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Despite Tight Job Market, Labor Force's Income Is Squeezed

Workers' slice of the pie has been shrinking, confounding economists

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WASHINGTON—With U.S. unemployment near lows seen a half-century ago and labor so scarce that companies routinely complain of shortages, you might think American workers, with more bargaining power, are getting a bigger slice of the nation's economic pie.
They're not.

Labor's share of domestic income has been declining since 1970 and has barely recovered in this expansion from lows last seen when the U.S. was pulling out of the Great Depression.

Employee pay and benefits as a percentage of gross domestic income fell to 52.7% in last year's third quarter, for the fourth straight quarterly decline, according to data from the Bureau of Economic Analysis. It was as high as 59% in 1970 and 57% in 2001. If workers were commanding as much of domestic income as they did in 2001, they'd have nearly $800 billion more in their pockets, or $5,100 per employed American.

While the labor share has fallen, business profits are on the rise. Income of corporations, proprietorships, landlords and other businesses has climbed from less than 12% of gross domestic income in the 1980s to more than 20%.

The numbers reflect a decadeslong trend that has coincided with stagnant middle-class incomes, lower union membership and increased global trade. While corporate profits benefit some households in the form of dividends and higher stock prices, wages are the biggest source of income for most Americans, meaning wealth is being distributed more unevenly than before.

What's puzzling about the labor share's decline in recent quarters is that it occurred at a time when unemployment was below 4%, wages were growing at the fastest pace in a decade and many company executives were complaining of worker shortages. Similar conditions in the past have pushed the labor share up and the profit share down as companies dug into their margins to retain increasingly scarce workers. During the tech boom in the late 1990s, for example, labor share increased by about 2 percentage points.

"It should be rising," said Julia Coronado, founder of economic-research firm MacroPolicy Perspectives. "This is the point of the cycle where workers should be able to bid back some of the production, and that really hasn't materialized."

For most of the 20th century, economists believed labor and capital would claim relatively constant shares of output because an overdependence on either would yield diminishing returns. An office with 10 state-of-the art computers and just one employee would become vastly more productive by hiring additional workers, just as an office with 10 Harvard graduates but a dial-up internet connection would benefit from upgrading its equipment.

"This is one of the most-surprising, yet best-established facts in the whole range of economic statistics," famed British economist John Maynard Keynes wrote in 1939 of the idea that wages claimed a relatively steady share of output, even though economic-growth rates varied. He called it "a bit of a miracle."

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From 1960 to 2000, employee compensation averaged 56.4% of gross domestic income. While the level fluctuated with the business cycle—rising in the run-up to recessions and falling in their aftermath—it never dipped below 55% for a full year.

Since then, its downtrend has intensified. In the current decade, workers' wages and compensation have never gone below 51.6% or above 53.4% of gross domestic income.
Economists cite a number of possible explanations for the change.
One is that workers' ability to negotiate wage increases has weakened. Local labor markets in the U.S. grew increasingly concentrated in the hands of fewer employers between 1977 and 2009, according to a 2018 paper by economists Efraim Benmelech, Nittai Bergman and Hyunseob Kim. Union representation has fallen from about a quarter of the U.S. employed population in the 1970s to less than 12% now. And employment contracts have become increasingly riddled with noncompete agreements, occupational licensing requirements and no-poaching clauses that inhibit worker mobility.
Globalization and technology have also played a role.

Soaring international trade, particularly after China's entry to the World Trade Organization in 2001, gave manufacturers a cheap labor alternative overseas. Moreover, corporate success is increasingly measured on a global scale, creating winner-take-all firms like Amazon, Google and Walmart that displaced smaller, more localized competitors.
"One of the features of these very big firms is that they've got high profits but they have low labor shares," said John Van Reenen, an economics professor at the Massachusetts Institute of Technology. "Part of what's happening is that as more and more of the weight of the economy goes toward these superstar firms, this tends to drag down the share of labor in the aggregate income."
As the unemployment rate falls, labor share ought to pick up, and it showed signs of doing when it hit a recent bottom in 2014.
"As we get closer and closer to full employment, you'd expect the labor share to rise…because firms find that in order to maintain wage increases, they need to dip into margins," said Ernie Tedeschi, an economist at Evercore ISI.
But such predictions have tended to miss the mark in recent years. On several occasions since the recession ended, the Congressional Budget Office projected that the labor share would stage at least a partial comeback. Instead, it kept falling.
Many economists say long-running trends could inhibit a full recovery.
The next challenge: Rapid advancements in robotics technology and artificial intelligence are expected to displace millions of jobs in coming decades as routine tasks from driving trucks to evaluating loan applications become automated.