is possible to have technical change biased toward labor alongside automation. Alternatively, Krusell et al. (2000) show that, in the presence of capital/skill complementarity, a type of capital can be a substitute for low-skilled labor but nonetheless complement an aggregate labor input (holding fixed its skill composition). In such an environment, Grossman et al. (2017) show that the subsequent skill acquisition means that declining capital costs can be compatible with long-run stability of the labor share.

4.4. Bottom Line on the Effects of Automation

Autor & Salomons (2018) seek to derive a bottom-line number for the impact of automation on the labor share using variation in TFP growth across countries and industries. As they acknowledge, however, their approach cannot distinguish between automation-based and nonautomation-based sources of TFP growth. Instead, they associate automation with industry-level movements in TFP that are common to the OECD countries. The authors identify four potential countervailing forces to the direct displacement effect of automation: (*a*) own-industry output effects, (*b*) cross-industry input-output effects, (*c*) between-industry reallocation effects, and

[15] Relatedly, Dao et al. (2017) find stronger correlations between the relative price of capital and the labor share in countries that perform greater fractions of routine tasks.

(*d*) final-demand effects resulting from changes in relative prices. Industries that experienced faster average TFP growth across the OECD economies also experienced steep declines in employment and their labor shares. Using cross-sectional regressions of changes in industry-country pair outcomes on changes in average industry TFP growth, they attribute a 5.2% decline in the labor share to the direct displacement effect of TFP growth over 37 years, from 1970 to 2007. Moreover, they find no positive countervailing effects. By their estimates, the input-output linkages contributed an additional 2.6% to the labor share decline, the induced substitution in final demand contributed 0.7% to the decline, and the shifts in composition added another 1.7%. All told, they attribute a decline of about 10% in the labor share over the full period to the effects of automation, a fall of about 7 percentage points from an average initial share of 67% in the 19 countries in 1970.

Autor & Salomons are well aware of the pitfalls in going from micro to macro. Indeed, their discussion pays heed to the general equilibrium effects that would be overlooked by a strict focus on direct displacement effects. Even so, their regressions identify deviations of technical change from Hicks neutrality, whereas aggregate changes reflect deviations of technical change from Harrod neutrality. A cross-section regression of changes in the industry labor share on industry-level TFP growth implicitly holds wages constant. The findings of Autor & Salomons are consistent with a pattern of technological progress that is mostly labor augmenting and an elasticity of substitution between capital and labor that is less than 1. However, aggregate TFP growth also generates a change in relative factor prices that is absent from Autor & Salomons's analysis. When technical progress is mostly labor augmenting and the elasticity of substitution is less than 1, the wage movements offset the direct effects on the factor shares. The aggregate shifts in the labor share depend only on the extent of deviations from Harrod-neutral technical change in the simple model that we outlined above. The coefficient of −0.579 that Autor & Salomons (2018, table 9) report from a regression of the labor share on TFP growth is consistent with their hypothesis that virtually all productivity improvements have been labor augmenting and very few, if any, have been capital augmenting.[16]

5. GLOBALIZATION AND THE RISE OF CHINA

Many commentators suspect that increased trade and foreign direct investment (FDI), and especially the emergence of China as the world's leading exporter, was a leading cause of the fall in the labor share in advanced industrial countries. The mechanisms that could link globalization to a declining labor share are similar to those that operate in the case of technology, as are the pitfalls in establishing these links. Offshoring, like robot adoption, might be a means to carry out a set of manual tasks that would otherwise be performed by domestic labor. Imports of labor-intensive consumer products, like industry-specific technological progress, could shift the composition of output from industries with high labor shares to industries with lower labor shares. Imported capital goods might enter the aggregate production function in a way that substitutes for labor. And rising world prices of traded raw materials might contribute to a reduction in the labor share if materials and labor are complements in production.

A great deal of empirical research examines the link between growing trade and wage inequality, but surprisingly little focuses on the contribution of globalization to declines in the labor

[16]In the model described in Section 3 and summarized in Equation 3, the predicted coefficient from this regression should equal $(\sigma - 1)/\theta$ for the case of purely labor-augmenting technological progress. If $\sigma \approx 0.65$ and $\theta \approx 0.65$, then an assumption of Harrod-neutral technical progress would predict a coefficient of −0.54.

shares.[17] Exceptionally, Elsby et al. (2013) consider trade alongside investment-specific technical change and declining unionization as potential causes of shifts in the functional distribution of US income. They estimate cross-industry regressions in which the role of globalization is proxied by import exposure, which they measure as the percentage increase in value added that would be needed to satisfy domestically the entirety of US final demand in an industry. Whereas they allude to offshoring of labor-intensive tasks to low-wage countries as a possible reason that import penetration might covary with the labor share, their analysis does not control for the source countries of imports nor their labor content. Their estimates also suffer from the likely endogeneity of import penetration to circumstances in US factor markets. Be that as it may, they find a negative association between the change in an industry's import exposure from 1993 to 2010 and the change in its labor share. Vom Lehn (2018) builds on Elsby et al. (2013) by examining several alternative measures of import penetration and by instrumenting for each industry's import exposure using China's exports in that industry to other high-income economies. He finds that increased imports are associated with declines in industry labor shares. Abdih & Danninger (2017) also include several variables that are intended to capture the impact of changes in the trade environment on industry labor shares. Industries with high offshorability are those that employ workers in occupations that do not require much direct face-to-face interactions or direct physical access to the client's work location. This variable—measured using O*NET variables at the beginning of the estimation period (see **https://www.onetonline.org**)—has a (counterintuitive) positive partial correlation with the subsequent change in the labor share, albeit not one that is statistically significant. A variable that captures the intensity of an industry's foreign input use does covary inversely with the change in its labor share, as does another that measures the share of imports in apparent consumption of an industry's final product. Of course, the endogeneity of these trade variables and their comovement with technological factors preclude a causal interpretation.

Whereas Elsby et al. (2013) and Abdih & Danninger (2017) focus on the United States, some researchers have examined the link between trade and investment liberalization and labor shares in developing countries. For example, Leblebicioğlu & Weinberger (2021) study the impact on factor shares of the Indian trade reform of the 1990s. Using data for a panel of Indian manufacturing firms, they regress the log of the ratio of labor share to capital share in firm value added on a set of explanatory variables that includes the height of the tariff on competing imports, the average tariff on the intermediate inputs used by the firm's industry, the average tariff on capital goods installed in the firm's industry, and a variable that measures the extent of liberalization of FDI in the firm's industry. In the cross-section, only capital tariffs and barriers to FDI are correlated with the firm's factor shares, and in both cases greater openness to trade is associated with a larger ratio of the labor share to the capital share. Meanwhile, Sun (2020) considers the reduction in barriers to multinational production across a broader range of developing economies. He documents in a cross-section of industries and countries that larger firms tend to use more capital-intensive technologies and that firms' capital intensities in their foreign operations are positively correlated with their home countries' capital abundance. Liberalization of multilateral production drives out smaller indigenous firms that are more labor intensive than average, and multinationals operate with more capital-intensive technologies than their indigenous counterparts. Both factors could contribute to a declining labor share. A calibrated version of Sun's general-equilibrium model can account for a decline of 1.2 percentage points in the average country's labor share as a result of (estimated) reductions in barriers to foreign operations that are consistent with the expansion of multinational activity in the early 2000s.

[17] On the link between trade and wages, readers are referred to the surveys by Feenstra & Hanson (2003) and Helpman (2018).

Finally, we should mention that Autor et al. (2020) included a China-shock variable in their regression of changes in labor share on industry characteristics. They find no evidence that manufacturing industries that were exposed to larger increases in imports from China experienced greater labor share declines.

Growth in China might also have been responsible for booming prices of traded raw materials in the early 2000s. Castro Vincenzi & Kleinman (2020) show that the decline in the labor share was concentrated in US industries that rely heavily on intermediate inputs. They regress changes in the industry labor share on changes in input prices, finding a negative and significant relationship. According to their estimates, an industry with an average change in its price index of imported materials experienced a 6.2 percentage point decline in its labor share relative to an industry that saw no change in input prices. They also estimate the elasticity of substitution between material inputs and nonmaterial inputs in the industry production functions and find suggestive evidence of strong complementarities between the two, as would be required for a commodity price boom to depress the labor share.

For the most part, studies addressing the impact of trade on income distribution have focused on cross-sectional differences in factor shares. As we stressed earlier, to account for the full impact of growing trade on the labor share one must also incorporate the general-equilibrium response of factor prices.

6. INCREASED PRODUCT MARKET POWER

Alongside (or, perhaps, instead of) technological change and increased globalization, some researchers indict increased product market power as a potential culprit for the declining labor share. As a matter of definition, national income accrues as payments to the factors of production or results in pure profits. If pure profits rise, there is less to share among the primary factors of production, including labor. Pure profits could rise due to less stringent enforcement of antitrust laws or because the evolution of technologies gives greater advantage to large firms and forces exit by their smaller rivals. Unfortunately, there is almost no research that ties aggregate trends in product market power and higher pure profits to more primitive causes.[18]

Profit maximization provides a starting point for linking a firm's labor share to its markup and profit share.[19] Two implications of profit maximization have been exploited in the literature. Writing the production function as $Y = F(K, L)$, the profit-maximizing choice of labor input equates the marginal revenue product with the wage, which implies[20]

$$\varepsilon_L = \mu\theta_L, \qquad 4.$$

where $\varepsilon_L \equiv LF_L/Y$ is the elasticity of output with respect to labor and μ is the markup, that is, the ratio of price to marginal cost. A rise in the markup will be associated with a fall in the labor share for a given production technology, although clearly this is a relationship between three

[18]As we shall discuss, technological change that leads to increased market concentration and the greater exercise of market power may be counted twice in assessing the causes of decline in the labor share, once as a technological shock and a second time as a market power or market concentration shock.

[19]Basu (2019) provides a very nice summary and discussion of recent work on measuring the markup.

[20]From $\rho F_L = w$, where $\rho \equiv p + Yp'(Y)$ is marginal revenue when $p(Y)$ is price as a function of output, we have

$$\frac{LF_L}{Y} = \frac{p}{\rho}\frac{w_L}{pY}.$$

Then, equating marginal revenue to marginal cost, as required for profit maximization, gives the result in Equation 4.

endogenous entities. Second, using the analogous relationship for capital, $\varepsilon_K = \mu\theta_K$, and summing, we find

$$1 - \theta_\pi = \frac{wL + RK}{pY} = \frac{\varepsilon_K + \varepsilon_L}{\mu}, \qquad 5.$$

where θ_π is the share of pure profits in revenues, or 1 minus the ratio of total factor costs to revenues, and $\varepsilon_K + \varepsilon_L$ is a measure of returns to scale (equal to 1 with constant returns to scale). Clearly, one can use Equation 5 to infer the change in the average markup from data on the change in the profit share and a measure of the change in returns to scale. Note, however, that an increase in the profit share need not reflect an increase in the markup, unless returns to scale remain unchanged.

Equations 4 and 5 can be combined to give a direct relationship between the labor share and the profit share that does not depend on the markup and thus on the form of imperfect competition. We write

$$\theta_L = \frac{\varepsilon_L}{\varepsilon_K + \varepsilon_L}(1 - \theta_\pi); \qquad 6.$$

here it is clear that when the profit share rises, no matter the reason, profit-maximizing firms will pay a smaller share of revenues to labor if the elasticities of output with respect to the primary factors remain in proportion. Moreover, Equation 6 and the analogous equation for θ_K show that a decline in the labor share need not be accompanied by a rise in the capital share, if the share of pure profits increases at the same time.

6.1. A Rising Profit Share?

Barkai (2020) argues that profit shares have been rising in the United States alongside a fall in the shares in value added of both primary factors. To make this argument, he attempted to measure the evolution of aggregate returns to installed capital. An obvious difficulty that he was forced to confront is that firms own most of their capital rather than leasing it, so it is impossible to distinguish rental income from pure profits in either aggregate or firm-level data. In view of this, Barkai sought to impute the required return to capital using a combination of returns on corporate debt and equity, along with an estimate of the depreciation rate.[21] He then estimated capital costs as the product of the required return and the value of the extant capital stock. He concluded that the capital share in value added fell by 22% between early 1984 and 2014, while the share of pure profits in gross value added rose by 13.5 percentage points. Using Equation 5 and assuming constant returns to scale, his estimates imply an increase in average markups from 2% to 19% over the period.[22]

These conclusions are controversial. Karabarbounis & Neiman (2019) point out that the decline in the real interest rate since the 1980s was preceded in the late 1970s by a sharp rate hike, which was not, however, accompanied by a rise in the labor share. Moreover, the profit share during the period before the spike in real interest rates was higher than it is today. Barkai and others might easily have underestimated growth in the capital share, which would have caused them to

[21] Gutiérrez (2017) instead estimates the required return to capital as the sum of a risk-free rate and an imputed risk premium.

[22] Gutiérrez & Philippon (2017) draw a similar conclusion using firm-level data drawn from Compustat. Note, however, that both studies rely on the assumption that technologies have not changed—for example, that there has been no bias in technological progress impacting the elasticity of output with respect to labor and no changes in returns to scale despite the evident growth of the largest firms.

exaggerate the growth of profits. For example, the imputed returns to capital fall short of true returns if measures of growth in the capital stock fail to capture all investments in intangible capital, for the reasons we discussed in Section 2.5. Also, estimates of required returns might be too low if depreciation rates increase with the shift in the composition of the capital stock from mostly structures and equipment to more intellectual property, or if market interest rates understate the appropriate discount rates for assessing the user-cost of capital. As Rognlie (2019, p. 241) observes about the evolution of markups implied by movements in imputed profit shares since the 1950s, it is "not an inconceivable sequence, but it does defy the structural explanations (e.g., market concentration) usually put forward for thinking about markups, none of which should have induced such sharp reversals."

6.2. Rising Markups?

An increasingly common procedure to estimate average markups, drawing on work by Hall (1988) and De Loecker & Warzynski (2012), uses Equation 4 together with observed data on some input share and econometric estimates of the elasticity of output with respect to that input. In a much cited paper, De Loecker et al. (2020) use firm-level accounting data for a composite input termed cost of goods sold (COGS), which comprises intermediate inputs and a subset of labor inputs that are deemed to be flexible in the short run. Meanwhile, they take capital as a quasi-fixed input. Using techniques popularized by Olley & Pakes (1996) to account for the endogeneity of flexible inputs in response to productivity shocks, they estimate a time-varying production function with variable returns to scale. Finally, they compute a time series for the weighted-average markup by dividing the estimated output elasticity by the cost share of COGS. They conclude that the average markup rose from 21% in 1980 to 61% in 2016, with almost all of the increase attributable to rising markups in the firms in the upper tail of the distribution of price-cost margins.[23] Because the markup μ should be equal to ε_V/θ_V for any factor V (i.e., the ratio of the output elasticity to the factor share), they conclude that the estimated rise in markups can explain the fall in the labor share.

Several authors have questioned whether the findings about the output elasticity with respect to COGS can in fact be used to draw inferences about the labor share. Raval (2020) and Doraszelski & Jaumandreu (2019) show, in different contexts, that the markups that are computed when using labor as the flexible input behave very differently from those derived using material inputs as the flexible input. Raval (2020) finds that these estimated markups are negatively correlated in the cross-section of firms and exhibit opposite time trends. Doraszelski & Jaumandreu (2019) compare exporters and importers and find that the estimates derived using labor versus materials inputs imply opposite orderings in which set of firms has higher markups. These findings hint at estimation bias in De Loecker et al.'s (2020) work, which creeps in if cross-sectional productivity differences have a factor bias that is correlated with firm size.[24] Meanwhile, Traina (2018) notes that De Loecker et al. (2020) do not include expenditures on marketing and management as part

[23] Edmond et al. (2018) argue that the aggregate markup should properly be measured as a cost-weighted average of individual markups rather than as a sales-weighted average. Inasmuch as larger firms tend to have greater markups, the increase in the cost-weighted average is much smaller than what is reported by De Loecker et al. (2020).

[24] Raval's (2020) and Dorszelski & Jaumandreu's (2019) findings could alternatively be explained by a particular pattern of adjustment costs for different factors. More generally, we note that imputing markups using production-function estimation relies on an accurate specification of firm-level technologies. While in principle these specifications might be quite flexible, in practice most applications rule out factor-biased technology differences by their assumption of Hicks neutrality.

of their measure of variable cost, as he argues would be appropriate considering that larger firms have greater expenses of this sort. When he includes these cost components, he finds a much smaller upward trend in markups.

6.3. Rising Concentration?

Several studies have pointed to increased industry concentration as evidence of an increase in market power, which in turn could spell a decline in the share of revenues available for distribution to the primary factors of production. Barkai (2020) and Autor et al. (2020) find a positive correlation across industries between the rise in concentration and the decline in the labor share. Barkai (2020), in fact, argues that increased concentration (taken to be exogenous) can account for most of the fall in the labor share. Hartman-Glaser et al. (2016) establish that larger firms—which have seen the greatest fall in labor share while growing faster than smaller firms—tend to operate in more concentrated markets.

However, a rise in concentration could easily reflect technological developments rather than (or in addition to) an easing of antitrust rules and enforcement. Berry et al. (2019) and Syverson (2019) argue that of the potential explanations for the observed increase in concentration, some would be associated with reduced competition whereas others would go hand in hand with increased competition. For example, if heterogeneous firms sell differentiated products, an increase in the substitutability between goods will result in greater concentration due to induced exit and a narrowing of firms' price-cost margins. Syverson (2004) provides evidence for such selection effects that simultaneously enhance competition and result in greater concentration of sales.

Another pitfall in associating concentration with market power arises from the identification and labeling of relevant markets. Benkard et al. (2021) argue that, to reflect competition, concentration should be measured in markets defined by the substitutability perceived by consumers, not by the similarity in production processes (as is common for Census industry groupings). When they construct concentration measures for consumption-based markets, along the lines of what is typically done in antitrust analysis, they find that concentration has been trending downward in the United States since 1994. Rossi-Hansberg et al. (2021) similarly argue that concentration has fallen in many industries at the more relevant local level, even as it has increased at the national level.[25] Smith & Ocampo (2021) focus on retail and find that while local concentration in retail has increased slightly, the trend is muted relative to the rise in national concentration. Amiti & Heise (2021) show that for manufacturing industries, national concentration is stable or declining once one accounts for imports.

6.4. Bottom Line on Product Market Power

Measuring unobserved profit shares, price-cost markups, or market concentration is a fundamentally difficult problem that relies on strong assumptions. Authors that measure the profit share must assume that investments recorded in the national accounts capture all forms of capital, including many that lack a physical manifestation. Moreover, they must assume that some particular market interest rate reveals the true user-cost of capital. Authors that infer markups from estimates of production functions typically use a cross-section of firm-level data. The methods applied to date typically rely on (untested) assumptions about technology—in particular, that there have been no factor-biased technological progress, no factor-biased productivity differences across firms, and

[25] Their story is that national chains have grown in aggregate market share while offering competition to many smaller local monopolies.

no time variation in returns to scale. De Loecker et al. (2020) do allow for production function parameters that vary over time, but they do not allow these parameters to differ across firms. If large firms experienced capital-biased technological progress relative to smaller firms, De Loecker et al.'s (2020) procedure would mechanically impute increased markups for large firms and reduced markups for small firms, even if there had been no change in any firm's markup. Finally, measured changes in market concentration are very sensitive to definitions of the market, a problem that has confounded antitrust economists for years.

In concluding this section, we wish to emphasize again that profit shares, markups, and measures of industry concentration are all endogenous outcomes. When researchers ascribe the fall in the labor share of national income to rising monopoly power in product markets, perhaps they have in mind some exogenous change in market power due to relaxation of antitrust rules and enforcement. However, there is little research that connects growth in these outcome variables to changes in the operation of antitrust policy; and, plausibly, some of the technological developments described in Section 4 above might be responsible for the observed changes in the variables that are taken as evidence of increased market power. Indeed, framing the question as whether the fall in the labor share has been due to changes in technology or changes in market power potentially presents a false dichotomy: If technological developments such as improvements in ICT and automation disproportionately benefit larger firms, as seems to be the case from the data, then these developments will also enhance the exercise of market power. The appropriate answer to the question "Was it technology or was it market power?" might well be "yes."

7. DECLINING MARKET POWER OF WORKERS

In addition to a possible increase in product market power, some researchers point to firms' ability to extract a greater share of the rents in their relationships with their employees as a source of the shifting distribution of income. A shift in bargaining power may have occurred due to changes in the regulations governing labor market interactions, to the sustained decline in union membership in some countries in the postwar period, or to increased concentration of employment within local labor markets that may have allowed firms to exercise greater monopsony power.

7.1. Changing Laws and Regulations

Blanchard (1997) and Blanchard & Giavazzi (2003) suggested years ago that changes in labor market regulations that affected the balance of bargaining power between firms and workers may have been responsible for movements in factor shares in the OECD countries in the 1970s and 1980s. More recently, Drautzberg et al. (2017, 2021) identified structural breaks in the evolution of the labor share following large political shocks that may have impacted labor laws and regulations, such as changes in states' right-to-work rules or minimum wages. Drautzberg et al. (2017) discuss the changes in the labor share that occurred in France following the worker strikes in 1968 that gave rise to a spate of prolabor measures,[26] in Portugal following the Carnation Revolution in 1974 that led to nationalizations and a new collective bargaining environment, in Argentina following the coups against the Peróns that brought business-friendly reforms and antiunion policies, and in other cases.[27]

[26] Caballero & Hammour (1998) list the policy changes in favor of labor that were enacted by France following the strikes there in 1968.

[27] Readers are also referred to Ciminelli et al. (2020), who show an association of declines in labor shares with the easing of employment protection legislation, and Bridgman & Greenaway-McGrevy (2022), who link declines in the labor share to reductions in public enterprise employment.

7.2. The Decline in Union Membership

Union membership in the United States, which peaked in the 1950s at about one-third of the private-sector labor force, declined slowly until the mid-1970s and then more precipitously, until it amounted to only 6% of US workers by 2019. Many authors point to deunionization as an explanation for a decline in worker power (Stansbury & Summers 2020) and a fall in the union wage premium—the premium that union members earn relative to nonunionized counterparts with similar skills and other attributes. Some go further by linking these trends to the recent decline in the labor share.

Consensus estimates put the union wage premium somewhere between 15% and 25% at its height (Rosenfeld 2014). Farber et al. (2018) show that the union wage premium has been fairly stable over the last century, with a modest decline over the last few decades. Farber and colleagues document a positive correlation between state-level labor shares since 1929 and state union membership rates, after controlling for time- and state-fixed effects and a variety of other factors. They use the passage of the Wagner Act in 1935, which legalized union organization, and the establishment of the National War Labor Board in 1942, which promoted unionization in establishments receiving defense contracts during World War II, as plausible exogenous sources of variation in states' unionization rates. Using these events as instruments, they continue to find that labor shares covary with union density. Stansbury & Summers (2020) also show a positive correlation across states and industries between the labor share and their measure of labor rents.

Why might the demise of unions lead to a reduction in the labor share? As Bentolila & Saint Paul (2003) point out, if unions force wages above the competitive rates and firms are left free to decide on employment, then the labor share will be higher with unions than without them whenever the elasticity of substitution between capital and labor is less than 1. Holmes et al. (2012) suggest another mechanism: If unions successfully impede the introduction of automated and other capital-biased technologies, then deunionization may result in greater adoption of technologies that imply a smaller revenue share for workers.[28]

Empirical efforts to link the union wage premium to the labor share may understate the role of unions in bolstering worker pay and the labor share. Stansbury & Summers (2020) point out that, in some industries where pattern bargaining is common, nonunionized firms often match the terms in union contracts. Farber (2005) provides suggestive evidence that nonunionized firms respond to a threat of unionization by preemptively raising their wages. Taschereau-Dumouchel (2020) develops a model of firms' response to union threat and shows by calibration that this mechanism can generate a quantitatively significant income boost for low-skill workers.

Of course, deunionization cannot have been an exogenous event. Some authors have argued that a quickening pace of skill-biased technological progress could be at least partly responsible for the demise of unions. Acemoglu et al. (2001) argue that skill-biased technical change causes deunionization, because it improves the outside option for skilled workers, thereby undermining the coalition between skilled and unskilled workers that may be needed to sustain a union. Açıkgöz & Kaymak (2014) provide some empirical support for this hypothesis. Dinlersoz & Greenwood (2016) suggest a different link between technology and unions. If organizing unskilled workers is costly, skill-biased technical change will reduce demand for low-skilled workers and, with it, the number of plants that unions will choose to organize. The same argument could apply to

[28] Schmitz (2005) argued that foreign competition that weakened unions in the iron ore industry led to modifications in work practices, with greater capacity utilization for capital and less idle time for workers. Changes in work practices can affect the factor shares even beyond the direct impact on wages by altering the productivity of each input.

globalization and offshoring, which might also be two forces behind deunionization; for example, Rothstein (2016) and Cohen & Early (2018) provide case studies of the automotive industry and the telecommunications industry, respectively.[29]

7.3. Increasing Concentration of Labor Demand

If firms exercise monopsony power in their relationships with their workers, then increasing concentration of firms in the relevant (local) labor markets could account for greater markdowns of wages relative to marginal revenue productivity and perhaps to a smaller labor share. There are now several theoretical models that capture this idea in one form or another, building on work by Manning (2013). Berger et al. (2019) develop an oligopsony model in which large firms face upward-sloping labor supply curves due to heterogeneous workers' preferences over the identity of their employers. The firms compete for labor by posting wages, which in equilibrium are below the competitive levels and are especially so for the larger, more productive firms. Jarosch et al. (2019) consider a search model with granular firms in which workers are more likely to reencounter larger firms in their job searches subsequent to failed bargaining or exogenous separations. They assume that firms can commit not to hire workers with whom prior negotiations have broken down. When a worker negotiates with a large firm, their outside option excludes that firm, and so their bargaining position is weak, resulting in a lower negotiated wage. Gouin-Bonenfant (2020) emphasizes the interaction between productivity dispersion and firm competition for workers. His model features search frictions and on-the-job search. In equilibrium, high-productivity firms post higher wages in order to poach workers from their lower-paying competitors and to avoid poaching from higher-paying competitors. He shows that a higher dispersion of productivities, which implies a greater concentration of employment, results in a lower aggregate labor share. Greater dispersion implies less sensitivity of the wage to the risk of being poached for the most productive firms, which pay their employees the smallest share of revenues.

Evidence of a link between wages or the labor share and labor market concentration is plentiful and varied. Azar et al. (2020a,b) use data from online job postings to show an inverse correlation between real wages and market concentration. Benmelech et al. (2020) do something similar using US Census data, and they show that the negative correlation is stronger when unionization rates are low. Arnold (2020) uses a difference-in-difference approach to establish that mergers and acquisitions that result in increased concentration of local labor markets induce relative wage declines, the more so the greater the initial level of concentration is. In tradable industries, mergers are associated with lower relative wages only where local labor market concentration increases, suggesting that the correlation is not driven by changes in product market power. Prager & Schmitt (2021) find that mergers of hospitals reduce wage growth for high-skilled workers when the mergers raise employer concentration, but that this is attenuated in the presence of strong labor unions.

These and other authors have worried about joint determination of concentration and wages. Arnold (2020) argues that, by using merger activity, it is possible to identify reasonably exogenous variation in concentration, especially if the mergers reflect national considerations. Schubert et al. (2021) develop an instrument for employer concentration based on differential local exposure to national enterprise growth trends. They argue that, when a large employer grows nationally, local concentration will grow more in those locations that had a large presence of that employer initially, and that a firm's decision to grow nationally will not depend on local economic conditions. Berger et al. (2019) use an instrument for labor demand shocks when estimating labor supply elasticities that is based on changes in state corporate tax rates.

[29]The threat of offshoring might also weaken the bargaining position of unions (see Jeon & Kwon 2017, 2019).

Hershbein et al. (2020) take a different approach. They use production function estimation à la De Loecker & Warzynski (2012) to compute wage markdowns. Assuming that there is no markdown for materials, they interpret differential gaps between the output elasticities with respect to labor and materials inputs and their respective revenue shares as indicative of monopsony power in the labor market. The pattern of markdowns that they estimate matches variation in the labor share across plants fairly closely. However, the production function that they estimate, much like the one estimated by De Loecker et al. (2020), allows only for Hicks-neutral differences in technology across plants and time. Thus, just like these other authors, they cannot distinguish changes in the exercise of market power from capital-biased productivity differences across space and time.

Whether or not higher concentration might result in lower wages and a smaller labor share, several researchers challenge the premise that local labor market concentration has in fact been rising. Using different definitions of the boundaries of the local labor market, a variety of authors such as Lipsious (2018), Rinz (2018), Berger et al. (2019), Hershbein et al. (2020), and Rossi-Hansberg et al. (2021) come to a similar conclusion: Local labor market concentration has actually decreased over the last few decades. Benmelech et al. (2020) find stable, or at most slightly increased, employment concentration over this period. In short, despite ample evidence that labor markets are imperfectly competitive and that workers are paid less than their marginal revenue product, it is not at all clear that firms' exercise of monopsony power has been rising over time.

8. DEMOGRAPHICS AND EDUCATION

Some authors attribute a portion of the decline in the labor share to changes in the composition of the labor force. The workforce in many advanced countries has been aging due to increased longevity and reduced fertility. Moreover, it has become better skilled due to steady gains in educational attainment.

Acemoglu & Restrepo (2022) assume that robots substitute for middle-aged workers but complement more senior workers, arguing that the former group has comparative advantage in performing production tasks, whereas the latter has a comparative advantage in providing services.[30] Demographic changes that reduce the ratio of middle-aged workers to senior workers create incentives for firms to develop automated technologies and to adopt robots for production. Acemoglu & Restrepo's (2022) model of directed technical change predicts greater use of robots in regions with relatively older populations, and it estimates that adoption of robots will be more pervasive in industries that rely more on middle-aged workers and that provide more opportunities for automation. Both predictions find support in their cross-sectional analysis of different industries, countries, and commuting zones. Interesting from our point of view are their findings that the decline in the labor share has been more pronounced in countries that are aging more rapidly and in industries that have greater reliance on middle-aged workers.

Glover & Short (2020) suggest a different link between the age distribution and the labor share. If job mobility falls with age, as seems plausible, older workers will command a smaller share of any match surplus in a labor market that admits on-the-job search. The gap between a worker's productivity and pay may widen with age, in which case labor as a whole will capture a smaller share of rents from employment in an economy with an older and less mobile labor force. In support of their hypothesis, Glover & Short (2020) show that industries that experienced greater aging

[30]Ramey (2017), in her discussion of an early draft of Acemoglu & Restrepo's (2022) paper, points out that industries that make more intensive use of robots still have a greater density of middle-aged workers than other industries, and that there is little evidence that industries that have been adopting robots rapidly have also been shedding middle-aged workers faster than others.

also saw a greater decline in their labor share. By their reckoning, this mechanism can account for 59% of the post-1980 decline in the US labor share.

Hopenhayn et al. (2018) propose yet another possible link between the rate of population growth and the functional distribution of income. They argue that a change in the population growth rate affects the size distribution of firms. In the long run, firm survival rates are time invariant for firms of a given age and average size. When population growth slows, labor market equilibrium must ultimately be realized by a slowdown in the entry rate of new firms. The effect on the size distribution will be magnified if, as the data suggest, hazard rates of exit are decreasing in cohort age. If, as Hopenhayn and colleagues suggest, reduced population growth shifts the age distribution of firms toward older enterprises, this could reduce the labor share, because older firms are larger and more capital intensive than their newer counterparts, and such firms pay a smaller share of their revenues to workers.

Not only has longevity increased, but many people are opting to remain in school longer and are accumulating more human capital. Grossman et al. (2021) examine the implications of endogenous educational choices for long-run factor shares. They consider an aggregate production function characterized by capital-skill complementarity. In a competitive equilibrium with an elasticity of substitution between capital and labor less than 1, there is an inverse relationship between human capital per worker and the labor share in national income for a given real interest rate. Grossman and colleagues develop a model of investment in education that features perpetual youth and a constant hazard rate of death. They show that in this setting it is optimal for members of each generation to attend school full-time until they achieve a (time-varying) target level of human capital. With growth driven by exogenous capital-augmenting and labor-augmenting technical progress, educational attainment grows over time provided that the former type of technical progress is positive. Then new generations delay their entry into the labor force in order to accumulate skills that are complementary to the latest and best machines. The economy approaches a steady state with stable factor shares, because the downward pressure on the capital share due to capital accumulation is offset by the boost in the marginal product of capital provided by the gain in skills.

Grossman et al. (2021) derive an expression for the long-run labor share as a function of the birth rate, the death rate, and the pace of capital-augmenting and labor-augmenting technological progress. A productivity slowdown, such as many advanced economies have experienced of late, generates a decline in the labor share, provided that the elasticity of substitution between capital and labor and the elasticity of intertemporal substitution are both less than 1. Intuitively, a productivity slowdown induces a decline in the real interest rate in excess of the decline in the growth rate of wages; so while the rate of increase of educational attainment may slow down, the target level of educational attainment rises. This causes the schooling-adjusted effective capital-to-labor ratio to fall, which redistributes income from labor to capital. Thus, Grossman and colleagues point to the slowdown in rates of technological growth as yet another possible explanation for the fall in the labor share.

9. WILL THE LABOR SHARE CONTINUE TO FALL?

As the Danish politician Karl Kristian Steincke once said, "It is difficult to make predictions, especially about the future."[31] However, many economists appear to believe that further automation, robotization, globalization, market concentration, and aging of the population spell ongoing

[31] The attribution of this quote is debated (see, for example, **https://quoteinvestigator.com/2013/10/20/no-predict/**).

declines for the labor share. Some even fear that the labor share in national income might fall to zero.

We are more sanguine. The remarkable stability of the labor share for more than a century—despite the fact that labor shares in specific industries regularly undergo large changes, and despite the long list of factors that, as we have seen, have the ability to alter the functional distribution of income—suggests to us the existence and operation of powerful stabilizing forces. The exact nature of these forces has yet to be firmly established, but the literature identifies several candidates. The simplest, of course, would be a unitary elasticity of substitution between capital and labor in an aggregate production function, if such a function can be defined. Then any shift in the supply or demand for labor would generate wage movements that exactly counteract the initial shock. However, as we discuss in **Supplemental Appendix A**, the evidence seems to reject a unitary aggregate elasticity of substitution between capital and labor.

Supplemental Material >

Stabilization could come from the demand side or the supply side of the factor markets. On the demand side, Acemoglu (2002, 2003) points to directed technical change. When the cost share of a factor in scarce supply begins to rise, private agents find an incentive to invest in innovations that reduce that cost. As long as capital and labor are complements in aggregate production, technical change directed at the factor whose share is abnormally high will tend to offset the short-term effects of any shock. In Acemoglu's (2003) work, the supply of capital is perfectly elastic in the long run. Since labor cannot be accumulated but capital ultimately is not scarce, the perpetually rising labor bill induces technical change directed at labor. Acemoglu & Restrepo (2018) and Jones & Liu (2021) similarly propose models with two types of technical change that have offsetting effects on the labor share. Acemoglu & Restrepo note the countervailing influences of automation that increases the range of tasks that can be performed by machines and innovation that creates new tasks that are performed by labor alone. Jones & Liu consider automation together with capital-embodied technical change, which raises the labor share if capital and labor are complements. But the more general point is that a rising factor share for any input will generate a technological response.[32]

On the supply side, agents might invest in children or schooling to overcome a short-term shortage of some factor. For example, in Becker et al.'s (1990) work, fertility responds endogenously to the return that altruistic parents reap from bearing children relative to the return on their investments in (physical and human) capital. When parents foresee ample earning power for their children, they choose to produce more of them. Grossman et al. (2017, 2021) propose that individuals spend more time in school when the skill premium is high. In their setting with complementarity between physical capital and raw labor, capital-augmenting technical change or investment-specific technical change induces a short-term decline in the capital share. Then, if the aggregate production function is characterized by capital-skill complementarity, the return to investments in skill rises, leading new generations to remain in school longer. The accumulation of skills in turn raises the return to capital, thereby offsetting the initial shock.

In the presence of stabilizing forces such as these on the demand or supply side, shocks that move factor shares in the short run are (at least partially) reversed in the longer run. A sudden burst of automation, a shift in industry composition due to nonhomothetic preferences, differential productivity growth of different factors, or increased competition from imports generates a short-run response in factor shares. However, the response of private agents is to conserve on the use

[32]Li & Bental (2019) show that if the technology for capital accumulation is nonlinear, say due to adjustment costs, then the growth process with endogenous technical change will combine elements of capital-augmenting and labor-augmenting progress. In general, more innovation is directed at the factor with the smaller long-run supply elasticity.

of the expensive factors or to provide more of these factors to take advantage of their temporarily high return. Although the conditions for exact long-run constancy of factor shares are delicate in any particular model, it is easy to believe that equilibrating forces might keep these shares in a relatively narrow range. Identifying and measuring these forces in the data are challenging tasks, however, because they operate slowly and may not be seen in cross-sectional data for the reasons discussed in Section 3.

10. WHY SO MUCH OVERCOUNTING?

As we have seen, a vast literature purports to explain the recent decline in the share of labor in national income. Unfortunately, it explains the phenomenon many times over. If we sum the amounts explained by the various mechanisms proposed in the literature, the total easily comes to three or four times the amount by which the labor share actually fell. In this concluding section, we offer two potential explanations for this embarrassment of riches.

First, the literature identifies many proximate causes of the decline in the labor share, but precious few fundamental ones.[33] As a result, many authors present different sides of the same coin. This creates a problem of interpretation inasmuch as the same primitive cause can move many endogenous variables together. Even if the various mechanisms that have been suggested all are active, it becomes difficult to gauge what part of the effect estimated in one study has already been accounted for elsewhere. Take, for example, technological advances that give rise to falling prices of ICT capital. Such advances can directly induce substitution of capital for labor, but if they disproportionately benefit larger firms, they can also lead to rising concentration, greater exercise of product and labor market power, and perhaps a change in returns to scale. Without an independent source of variation in the data, it will be difficult to distinguish which effects on factor shares work through the mechanism of rising markups and increased profits and which ones work through altered production techniques. Meanwhile, the nature of technological progress could reflect directed innovation, which in turn could be a response to the reduced costs of offshoring. Improved opportunities for offshoring might result from lower communications costs and might also be responsible for deunionization and loss of worker power. In short, the literature on the declining labor share offers a long list of potential mechanisms, many of which seem plausible. The operation of these mechanisms can be studied in a cross-section of firms and industries, and much can be learned about whether microeconomic responses correspond to the predictions of the models. However, cross-section evidence may not shed much light on the evolution of the aggregates, for the reasons we outlined in Section 3. Meanwhile, the recent economic history is short and macroeconomic variables move together, so identification in the time series raises insuperable challenges.

Second, publication bias may be at play. It is widely (though not universally) accepted that the labor share fell in recent decades and that this fact demands elucidation. Many events happened during the period in question, and whereas some have likely pushed the labor share downward, others may have buffeted the decline. With the goal of finding an explanation for the decline, economists conducting research on the topic may well have pursued mechanisms that predict a decline in the labor share and may have abandoned those with predictions of countervailing effects. If researchers selectively pursue ideas that imply a fall in the labor share and neglect those that predict the opposite, the cumulative weight of the theories and their quantifications is bound to overshoot its target.

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[33]This predicament is shared by the literature that assesses cross-country differences in income. We thank Richard Rogerson for pointing out this analogy.

The literature we have reviewed is voluminous and interesting. It has taught us a lot about different kinds of capital technologies, about the determinants and evolution of market power in product and labor markets, and about the possible consequences of demographic changes. However, the explanation for any durable realignment of factor shares—if indeed such a realignment has occurred—remains elusive.

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