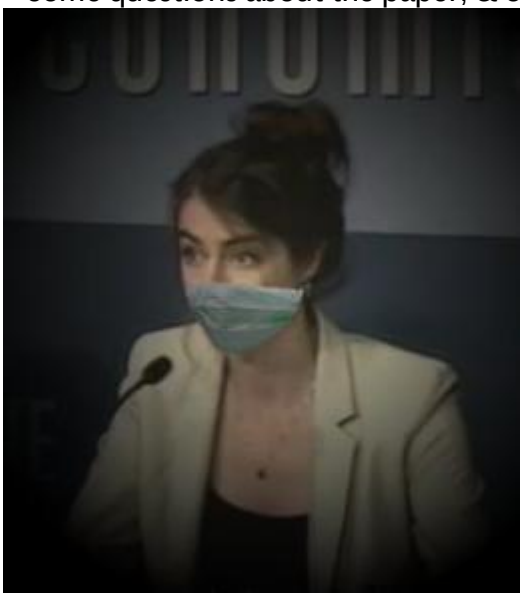
A thread written by @annastansbury,

Anna Stansbury, May 28, 2020

+ Some questions about the paper, & our responses : see below



We argue* that the decline in worker power in the U.S. economy can explain:
(1) the entirety of the decline in the labor share,
(2) much of the increase in corporate valuations, profitability, & measured markups,
(3) a large share of the fall in the NAIRU

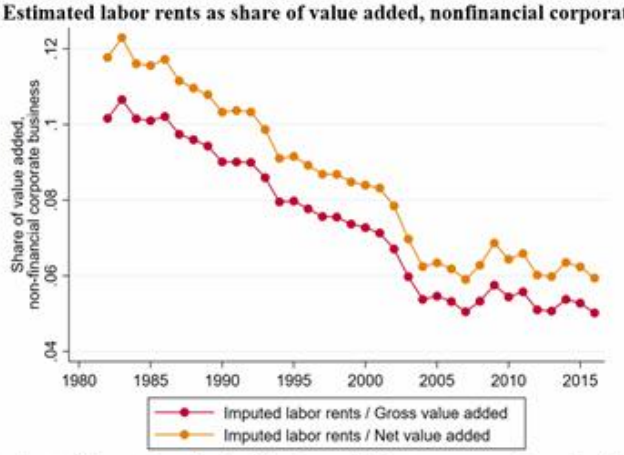
Of course, our focus on the decline of worker power is not new: we build on a long history of progressive institutionalist work in econ, sociology, and political science, which identifies the decline of worker power as one of the major structural trends in the U.S. economy. But falling worker power has been *under-emphasized* as a cause of these trends in recent macro debates - relative to explanations based on globalization, tech change, or rising monopoly/monopsony power. The declining worker power explanation is –we think– more compelling

How could declining worker power explain these trends? If firms have some monopoly power & earn rents, worker power means workers receive a share of rents. As worker power falls, rents are redistributed from labor to capital, leading to ⇩ labor share, ⇧ profitability & Q. Falling worker power could also explain rising measured markups: commonly-used markup measures are based on some ratio of sales to costs, where costs includes labor costs. As rents to labor fall, measured labor costs fall - without any change in underlying product market power

We roughly quantify the decline in labor rents, using estimates of wage premia for workers in unions, large firms, and high-paying industries. We estimate that labor rents fell by half over 1982-2016: from 12% to 6% of net value added in the nonfinancial corporate sector

* Anna Stansbury, Lawrence H. Summers, "Declining Worker Power and American Economic Performance », *Brookings Papers on Economic Activity*, Spring 2020; "The Declining Worker Power Hypothesis: An Explanation for the Recent Evolution of the American Economy », NBER, May 2020.

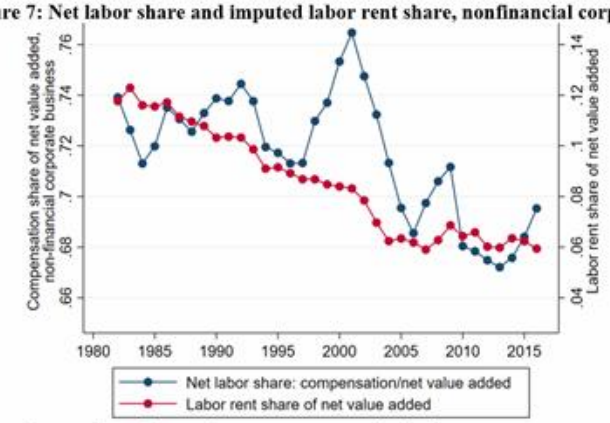
Figure 5: Estimated labor rents as share of value added, nonfinancial corporate sector



Note: Labor rents imputed from estimated union, firm size, and industry wage premia as described in Section II. Data on compensation and value added in nonfinancial corporate business sector from BEA NIPA.

The decline in labor rents we estimate – caused by the decline in worker power – is big enough to explain the *entire fall in the U.S. labor share* since the 1980s.

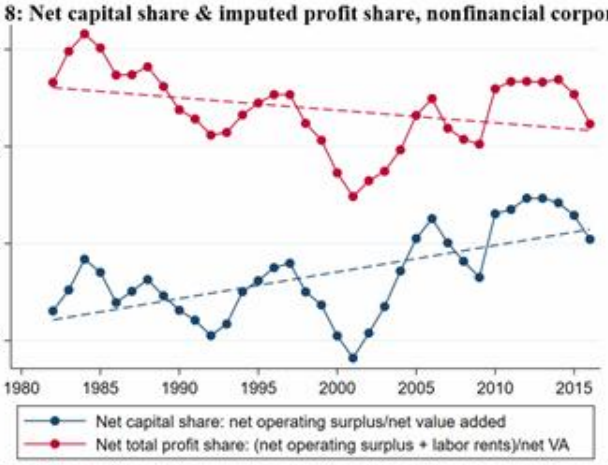
Figure 7: Net labor share and imputed labor rent share, nonfinancial corporate



Notes: Net labor share in the nonfinancial corporate sector is calculated as compensation over net value added, using BEA NIPA data. Our measure of the imputed labor rent share of net value added is calculated as described in Section II.

Note that labor rents, in our framework, come from firms' profits. Some profits go to capital, some go to labor. So while it looks like the aggregate profit share has risen, the *underlying* profit share (profits to capital + labor rents) may have stayed pretty constant.

Figure 8: Net capital share & imputed profit share, nonfinancial corporate



Notes: Net capital share in the nonfinancial corporate sector is calculated as net operating surplus over net value added. Our measure of the net total profit share is calculated as the net operating surplus plus our measure of imputed labor rents (explained in Section II), divided by net value added. Dashed lines are lines of best fit.

This holds up at the more disaggregated level too. Industries and states with bigger declines in our measure of labor rents also saw bigger falls in their labor shares. And industries with bigger falls in labor rents saw bigger increases in profitability and Tobin's Q.

Figure 10: Change in labor share and imputed labor rent share, by industry

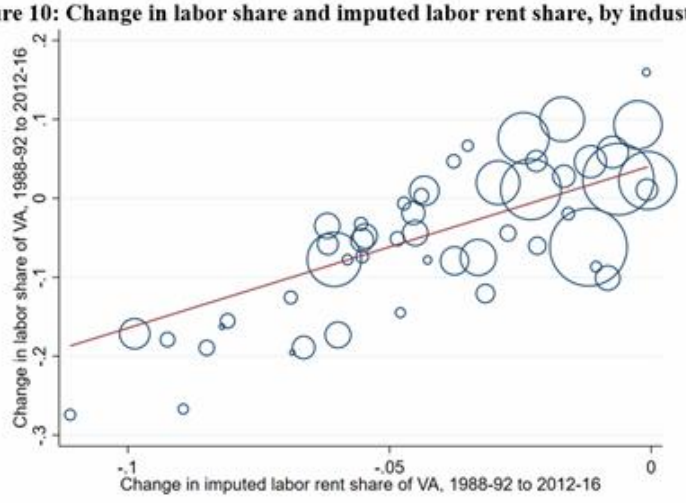
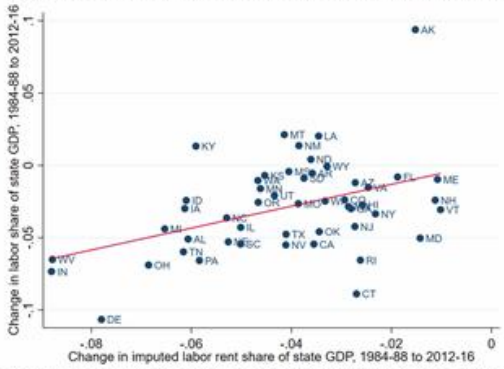
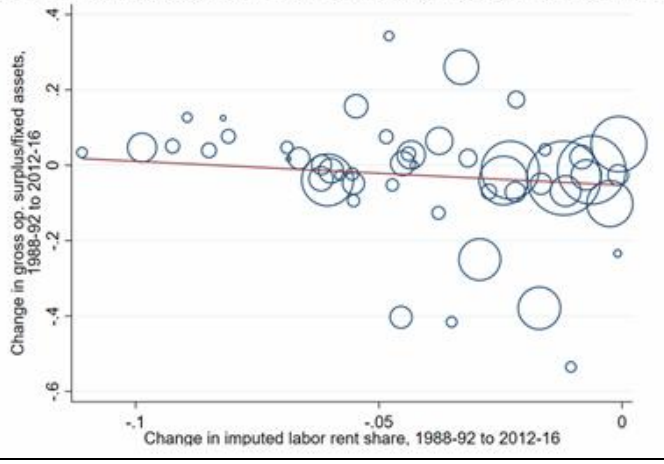


Figure 9: Changes in state-level labor share and labor rent share, 1984-88 to 2012-16



Note: Imputed labor rent share of state GDP calculated from estimated union, firm size, and industry wage premia, state-level unionization rates (estimated in CPS), and compensation by industry (from BEA Regional Economic Accounts). Labor share of state GDP defined as state-level compensation over GDP.

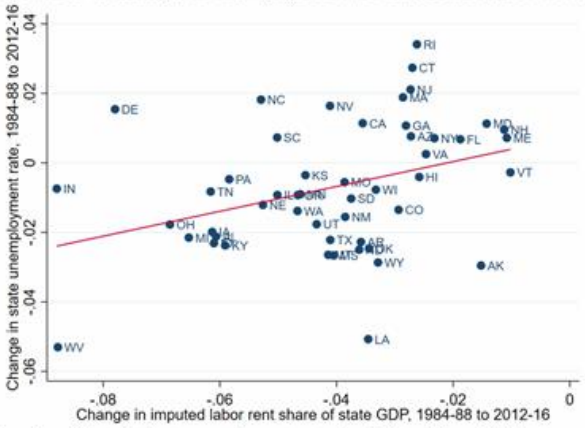
Figure 12: Change in gross profitability and imputed labor rent share, by industry



A third major macro trend has been the decline in the NAIRU: average unemployment had fallen substantially (until now...) even as inflation has stayed low and stable. On the basis of most models, you'd expect a decline in worker power to lead to a fall in the NAIRU…And indeed, we find that states and industries with bigger falls in labor rents also had bigger falls

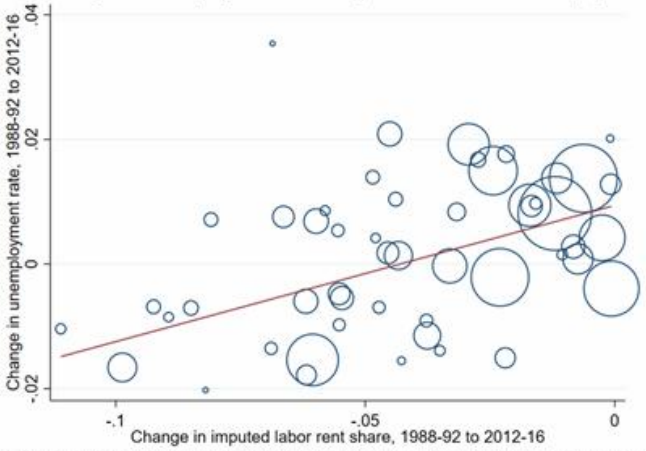
in unemployment since the 1980s. A simple extrapolation of the coefficients from the state-level analysis predicts a fall in the NAIRU of 0.75pp since the 1980s.

Figure 14: State-level changes in unemployment and labor rents, 1984-88 to 2012-16



Note: The red line is a line of best fit. State unemployment rate is calculated from CPS. Labor rent share of GDP is our calculation.

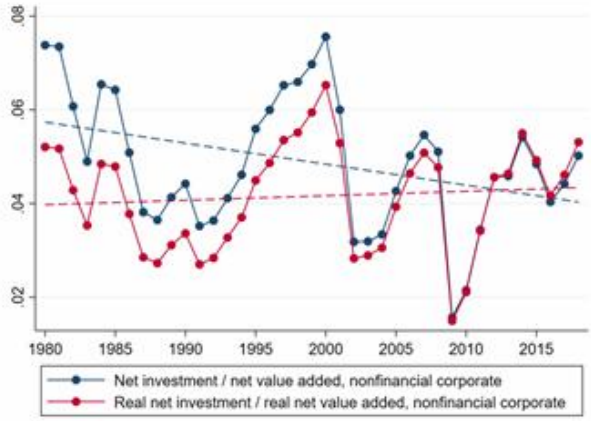
Figure 15: Change in unemployment and imputed labor rent share, by industry



Notes: Each bubble is an industry (at the BEA industry code level), where the size of the bubble represents industry average employment over 2012-2016. The red line is an employment-weighted line of best fit.

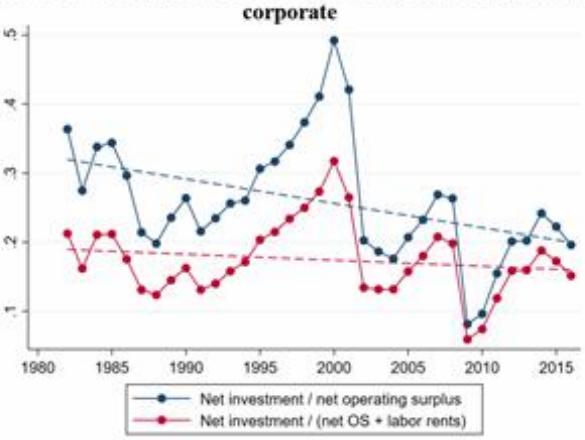
Finally, some argue that falling investment/fundamentals could have been caused by monopoly power. But (1) real investment has fallen much less than nominal, and (2) investment relative to *underlying profits* (profits to capital + rents to labor) has fallen very little.

Figure 17: Real and nominal net investment over net value added, nonfinancial corporate sector



Notes: Gross nonresidential investment and consumption of fixed capital for nonfinancial corporate sector are from Fed Z1 accounts. Gross value added for nonfinancial corporate business is from BEA NIPA. Deflator for investment is implicit price deflator for nonresidential fixed private sector domestic investment from BEA; deflator for value added is implicit price deflator for nonfinancial corporate business from BEA.

Figure 18: Net investment to profits to capital, and imputed total profits, nonfinancial corporate



Notes: Investment is measured as gross fixed investment in nonresidential structures, equipment, and intellectual property products for nonfinancial corporate business, from Federal Reserve Z1 Flow of Funds Account. We obtain net investment by subtracting the consumption of fixed capital for the nonfinancial corporate sector (also from the Fed Z1 accounts) from gross investment. Gross nonresidential investment and consumption of fixed capital for nonfinancial corporate sector are from Fed Z1 accounts. Gross operating surplus for nonfinancial corporate business is from BEA NIPA. Labor rents measure is constructed as described in Section III.

At the start of this thread, we wrote that declining worker power had been under-emphasized relative to other explanations based on globalization, technological change, and monopoly or monopsony power. What about those explanations?

While globalization & tech change are clearly important:
(1) the labor share decline has been bigger in US than other countries, & (2) trends in Q, profitability, markups are hard to explain under perfect comp, suggesting a role for country-specific non-competitive factors
Of course, unionization was affected by globalization and tech change (increasing elasticity of labor demand)- but this can't be the whole story. A similar proportional fall in unionization occurred across industries, & cross-country trends in unionization have been very different

Figure C1: Decline in unionization rates by sector, 1984-2019 (3-year moving average)

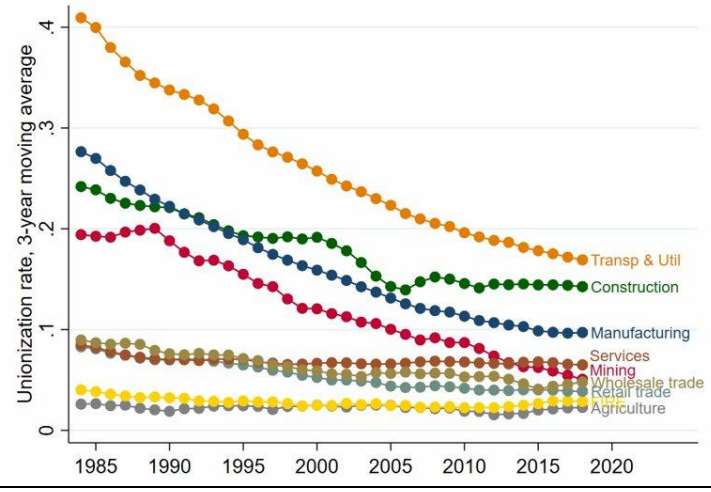
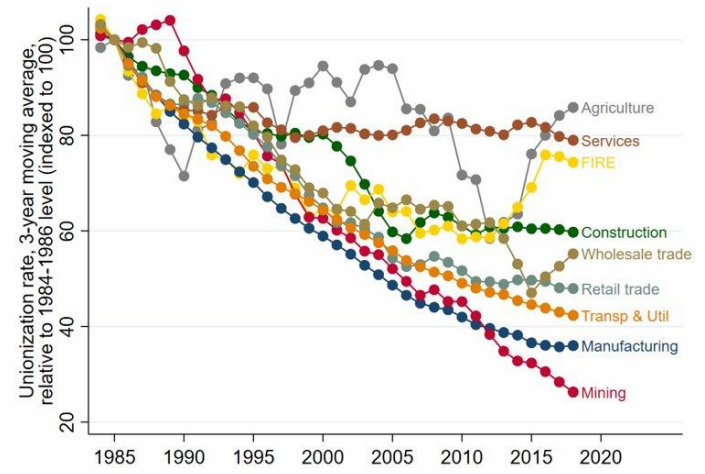


Figure C2: Decline in unionization rates by sector, 1984-2019 (3y ma, indexed to 1984-86)



While monopoly and monopsony power matter in a static sense, and have likely ⇧ in some markets:

(1) declining worker power can explain aggregate trends in labor share, Q, profitablIity, markups equally well, *defining monopsony as arising from elasticity of LS to firm

(2) Declining worker power is more consistent w/ industry level evidence:

- Worker power has more explanatory power than concentration for labor share, profitability & Q
- Much of labor share ⇩ was in manufacturing (where, w/ globalization, ⇧ monopoly power seems unlikely)

(3) Declining worker power is more consistent with the fall in the NAIRU,

(4) There is more direct evidence of a broad-based decline in worker power than of a large aggregate increase in monopoly or monopsony power

What do we actually mean by "decline in worker power"? Falling unionization & union power, falling real min wage, & increased shareholder empowerment & activism of shareholders have all disempowered workers in recent decades. Lots of work demonstrating and studying this.

What does this all mean?

The evidence is quite compelling that institutional changes, causing a decline in worker power, have been at the root of many of the major macro trends in the American economy over recent decades....And if falling worker power has indeed been a major cause of rising inequality & low wage growth, & if these problems can't be addressed by making markets more competitive, it would strongly suggest that more should be done to promote workers' countervailing power.

Finally, it is worth highlighting that our hypothesis is perhaps more deeply threatening to existing thinking than the other prominent hypotheses for the causes of the decline in the labor share. The globalization or technological change perspectives would imply that any adverse distributional consequences have come alongside greater efficiency, which would have made Pareto-improving redistribution possible (at least in principle). The monopsony and monopoly perspectives suggest that the rise in inequality has come alongside the economy becoming less efficient, which allows economists to be in the congenial place of arguing for policies that simultaneously perfect markets, increase efficiency and promote fairness. In contrast, the declining worker power perspective would imply that the increased inequality we have seen over recent decades may not have come alongside greater efficiency. And the policy implication if these trends are to be reversed - doing more to preserve rent-sharing - interferes with pure markets and may not enhance efficiency on at least some measures.

The Declining Worker Power Hypothesis: Questions & Responses

scholar.harvard.edu/stansbury/declining-worker-power-hypothesis-questions-responses

In this post, Larry Summers & I collate questions people have asked about our paper, "The Declining Worker Power Hypothesis", and respond to them (thanks to Tyler Cowen for the impetus for us to write this up!).

1. Could the decline of labor rents have been caused by "management measuring the marginal product of labor more precisely", perhaps through increased use of employee monitoring technologies?

Yes, this is possible. Increased ability for managers to monitor employee activity would likely lead to increased pay dispersion within employees and, under certain conditions, can also cause an across-the-board decline in wages. This is partly what we mean when we allude to more "ruthless" management practices. These practices would tend to push workers' pay closer to the minimum that a company can afford to pay while retaining each worker – that is, the worker's outside option – which would be the marginal product of labor in a perfectly competitive labor market or the monopsonistically competitive level in a monopsonistic labor market.

2. Don't some – highly paid – workers have more bargaining power than before? This might include managers and executives, or financial professionals.

*Yes: for this reason, we note explicitly that we are measuring the decline in worker power and labor rents of the *majority* of workers. Our measure doesn't capture the very highest paid. Some of the redistribution of labor rents may have been upwards from the majority of workers to a small segment at the top of the income distribution of very highly paid managers and executives (See Appendix Section C11). Our baseline analysis is for the nonfinancial corporate sector so excludes workers in finance, but we replicate similar results for the corporate sector including finance. Note, though, that our estimates of labor rents won't include highly paid workers in finance, so it's also possible that there was redistribution of labor rents upwards to highly paid workers in finance (See Appendix Section B2).*

3. Has the labor share even fallen? Part 1: Labor's share does not appear to have fallen nearly as much if you consider workers' receipts of equity compensation, or if you consider the owners of passthrough firms (i.e. people who run and own their own businesses).

*It's unclear whether to consider equity-based compensation, or the compensation of the owners of passthrough firms, to be labor income or to be capital income. Regardless, our work focuses on the decline in worker power and in labor income for the *majority* of workers. The large increases in income in the form of equity-based compensation, or accruing to owners of passthrough firms, have been at the very top of the income distribution. So while*

the magnitude of the decline in the aggregate labor share may not be clear, it is very clear that the share of income which is labor income for – say –the bottom 90% of workers or even 99% of workers has fallen substantially.

4. Has the labor share even fallen? Part 2: How do we take into account housing (Rognlie), depreciation (Bridgman), or the imputation of mixed income?

*We focus on the compensation share of income in the *corporate* sector (to be precise: the nonfinancial corporate sector in our main analysis, and the entire corporate sector in the Appendix). Focusing on the compensation share in the corporate sector excludes housing, and excludes issues of the imputation of mixed income. Furthermore, in our main analysis we focus on the labor share of value added net of depreciation. Since depreciation rates rose over the period, the decline in the gross labor share was bigger than the decline in the net labor share (See Appendix Section C6). Most of the analyses of the labor share in recent years have focused on the corporate sector for these reasons, and indeed Rognlie (2014), who raised the point about the role of housing, finds a decline in the labor share in the corporate sector since the 1980s and identifies a large role for what he calls "pure profits" (which could represent our channel of the redistribution of rents between labor and capital).*

5. If corporate profits are so high, how is this consistent with the persistently low demand postulated by Summers' "secular stagnation" hypothesis?

Secular stagnation as we think of it is the product of a rising gap between the desire to save and the desire to invest (which, in an IS-LM type framework, would push down the neutral real interest rate). Falling worker power redistributes income from lower and middle-income people to the rich. The rich have a higher propensity to save. Thus, falling worker power increases the desire to save relative to the desire to invest. Rising inequality has been posited by several authors as a contributor to the declining neutral real interest rate (see e.g. Smith and Rachel 2015). Under this view, secular stagnation is exemplified by low private return to capital investment – but, in a noncompetitive world, this may or may not be the same thing as an abnormally low profit rate or capital share.

6. Was the decline in worker power endogenous to changes in globalization and/or technology?

Certainly both technological developments and globalization, by influencing the "outside options" of firms, influenced the extent to which workers can exercise power. In addition, for some firms, increased global competition may have destroyed product market rents, reducing the degree to which even workers with some degree of rent-sharing power are able to increase their pay.However, there are strong indicators that at least some large part of the decline in worker power was not endogenous to these broader macro trends. First, different countries, with arguably similar exposure to globalization and technological change, saw very different trends in unionization rates – one measure of worker power – over the period (see e.g. Schmitt and Mitukiewicz 2012). Second, within the U.S., both tradable and non-tradable industries – i.e., with different exposures to globalization – saw similar proportional declines in unionization rates. Third, within manufacturing, the industries with the biggest declines in

wage premia were not those with the biggest increases in import competition (see Section II.B). Fourth, there is a wealth of direct evidence of changes in policy, institutions, and norms, which would be expected to decrease worker power (and which did not stem from globalization or technological change), including the weakening of labor law and labor law enforcement, the breakdown of pattern bargaining, the expansion of right-to-work across several states, and the increase in shareholder activism.

7. The measure of inequality you focus on is the share of income going to labor vs. capital. What about other aspects of income inequality?

While we don't focus on it in our paper, there is good evidence that declining worker power – particularly, the evidence focuses on the decline of unions – has increased income inequality in the U.S.. For recent evidence, see Farber et al (2018) and Fortin et al (2019), for example. We do estimate labor rents for college vs. non-college workers, and find that labor rents as a share of compensation fell much more sharply for non-college workers, both because the non-college unionization rate declined much faster, and because the large firm wage premium declined much more for non-college workers. We also carry out a back-of-the-envelope estimate as to the degree to which the decline in worker power might explain the rise in the income share of the top 1% (See Appendix Section C11).

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