

RATHER HAVE THE CAPITAL DO THE WORK?

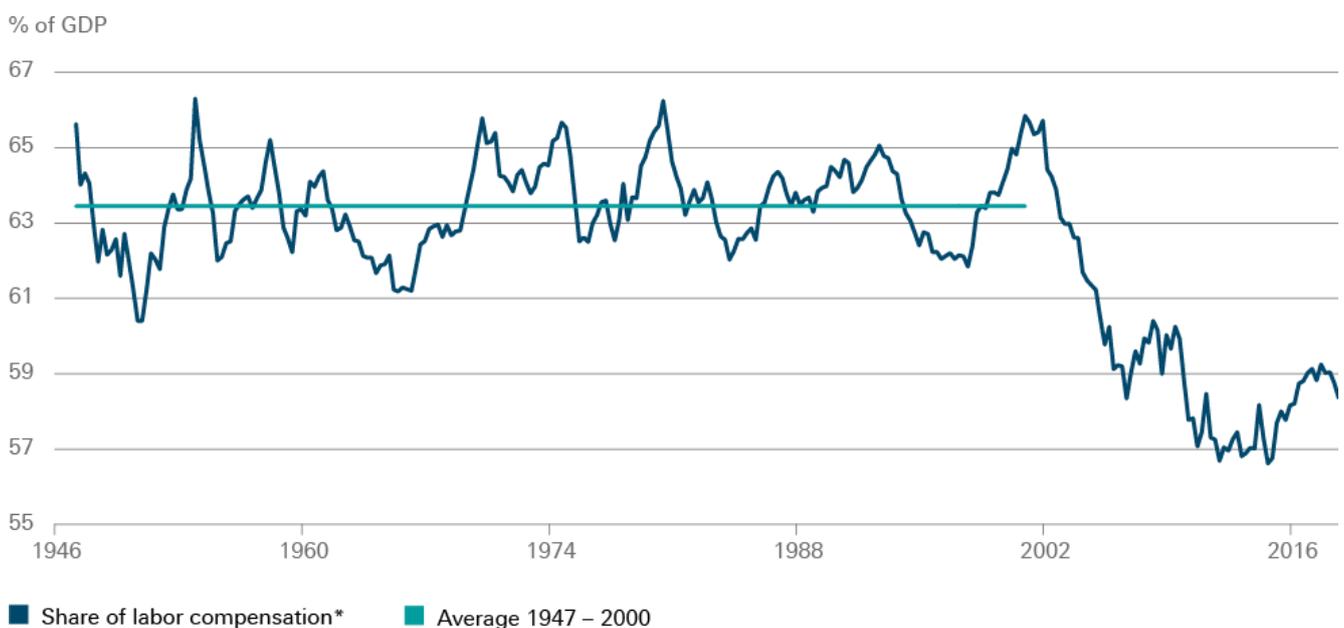
For almost 20 years, the labor share of U.S. GDP has been falling. Is record employment enough to reverse the trend?

This week, we are taking a look at the share of labor compensation in the real economy as a percentage of gross domestic product (GDP). As our "Chart of the Week" shows, the labor share was pretty trendless in the United States over the second half of the 20th century. This means, as Joshua N. Feinman, U.S. Chief Economist at DWS, explains, that productivity and real-labor compensation per hour worked (nominal compensation deflated by the same output prices used to construct productivity) grew at the same average rate. Over the last two business cycles, however, the picture changed: the labor share has slipped as evident in the chart and the capital share has risen, as real compensation has not fully kept pace with productivity. That is part of the explanation why, despite a weak economic environment in historical comparison, the corporate sector managed to retain its profitability.

Which course the curve will take in the coming years is an important question not only from an economic, but also from a social perspective. After all, the increasing inequality of income distribution – which owes in part to the smaller labor share -- is regularly blamed for the rise of populist trends.

Whether the labor share remains subdued depends in part on why it declined in the first place. Some argue that it is a result of technological changes amplified perhaps by globalization that have rendered capital more easily substitutable for labor, as well as shifts in the economy's structure such as the declining degree of organization of workers and the increasing concentration of the supply side that have lifted firms' power in labor markets, better enabling them to restrain compensation without fully sacrificing their ability to attract and retain talent. If these are fundamental, enduring changes, the smaller labor share may be here to stay.

Alternatively, labor may begin to claw its way back if some of these forces dissipate, if a social and political backlash intensifies, and if labor markets remain tight. Recent wage increases hint at how this might happen. While wages only grew around 2.5% in 2016 and 2017, growth has picked up since the beginning of 2018, to 3.2% most recently. If this trend continues and eventually exceeds productivity gains, the result would be declining corporate margins and a rebound in the labor share. In our opinion, the answer is likely to be somewhere in the middle, with the labor share recouping some but not all of its losses. But we will be keeping a close eye on the path towards that result.



* in the nonfinancial corporate-business sector as part of GDP

Sources: DWS Investment GmbH, Haver Analytics Inc., U.S. Bureau of Economic Analysis as of 2/14/19

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Source: DWS Investment GmbH

GLOSSARY / GLOSSAR

Gross domestic product (GDP)

The **gross domestic product (GDP)** is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

Real

In economics, a **real** value is adjusted for inflation.

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