Declining Labor Shares and the Global Rise of Corporate Saving

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One of the most recognized stylized facts of economic growth is the stability of the labor share (Kaldor, 1957), defined as the proportion of an economy’s total income paid out to workers as compensation for their time. While this regularity may very well hold across centuries or in the very long run, our recent work (Karabarbounis and Neiman, 2012) demonstrates its failure over the last three decades.

We show that labor shares have eroded in most countries around the world, including seven of the eight largest economies. Globally, corporations paid about 65 percent of their income to labor (as opposed to capital) in 1975, compared with about 60 percent in 2007.\(^1\) This trend can be seen

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\(^1\) Earlier work including Blanchard (1997), Jones (2003), Bentolila and Saint-Paul (2003), Harrison (2002), and Rodriguez and Jayadev (2010) also note variability in the labor share over the medium run. Our work is generally consistent with these papers, but differences in focus, data, and methodology discussed in our paper allow us to more broadly conclude that the global labor share has declined.
in the red dashed line in Figure 1, which shows a more than 5 percentage point decline in the labor share in the eight largest economies of the world.\(^2\)

What happened to the increasing share of income not being paid to labor? We demonstrate that a large fraction of increased corporate profits was retained within the corporate sector in the form of saving (rather than distributed back to shareholders in the form of dividends). Indeed, all eight of the world’s largest economies experienced increases in the share of their total saving originating from the corporate sector rather than from households or the government. The upward sloping black line in Figure 1 shows a striking increase of more than 20 percentage points in the share of saving originating from the corporate sector. In essence, thirty years ago global investment was primarily funded by household saving whereas now it is primarily funded by the saving of corporations.

What caused these trends? One might hypothesize that international trade has allowed capital abundant countries like the United States to shift out of labor-intensive sectors. This explanation, however, would counterfactually imply an increase in labor’s share in developing countries such as China. An alternative hypothesis is that the increase in market power led to higher profit margins and lower labor shares. However, such an explanation would also imply a distortion of the incentive to invest in corporate physical capital which would likely cause a decline in corporate saving. In this sense, studying jointly the trends in labor and corporate saving shares offers powerful corroboration of any explanation relative to other explanations which could on their own generate only one of the two trends.

Our explanation emphasizes the decline in the cost of capital that firms have faced over the last thirty years. In particular, the relative price of investment goods compared to consumption goods declined sharply around the world beginning around 1980, right around the same time the trends began in the data.\(^3\) Further, we demonstrate that countries experiencing greater investment price declines also experienced greater reductions in labor shares and greater increases in corporate saving.

\(^2\) The figure plots year fixed effects (normalized to 0 in 1975) from a regression of corporate labor shares in the eight largest economies on year and country fixed effects. We measure the labor share within the corporate sector and therefore exclude government and unincorporated enterprises.

\(^3\) Fisher (2006) documents an acceleration of this decline in the United States in the early 1980s. In our paper we also show that other components of the cost of capital, such as corporate income taxes, have declined globally over the last thirty years.
saving shares. To the extent that the decline in investment prices reflects the IT revolution, these empirical relationships suggest that the computer and internet age may have also brought a shift in labor’s role in production.

To assess the effects of a decline in the price of investment goods, we develop a model in which firms produce output by combining capital and labor and in which capital market imperfections lead firms to prefer financing investment opportunities with internal saving rather than with external funds (such as equity). In response to a decline in the investment price, firms substitute away from labor and toward capital, reducing labor’s share. They increase corporate saving as the cheapest means to finance this expansion of the capital stock, increasing the share of corporate saving. When we feed into our model the 21 percent decline in the relative price of investment goods observed globally, we find that this decline accounts for roughly half of the trends in corporate labor shares and saving shares observed in the data.

Changes in the labor share have broader implications including for inequality and for our understanding of how firms operate. Similarly, changes in corporate saving have important implications for domestic and international financial markets. In future work we hope to explore the implications of these global trends for business cycles, inequality, and global imbalances.

References