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Some Cross-Country Evidence

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Has Globalization Eroded Labor’s Share? Some Cross-Country Evidence

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Abstract

In recent years, economists and other social scientists have devoted extensive research efforts to understanding the widening wage gap between high-skill and low-skill workers. This paper focuses on a slightly different question: how has globalization affected the relative share of income going to capital and labor? Using a panel of over one hundred countries, this paper analyses trends in labor shares and examines the relationship between shares and measures of globalization. Contrary to recent literature, the evidence suggests that labor shares are not constant over time. Over the 1960 to 2000 period, labor shares in poor countries fell, while shares in rich countries rose. These changes in labor shares are driven by changes in factor endowments and government spending, as well as by traditional measures of globalization, such as trade shares, exchange rate crises, movements in foreign investment, and capital controls. In particular, the results suggest that rising trade shares and exchange rate crises reduce labor’s share, while increasing capital intensity, capital controls and government spending increase labor’s share.

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“The widening of inequalities of income distribution in the 1990's is without precedent in the post-World War II history of the U.S. economy. The share of national income going to the owners of capital through corporate profits is surging. The share going to compensation is falling. This is not the way a democracy is supposed to work....”

Stephen Roach of Morgan Stanley, as interviewed in

“Although advanced countries were exporting capital-intensive goods and importing labor-intensive goods, as of the early 1990s there had been virtually no change in the distribution of income between capital and labor; the share of compensation (wages plus benefits) in U.S. national income was the same in 1993 as it had been in 1973. So at most the trade story could apply to a shift in the distribution of income between skilled and unskilled workers, rather than between workers and capital.”


I. Introduction

In recent years, economists and other social scientists have devoted extensive research efforts to understanding the widening wage gap between high-skill and low-skill workers. The increasing wage gap between the A-haves@ and the A-have-nots@ has been well-documented not only in the United States but also in many other developed and developing countries. Much of this research effort has focused on trying to identify the importance of factors such as immigration, the supply of different kinds of workers, skill-biased technical change, and globalization. Globalization has been broadly defined to include everything from falling prices for goods which use low skill labor (such as garments) to increasing outsourcing by multinationals.

This paper focuses on a slightly different question: how has globalization affected the relative share of income going to capital and labor? Numerous reports in the popular press describe a struggle between capital and labor, with owners of capital winning at the expense of labor. These accounts typically present owners of capital as having greater bargaining power compared to labor, ostensibly because capital is footloose and can quickly relocate to wherever it can find the highest returns. Rodrik,
(1997), in his book Has Globalization Gone Too Far, describes a similar type of bargaining game between capital and labor. Despite these claims, however, there have been almost no efforts to test the relationship between globalization and labor’s share.

This paper begins by examining long run changes in the distribution of income between owners of capital and labor. Several macroeconomists have reported that the share of GDP accounted by capital income (profits) has increased, while labor’s share of GDP (wages) has declined. Blanchard (1996) documents these changes for a number of European countries, while Poterba (1997) examines trends in the United States. In Europe, the change is enormous: labor’s share of aggregate income has declined as much as ten percentage points of GDP. In the United States, the trend is still discernable but much smaller: labor’s share in national income has declined by several percentage points in GDP. Anthony Atkinson, reviewing the evidence presented by Poterba and others, concludes that in the majority of the G-7 countries there has been a shift toward nonlabor income since 1980 (Atkinson (1997)).

The macro-economists who have examined this trend have explored in some detail the role of labor supply and labor demand shifts, the role of technological change, and other factors, but have not focused on international competition as a potential explanation. But a number of trade economists, such as Rodrik (1997), Slaughter (1996), and Richardson and Khripounova (1996) have argued that globalization is affecting labor by increasing the elasticity of labor demand. Slaughter (1996) presents convincing evidence that the elasticity of demand for labor is rising, and relates it to measures of globalization. Although he finds that labor demand within US manufacturing is becoming more elastic, there is no strong relationship between changes in labor elasticity and globalization. In another study, Budd and Slaughter (2000) show that union wage determination in Canada is affected by changing profits in both Canada and the United States. Their work suggests that globalization does affect union wages, although they do not test the impact on labor shares. Diwan (1999) shows that financial crises have systemically led to a decline in labor’s share relative to capital, but does not address the role of globalization directly.
This paper begins by outlining a framework which shows how globalization could account for changes in the share of labor income in GDP. In this imperfectly competitive framework, firms and workers bargain over excess profits, and whoever has the stronger bargaining position receives a larger share of the profits. Bargaining strength depends on a number of factors, including the fixed costs of relocating and the alternative return available elsewhere. To the extent that the fixed costs of relocating are much larger for workers than for capital, this could lead capital’s share of national income to rise relative to labor.

The empirical section of the paper begins by examining the stylized facts on labor shares in the United States and in other countries. The dataset, constructed using United Nations national account data, provides information on the share of labor compensation in national income or GDP across 100 countries and over 40 years. The results show that labor and capital shares have fluctuated significantly in the last 30 years, contrary to the assumptions of constant factor shares embedded in any models which use a Cobb-Douglas production technology. Across poor and middle income countries, the share of GDP going to wages and benefits is declining. However, the global trend masks major differences across countries. In the United States, capital and labor shares have remained fairly constant over the last 35 years, while in Japan labor’s share in GDP has consistently increased. The perception of falling labor shares in high income countries is driven primarily by the European experience. In Europe, many countries exhibit a dramatic fall in labor shares. Overall, the results suggest that labor’s share is rising in rich countries, and falling in poor countries. As pointed out by Gollin (2002), however, fluctuations in labor’s share are significantly reduced if labor’s share is expanded to include self-employment income. In this paper, we show that this conclusion continues to hold in the time-series data as well. Nevertheless, even if we include self-employment income in our definition of labor’s share, this new dataset still shows significant variation across countries and over time. While Gollin focused on cross-country data for a smaller set of countries at one point in time, this paper focuses on time series variation across a broader sample of countries.
The remaining part of the paper explores the relationship between labor shares and its determinants. The results suggest that changing labor shares are driven by changes in factor endowments, as well as by traditional measures of globalization, such as movements in trade shares, exchange rate crises, movements in foreign investment, and capital controls. In particular, rising trade shares and exchange rate crises reduce labor’s share, while capital controls and government spending increase labor’s share. Section II outlines the theoretical framework for estimation. Section III discusses estimation issues, while Section IV discusses the empirical results. Section V concludes.

II. Theoretical Framework for Estimation

This framework combines the approach used by general equilibrium researchers in international trade to test for Stolper Samuelson effects (see, for example, Balaban and Harrigan (1997)), with the more partial equilibrium approach used by labor economists to test for rent-sharing. Tests of general equilibrium trade theory typically transform equations for determining the quantity of a firm’s revenue into an equation where labor’s share in revenues is a function of both final goods prices and changing factor inputs. Harrigan (1997) and others assume that product and factor markets are perfectly competitive. We relax that assumption, introducing the possibility that firms make excess profits. We then allow the rents to be divided between firms and employees on the basis of bargaining strength, which in turn is a function of the firm’s expanding affiliate presence abroad.

This approach differs from previous work by Borjas and Ramey (1995), who examine the link between rising wage inequality and falling industry rents. They assume that the fraction of rents allocated between workers and owners is constant; what changes is the extent of rents as global conditions become more competitive. Borjas and Ramey (1995) and Abowd and Lemieux (1993) also assume that bargaining power is fixed; in this proposal, bargaining power varies with the ease of relocation abroad. Unlike previous work, we include capital in the production function, which allows us to model rent-sharing as a function of both worker bargaining power and capital’s
bargaining power. The framework is complementary to, but differs from, Rodrik (1997) and Slaughter (1996), who argue that rising labor demand elasticities could shift the incidence of nonwage costs, costs associated with the implementation of labor standards, and government taxes towards labor.

Output and Factor Markets

Firms and workers first choose the profit maximizing level of output, and then bargain over the rents. This approach was pioneered by Brown and Ashenfelter (1986) and in the bargaining literature, has come to be known as the efficient bargaining model. An alternative approach would have been to allow employment to be chosen taking into account the negotiated wage, the so-called right to manage model. Like Blanchard and Giavazzi (2001), we propose an efficient bargaining model because we want to capture the possibility that the actual wage may be different from the marginal revenue product of labor. In this framework, the share of rents going to workers depends on the relative bargaining strengths of labor and capital. A natural extension of this work is to explore the consequences of relaxing the assumption of efficient bargaining.

We assume there are only two factors of production, labor and capital. The representative firm uses a vector \( \mathbf{v} \) of inputs, with \( v_L \) units of labor and \( v_K \) units of capital. The competitive return to factors is given by the vector \( \mathbf{w}_0 = (w_{L0} w_{K0}) \). The wage under perfect competition would be \( w_{L0} \), and the return to capital would be \( w_{K0} \). Total returns are denoted by the vector \( \mathbf{w} = (w_L w_K) \) with excess returns given by the difference between the two vectors. The utility functions for labor and capital are denoted by:

\[(1a) \quad U_L = (w_L - w_{L0})v_L \]

\[(1b) \quad U_K = (w_K - w_{K0})v_K \]
The revenue function is denoted by \( G(P,v) \). The price vector \( P \), in turn, can be written as a function of the production function \( Y(v) \), so we have \( P(Y(v)) \). Under imperfect competition, excess profits are equal to:

\[
(2) \quad G(P(Y(v)), v) - w_0 v
\]

Maximizing (2) with respect to \( v \) yields the following first order condition:

\[
(3) \quad \left[ \frac{\partial Y}{\partial v} \right] P = \mu w_0 \quad \text{where} \quad \mu = \left( \frac{1}{\varepsilon} + 1 \right)^{-1}
\]

The elasticity of demand is given by \( \varepsilon \). We can implicitly define the optimal choice of \( v \) as:

\[
v^* = R(P, \mu, w_0)
\]

The excess rents given by (2) can be written as:

\[
(4) \quad \text{Rents} = G(R) - w_0 R
\]

Thus, total revenue, \( G(R) \), factor demands, \( v^* \), and total rents are determined by equations (1) through (4) and are independent of labor and capital’s bargaining power.

**Bargaining Over Rents**

Labor and capital bargain to determine their share of the rents. The outcome of bargaining, if we assume Nash bargaining, can be derived from finding the solution to maximizing—over \( w_L \) and \( w_K \)—the following:

\[
[(w_L v_L - U_{L0}) x (w_K v_K - U_{K0})]
\]

Before we can solve for \( w \), we need to define the threat points. We assume that if bargaining breaks down, capital or labor has the option to leave the firm, incur a fixed cost \( F_L \) or \( F_K \), and receive alternative returns \( w_L^* \) or \( w_K^* \). These alternative returns are not necessarily equal to the competitive return. For example, if there is significant unemployment and labor is not very mobile, labor’s alternative return might be unemployment benefits which may be less than the competitive return. Alternatively, capital’s alternative return may exceed the competitive
return if capital can relocate to countries in which capital is relatively scarce. Nor have we defined whether the alternative return is set locally or abroad. However, since labor’s fixed costs of relocating to a foreign country are likely to be extremely high while capital’s costs are much lower, in the empirical section which follows we will define the alternative wage based on the local labor market and the alternative return to capital based on returns abroad. We will assume that fixed costs are proportional to the quantity of the factor employed, so that we can write $F_i = f_i v_i$. Consequently, we can write the threat points as:

\[(5a) \quad U_{L0} = w_L^* v_L - f_L v_L \]

\[(5b) \quad U_{K0} = w_K^* v_K - f_K v_K \]

So our maximization problem becomes:

\[(6) \quad \text{Maximize} \quad \{w_L v_L - w_L^* v_L + f_L v_L\} \times \{w_K v_K - w_K^* v_K + f_K v_K\} \]

\[\text{over } w_L \text{ and } w_K \text{ and subject to } w_L v_L + w_K v_K = G(R)\]

The first-order conditions with respect to $w_L$ and $w_K$ are (where $\lambda$ is the multiplier on the constraint):

\[(7) \quad v_L (w_K v_K - w_K^* v_K + f_K v_K) = \lambda \]

\[(8) \quad v_K (w_L v_L - w_L^* v_L + f_L v_L) = \lambda \]

Combining these first-order conditions yields the following expression for the wage:

\[(9) \quad w_L = \frac{1}{2} \left[ \frac{G(R)}{v_L} + w_L^* + (f_K - w_K^*) \frac{v_K}{v_L} - f_L \right] \]
The expression for the return on capital is analogous to (9). With bargaining, wages depend positively on labor productivity, but now they also depend positively on the alternative returns to labor and the fixed cost to capital of relocating and negatively on the alternative return to capital and the fixed cost to labor of relocating.

Multiplying both sides of (9) by $v_L$ and dividing both sides of (9) by $G(R)$ yields the following expression for the labor share $S_L$:

$$S_L = \frac{1}{2} + \frac{1}{2} \left[ \frac{w_L v_L}{G(R)} - \frac{f_L v_L}{G(R)} - \frac{w_K v_K}{G(R)} + \frac{f_K v_K}{G(R)} \right]$$

The expression for capital’s share is analogous to (10). Recognizing that the alternative returns equal the competitive return plus some premium, we can show that if both parties have equal bargaining strengths, factor shares depend only on $\frac{1}{2} \left[ \frac{w_{0L} v_L - w_{0K} v_K}{G(R)} \right] + \frac{1}{2}$. In this case, the factors each receive their competitive share $w_{0i} v_i$ for $i = L, K$ and then divide equally the excess profits between themselves. If, however, fixed costs of relocating or alternative returns to the factors differ, then excess profits will not be split equally across factors. In particular, labor’s share will rise if: (1) alternative returns to labor rise (2) alternative returns to capital fall (3) fixed costs to capital of relocating rise or (4) fixed costs to labor of relocating fall.

Using what appears to be a very different approach, which incorporates monopolistic competition, unemployment and Dixit-Stiglitz utility functions in a general equilibrium framework, Blanchard and Giavazzi (2001) also derive an expression for labor’s share which is remarkably similar to equation (10). One major difference is that they assume that worker rents are a function of labor market institutions, while we derive the share of rents going to workers as a function of global market factors. Under perfect competition, labor’s share will be equal to $\frac{w_{0L} v_L}{G(R)}$, where $G(R)$ is equal to $PY$ and $P$ is equal to marginal costs. In Blanchard and
Giavazzi (2001), labor’s share is equal to the competitive share, multiplied by $(1 + \mu \exists) / (1 + \mu)$. Labor’s share rises with an increase in bargaining power, which is proxied by $\exists$. They do not model the determinants of bargaining power, stating only that they are a function of labor market institutions. In our framework, labor’s share is also equal to the competitive share plus a fraction of the excess rents as determined by worker bargaining power. However, bargaining power is determined by global market factors, which are explicitly incorporated into the bargaining framework.

III. Estimation Issues

To transform (10) into an estimating equation, we begin by rewriting $w_i^* \phi_i$ as equal to what the factor would have received under perfect competition, plus a premium above or below the competitive return derived from relocating: $w_i^* = w_{i0} + \phi_i$. Next, we note that $\frac{w_{0L}v_L}{G(R)}$ and $\frac{w_{0K}v_K}{G(R)}$, which are simply $\frac{w_{0L}v_L}{PY(v^*)}$ and $\frac{w_{0K}v_K}{PY(v^*)}$ and can be rewritten as $\left(\frac{d \ln Y}{d \ln v_L}\right) \mu$ and $\left(\frac{d \ln Y}{d \ln v_K}\right) \mu$, using the first order conditions. To simplify the analysis, we will begin by assuming only one price. We will relax this assumption later, to allow relative prices of labor- and capital-intensive goods to vary. The final estimating equation will depend on which functional form we choose to approximate the production function, $Y$. We assume that $Y$ can be approximated by a translog function:

(11) $\ln Y = \ln Y(v_{iL}) = a_{00} + \sum_i b_{0i} \ln v_{iL} + \frac{1}{2} \sum_i \sum_m b_{im} \ln v_{iL} \ln v_{im}$

Differentiating (11) with respect to each $\ln v_i$ yields the following:
Combining (11), (12a) and (12b) yields the following estimating equation for labor’s share in firm i’s revenues:

\[ S_{Li} = \gamma_0 + \gamma_1 \ln \left( \frac{L_i}{K_i} \right) + \frac{1}{2} \left( \frac{\phi_L v_{L_i}}{G(R)} - \frac{\phi_K v_{K_i}}{G(R)} \right) + \frac{f_K - f_L}{2} \]

To get an estimating equation for wages, we divide both sides of equation (9) by the price level to obtain the following estimating equation for the real wage paid by firm i:

\[ w_{Li} = \beta_0 + \beta_1 \frac{Y}{v_{L_i}} + \beta_2 w^*_{Li} + \beta_3 f_K \frac{v_{K_i}}{v_{L_i}} - \beta_4 w^*_{Ki} \frac{v_{K_i}}{v_{L_i}} - \beta_5 f_{Li} \]

This framework suggests that real wages and labor’s share are positively related to labor’s alternative return and capital’s fixed costs of relocating, and negatively related to capital’s alternative return elsewhere and labor’s cost of relocating. The correlation between the labor-capital ratio \( \frac{L}{K} \) and labor’s share is ambiguous, since the derivative of labor share with respect to \( \ln(\frac{L}{K}) \) varies with the elasticity of substitution between labor and capital. In the Cobb-Douglas case, for example, the derivative of labor share with respect to \( \ln(\frac{L}{K}) \) is zero and factor shares should be unaffected by changes in endowments. However, the coefficient on \( \ln(\frac{L}{K}) \) could also be positive or negative, depending on whether the elasticity of substitution is high or low. Real wages are a positive function of labor productivity, captured by our \( G(R)/v \). As long as the fixed costs for capital of relocating exceed capital’s alternative return, real wages are positively related to capital intensity. However, if the fixed cost for capital is lower than its’ alternative return,
making it likely that capital will relocate, then real wages are a negative function of capital intensity.

In addition, the basic specification in (13) assumes only one output and no factor-biased technical change. If there were several outputs, then relative prices of labor versus-capital intensive goods would affect relative shares. Similarly, factor-biased technical change could also affect labor shares. A modified estimating equation which includes n relative prices $P$ and factor-biased technical change $\theta$ is given by:

\[
S_{Lt} = \gamma_0 + \gamma_1 \frac{w_L^* v_L}{G(R)} - \gamma_2 \frac{f_L v_L}{G(R)} - \gamma_3 \frac{w_K^* v_K}{G(R)} + \gamma_4 \frac{f_K v_K}{G(R)} + \sum_{n=1}^n \gamma_n \ln\left(\frac{L_i}{K_i}\right) + \gamma_0 \ln\left(\frac{\theta_{Lt}}{\theta_{Kt}}\right) + \sum_{n=1}^n \gamma_n \ln\frac{P_n}{P_{Lt}}
\]

The estimating equation (15) embeds a number of potential explanations for labor’s changing share in firm-level value-added. Changes in labor’s share could occur primarily due to factors unrelated to globalization, such as changes in endowments of $L$ and $K$, or factor-biased technological change. Another possibility is that globalization affects factor shares through changes in final goods prices. This is the standard effect deriving from a Heckscher-Ohlin (HO) framework. In the HO framework, globalization affects final goods prices, which in turn affect returns to factors used intensively to produce those goods. This effect has been examined in some detail by Harrigan and others (see, for example, Harrigan and Balaban(1997)) and is captured in our framework by the $\gamma_i$'s. To the extent that globalization affects factor shares by altering the bargaining power of labor relative to capital, then other factors should matter as well. These include alternative returns to capital and labor, as well as the fixed costs of relocating abroad.1

, which allows us to rewrite (11) as:

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1 One issue that we have not discussed is openness per se, as measured either by policies such as tariffs or the outcomes of such policies, typically captured by trade shares. In our framework, barriers to trade affect factor shares through their impact on the prices of labor-intensive relative to capital-intensive goods. To the extent that our measure of relative prices fails to capture the importance of trade restrictions, an ideal variable would be a measure of relative tariffs on labor versus capital. We are working on creating such measures.
(12) \( S_L = \gamma_0 + \gamma_1 \ln(L/K) + \gamma_2 \ln(\theta_L/\theta_K) + 1/2(\phi_L \nu_L/G(R) - \phi_K \nu_K/G(R)) + (f_k - f_L)/2 \)

Clearly, we cannot distinguish between factor-augmenting and product-specific technical change, since these variables could affect the latter as well as the former. If, however, technological change is factor augmenting, then one testable implication is that \( \gamma_1 \) should equal \( \gamma_2 \). It is easy to show that the coefficient \( \gamma_1 \) (and consequently, \( \gamma_2 \)) does not need to be positive. The derivative of labor share with respect to \( \ln(L/K) \) is equal to:

\[
\frac{\partial S_L}{\partial \ln(L/K)} = \gamma_1 = \frac{1 + 1/\sigma}{[(S_L/S_K)(1 + S_K/S_L)]^2}
\]

In the Cobb-Douglas case, the elasticity of substitution \( \sigma \) is equal to \(-1\), so the derivative of labor share with respect to \( \ln(L/K) \) is zero and factor shares should be unaffected by changes in endowments. However, the coefficient on \( L/K \) could also be positive or negative, depending on whether the elasticity of substitution is high or low.

**Data**

To estimate (11) or (12) requires data on labor shares, endowments, returns to factors in excess of the home competitive return if the factor relocates abroad, and measures of the fixed costs of relocating for labor and capital. The United Nations gathers detailed national accounts data across countries from 1950 onwards. Labor share is defined as total compensation to employees divided by either national income or Gross Domestic Product (GDP). The number of years available by country varies; some countries begin in 1950 while others begin in 1990. Compensation includes both wages to employees and other benefits (such as realization of stock options). Since national income also includes payments to unincorporated enterprises, which are typically included as part of operating surplus and classified as payments to capital, this definition of labor share is likely to represent a low estimate of labor’s share. Krueger (1999)
discusses in detail some of the pitfalls involved in using national accounts data to measure labor income. He argues that the reported labor income share is probably a ceiling. Gollin (2002) argues that at least part of payments to unincorporated enterprises, also known as self-employment income, should be included in labor’s share. He argues that including self-employment restores the constancy of labor shares, using a smaller cross-section of the same data source as we do here. Consequently, I also estimate (12) including alternative measures of self-employment in my definition of labor share. However, fewer countries actually report self-employment income, and those countries that do report are primarily the upper income countries. Consequently, we are faced with a dilemma: As Gollin points out, at least part of self-employment income should be included in labor’s share, however, if we only include those countries, then we exclude many countries.

Labor inputs can be captured by the nation’s labor force, which is collected and reported by the World Bank. For capital stock I use the series constructed by Nehru et al (1993), updated to include 1997 data. I assume that the fixed cost of relocating for labor is large (possibly infinite in the short run) and captured by the country and year specific effects. The fixed costs of relocating for capital can be captured by several measures. The nominal exchange rate captures the cost of purchasing new plant and equipment if relocation occurs. We would expect that a depreciated exchange rate would increase the costs of relocating for capital, raising labor’s share. I measure the nominal exchange rate as the market rate, period average, as reported by the International Monetary Fund. Other fixed costs of relocating include capital account restrictions such as withholding taxes, which make it difficult for capital to relocate. These can be captured using variables from the International Monetary Fund’s annual publication, Trade and Exchange Restrictions. We simply add up the different measures of capital controls (equal to 1 if there are controls; zero otherwise) to arrive at a composite measure. A country with no capital controls would have a value of zero; a country with all types of controls would have a maximum value of 5.
The independent variables \( \phi_L \) and \( \phi_K \) measure the return to labor and capital in the foreign country, relative to the home competitive return. Unfortunately, these are not directly observed. As a proxy for the return to labor if it relocates in a foreign country, I use the ratio of foreign GDP per worker to GDP per worker at home, lagged one period, as well as net remittances into and out of the country. We would expect that if alternative returns to labor are higher abroad, then inward remittances rise. In our model this would be associated with an increase in labor’s share. As a proxy for the relative return to capital at home versus abroad, I use gross inflows and outflows of foreign direct investment. In future versions of this paper, alternative returns to both factors will also be calculated using the data on capital and labor payments, divided by measures of \( L \) and \( K \). For each country, an alternative return to each factor can be calculated using the rest of the world data on factor payments and factor quantities.

The basic specification assumes only one output and no factor-biased technical change. If there were several outputs, then relative prices of labor versus-capital intensive goods would affect relative shares. Similarly, factor-biased technical change could also affect labor shares. A modified estimating equation which includes relative prices as well as factor-biased technical change is given by:

\[
S_{Lt} = \gamma_0 + \gamma_1 \ln(L_t/K_t) + \gamma_2 \ln(\theta_{Lt}/\theta_{Kt}) + 1/2(\phi_{L,v}/G(R) - \phi_{K,v}/G(R)) + (f_K - f_L)/2
\]

At the aggregate level, prices of labor-intensive and capital-intensive goods are not available. However, relative prices can be proxied in several different ways. Bourguignon and Morrisson (1990) argue that relative prices are a function of relative world supplies of factors. This suggests using world endowments of labor relative to capital as a proxy for relative prices. Another possibility, which is used in this paper, is to use the export and import price indices calculated by the World Bank. I define the price of labor-intensive goods as the average export price of the most labor-intensive countries, defined as
those countries with labor to capital ratios in the top 5 percent of the distribution each year. Similarly, the price of capital-intensive goods is defined as the average export price of the most capital-intensive countries, defined as those countries with labor to capital ratios in the bottom 5 percent of the annual distribution. To allow these prices to have differential effects across countries, the relative price is multiplied by the country’s labor to capital ratio.

The estimating equations (12) and (13) embed a number of potential explanations for labor’s changing share in GDP. Changes in labor’s share could occur primarily due to factors unrelated to globalization, such as changes in endowments of L and K, or factor-biased technological change. These effects are captured by coefficients $\beta_1$ and $\beta_2$. Another possibility is that globalization affects factor shares through changes in final goods prices. This is the standard effect deriving from a Heckscher-Ohlin (HO) framework. In the HO framework, globalization affects final goods prices, which in turn affect returns to factors used intensively to produce those goods. This effect has been examined in some detail by Harrigan and others (see, for example, Harrigan and Balaban(1997)) and which is captured in our framework by $\beta_3$. To the extent that globalization affects factor shares by altering the bargaining power of labor relative to capital, then other factors should matter as well. These include alternative returns to capital and labor abroad, as well as the fixed costs of relocating.

One factor that we have not discussed is openness per se, as measured either by policies such as tariffs or the outcomes of such policies, typically captured by trade shares. In our framework, barriers to trade affect factor shares through their impact on the prices of labor-intensive relative to capital-intensive goods. To the extent that our measure of relative prices fails to capture the importance of trade restrictions, an ideal variable would be a measure of relative tariffs on labor versus capital. Unfortunately, relative tariffs are not available across countries and over time. Typically, the only available data are trade shares or average tariffs across all goods. However, to the extent that protection is typically imposed to protect labor interests, regardless of a country’s comparative advantage, then
aggregate measures could provide a useful indication of trends in the prices of labor-intensive goods. Evidence in countries such as the United States suggest that protection is typically focused on labor-intensive sectors. Even in developing countries, such as Mexico or Morocco, Currie and Harrison (1997) and Hanson and Harrison (1999) show that the pattern of protection is also skewed towards protecting labor-intensive goods. Consequently, the empirical analysis will include openness to trade as an independent variable, as an imperfect means of capturing the impact of trade policy on the relative prices of labor and capital intensive goods. To the extent that increases in trade reflect a fall in the protection of labor-intensive goods, we would expect increasing openness to be associated with a fall in labor shares.

IV. Empirical Results

A. Stylized Facts  The United Nations gathers detailed national accounts data across countries from 1950 onwards. As discussed above, labor shares are computed both as the share of wages and benefits in national income and as a fraction of GDP, following Gollin (2002). Table 1 summarizes changes in labor shares across income categories during the entire period, where labor share is defined as wages plus compensation divided by national income. We begin the analysis by focusing on changes in labor’s share after 1993, since this has been a topic of recent concern. Countries are defined as rich if they are above the median GDP per capita in 1985. Raw means, reported in the first two rows and first two columns, indicate a slight increase in labor’s share in national income from the 1960s through 1993 to the 1993-96 period. The means also show that labor’s share in national income is almost the same in poor and rich countries.
These means, however, hide important within country changes in labor shares. Since the composition of the means may change as countries are added or leave the sample, the last three rows in Table 1 are more informative for indicating within country changes in labor’s share. These means show that in poor countries, labor’s share fell on average by .1 percentage points per year prior to 1993. The decline in labor’s share was more rapid after 1993: labor’s share fell on average by .3 percentage points per year. In the rich countries, labor’s share grew by .2 percentage points prior to 1993 and fell by .4 percentage points per year after 1993. These means indicate a reversal in the trend for rich countries post-1993, while they indicate a persistent decline in labor’s share for poor countries during the entire period.

If we take means for all countries within each subperiod, then look at within country differences, we get a slightly different story. The last row in Table 1 shows again that poor countries on average exhibited a decline in labor share post-1993, if we take within country means before and after 1993 and then take the difference between the two. Using this approach, labor shares in rich countries increased slightly. Overall, the trends suggest a fall in labor shares in the poorer countries, and a slight increase in rich countries post 1993.

The next 5 columns of Table 1 report changes in labor shares by quintiles. The results are similar to those in the first two columns. In general, labor shares rise with income, although the progression is not perfect. Focusing on the last row of Table 1, the mean changes in labor income follow a clear pattern: labor share fell in the poorest countries, changed very little in the upper middle 20 percent of countries, and increased in the richest countries. The progression is quite clear: enormous declines in labor’s share in the poorest 20 percent of countries, and significant increases in labor’s share in the top 20 percent of all countries.

Chart 1 summarizes the overall trends in labor shares across 53 countries with data for both 1970 and 1990. The results show that for some countries, there have been dramatic changes over the period. The results in Chart 1 are consistent with the results reported in Table 1: those countries which
experienced the most significant reductions in labor share are the poorest ones. In Chart 1, we used the World Bank’s 1990 category of countries as low income, middle income, or upper income, a definition which is based on GDP per capita. Labor shares in national income fell between 6 and 8 percentage points for the low income countries in our sample. Again, there is a systematic relationship between movements in labor shares and income status. Although middle income countries also experienced a fall in labor’s share in income, the reduction was not large, especially for upper middle income countries. For the high income countries, labor’s share in national income actually rose. The average increase was almost four percentage points of GDP. The results are unchanged if we compute average changes in labor shares weighted by population: while labor shares in poor countries fell, the share of labor’s income in GDP in the high income countries rose by almost 4 percentage points. If we redo the analysis with 1960 as the starting point, the trend is the same: labor shares for the high income countries rose on average during the thirty year period, while labor shares for the poorer countries fell.

One question which naturally arises is how accurate are these data? Since this is the only comprehensive source of national accounts data, a systematic comparison with other data sources is not possible. However, UNIDO does collect manufacturing wages for a select number of countries. For six countries in Figure 0, we calculated changes in labor shares relative to an index using the UNIDO data. For both data sources, we set 1977 equal to 100. Average manufacturing wages, weighted by employment in each subsector, were multiplied by the labor force and then divided by value-added. The movements in labor shares are denoted by lshgol1. Labor shares calculated using the UN data were then plotted on the same graphs, with UN data indicated by lshgol. What is remarkable about these two different data sources is that movements in labor shares are highly correlated, although the manufacturing wage data shows larger year to year fluctuations than the UN data. This is reasonable, since the manufacturing sectors of most countries only account for a small share in the labor force, and consequently we would expect less fluctuations in the UN data, which includes all sectors of the economy.
Figures 1 through 6 provide time series evidence on labor shares for individual countries in our sample. The first 4 figures show trends in labor shares, measured using labor compensation as a share in GDP. Graphs using labor compensation as a share of national income are not included here, since the time series behavior of both is highly similar. The econometric results that follow also are very similar if we use labor compensation divided by national income or divided by GDP. A number of interesting facts emerge. First, among the high income countries (see Figure 4) the United States is almost the only country where labor’s share in GDP has remained relatively stable. Since the late 1960s, labor’s share in GDP in the United States has fluctuated by only a couple of percentage points of GDP. This contrasts sharply with many other countries, which have experienced both large increases as well as declines in labor shares. Among the high-income countries, Canada, Japan, and Switzerland steadily increased their labor shares over more than thirty years. However, a number of European countries have experienced declines in labor shares since the early 1970s. Those countries include Belgium, France, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, and the United Kingdom. Those declines explain the preoccupation by macro-economists such as Olivier Blanchard with falling labor shares in Europe. The results are consistent if we use national income as the denominator or GDP.

Figure 5 shows trends in labor shares if we include self-employment in the numerator with labor compensation. Including self-employment as part of labor’s share significantly reduces the cross-country variation in labor’s share, as pointed out very clearly in Gollin (2002). The reduction in dispersion is also evident from Figure 7. While Gollin (2002) made this point with a pure cross-section, his point is also correct if we extend his sample to include time series data, as we do in both Figure 5 and Figure 7. However, it is important to note that the sample size is significantly reduced—to less than one third of the original sample. The sample is heavily weighted towards developed countries and a number of the eastern European countries. The second point is that even these measures of labor share do continue to vary over time, although clearly the variance is lower. Countries with large fluctuations in labor’s share over time
include Botswana, Congo, Finland, Hungary, Jamaica, the Netherlands, Korea, and Sweden. In these countries, labor’s share (even including self-employment) has fluctuated by more than 10 percentage points of GDP. Figure 5 also shows that there is a strong relationship between movements in the two measures of labor share over time for many countries. Simple correlations across the 35 countries with both measures shows that for 27 of the 35 countries, the correlation between labor share including and excluding self-employment is positive and significant and generally exceeds .7. Since self-employment has been declining in recent years (in part due to a reduction in agricultural income), this measure of labor’s share shows a steady decline in many countries. Nevertheless, the range of change is smaller than if we measure labor’s share using the more conventional measures. Again, the only stable country is the United States, where this modified measure of labor’s share shows a variation of less than 3 percent of GDP over the last 37 years!

This paper focuses primarily on the impact of increasing globalization on labor shares. However, it is worth examining trends in one other measure that could be used to as indicators of the relative strength of capital versus labor: corporate tax rates. Rodrik (1997, p. 64) has argued that globalization has made it more difficult to tax capital and has increased labor’s share of the tax burden. In theory, this is because it is easier for capital to relocate to low tax regions, while labor finds it more difficult to move.

Figure 6 reports corporate taxes paid by corporations for 25 countries with available data. There is no clear trend in corporate tax rates according to Figure 6. While it is certainly true that corporate tax rates in France, the United Kingdom, and the United States have fallen since the mid-1980s, corporate tax rates in Italy, Japan, the Philippines, the Netherlands, and Korea have increased. Nor, without further analysis, can we link these trends to globalization per se. In the remainder of this paper, we focus exclusively on explaining trends in labor shares.

Before turning to the estimation results, we report trends in labor shares using simple regressions with labor share regressed on time. The results are reported in Table 2 and Appendix Table 1. While Appendix Table 1 reports the coefficients on time by country, Table 2 reports the results across all
countries, as well as across income quintiles based on 1985 GDP per capita. Defining labor shares as either labor compensation divided by national income or GDP, the trends are consistent with those reported in Table 1 and Chart 1. Labor share is rising across all countries, by .1 percentage point per year if labor share is defined as compensation/national income, and by .02 percentage points per year if labor share is defined as compensation/GDP. Across income categories, labor share is falling for the poor countries and rising for the rich countries. Using both definitions of national income, labor share is falling by .2 percentage points per year for countries in the bottom quintile, falling by .1 percentage points per year for the lower middle 20 percent, and falling slightly or rising for the middle and upper middle quintiles. Labor shares are rising for the top quintile, by .2 percentage points per year using either definition of labor share.

We also report results for self-employment. Across the 38 countries with available data, self-employment earnings as a share of GDP are falling, by an average of .3 percentage points per year. Consequently, if we define labor’s share to include self-employment, we find that labor’s share is falling across all countries with available data, by .2 percentage points per year. Clearly, our perceptions on the trends in labor’s share are affected by the definition we use. However, it is also clear from the time trends reported in Tables 1 and 2 and the figures that labor share—however defined—is not constant over time.

B. Estimation Results

Results from estimating (13) using cross-country, annual time series data are reported in Table 3. In the remaining analysis, we chose to report results defining labor share as a percent of GDP, rather than national income. The results are similar if national income is used as the denominator, but the sample size is larger if we use GDP. A number of consistent results emerge across specifications, although with the addition of more independent variables the number of degrees of freedom falls significantly and standard errors become quite large. Across all specifications, the coefficient on relative endowments L/K is
negative and significant. This suggests that one important factor driving labor shares is changes in endowments: increases in the labor force (or declines in the capital stock) lead to a fall in labor shares. This implies that the elasticity of substitution between labor and capital is relatively low. For example, a fall in the capital stock cannot be easily substituted with more labor, leading to a more than proportionate increase in return to capital relative to labor and resulting in a fall in labor’s share. This is Poterba’s explanation for the observed decline in US labor shares in the early 1990s. As indicated in columns (7) and (8), the results also suggest that capital and labor are less substitutable in rich countries than in poor countries: the coefficient on L/K is larger (and more negative) by a factor of 2 for rich countries relative to poor countries.

The coefficient on relative GDP per capita is generally negative, as predicted by the model. Higher income per person at home, relative to income abroad, weakens labor’s bargaining position and leads to lower labor shares. Not surprisingly, however, this result is only true in “rich” countries. In columns (7) and (8), we distinguish between poor countries and rich countries by splitting the sample in two, based on the median GDP per capita in 1985. As the results indicate, the negative coefficient on GDP per capita in columns (2) through (6) are driven by the observations for rich countries.

Across a number of specifications, we find that capital controls are positive and statistically significant. These results are predicted by the model: higher fixed costs of relocating, as proxied by capital controls, weaken capital’s bargaining position and lead to higher labor shares. The magnitude of the effect is large: For example, eliminating capital controls would raise labor’s share in GDP between 1 and 2 percentage points. However, the significance on the capital control measure is not present in all specifications. In particular, capital controls are only significant if we introduce government spending as a share of GDP as an additional variable. We introduce government spending as an additional variable to investigate whether capital controls are a proxy for general government intervention in the economy. In fact the results suggest the opposite: the stronger effects of capital controls in the last four columns of
Table 3 suggest that there is a negative relationship between capital controls and government spending in the data.

In column (3) we introduce the log of the nominal exchange rate. We had hypothesized that a more appreciated exchange rate would lower the fixed costs for capital of relocating abroad, resulting in a positive relationship between exchange rate depreciation and labor shares. Although our hypothesis is correct for rich countries, the coefficient is the opposite sign (negative) and significant for poor countries. One alternative interpretation is that the exchange rate captures the relative price of tradeables relative to non-tradeables. An exchange rate depreciation would indicate a fall in the price of non-tradeables, which could be linked with falling labor shares if non-tradeables are more labor-intensive. This is likely to be the case. In poor countries. Nevertheless, these results (and the results that follow) show a strong, significant correlation between exchange rate movements and labor shares for poor countries: an exchange rate depreciation is accompanied by a sharp fall in labor’s share. This point is illustrated by Appendix Figure 1, which highlights the movements in labor’s share in Mexico. Movements in labor share in Mexico have been driven almost entirely by movements in the exchange rate, which depreciated sharply in the early 1980s, appreciated in late 1980s and early 1990s, then depreciated sharply at the end of 1994.

In column (3) we also add the trade share in GDP, defined as exports plus imports divided by GDP. As we indicated earlier, the interpretation of the coefficient on this regressor is somewhat problematic. Nevertheless, the negative coefficient on trade shares is negative and significant, suggesting that an increase in trade shares is associated with a fall in labor shares. In column (4) we add our measure of relative price. As expected, the relative price of labor relative to capital intensive goods are positively correlated with labor’s share, although the effect is not statistically significant.

In a recent paper, Diwan (1999) examines the relationship between labor shares and financial crises. Diwan defines financial crisis broadly, as a year where the nominal exchange rate depreciates by more than 25 percent between the beginning and the end of the calendar year. He finds a significant negative impact of financial crisis on labor shares. This leads him to conclude that labor is bearing
disproportionately the burden (relative to capital) from financial crises associated with large swings in the exchange rate. To test whether our other measures, such as capital restrictions or trade shares, are proxying for such crises, we add Diwan’s definition of financial crisis in column (4) of Table 3. Even after controlling for annual exchange rate changes, the crisis variable has a negative and statistically significant coefficient, supporting Diwan’s finding that large swings in the exchange rate lead to a fall in labor’s share. However, the addition of this variable leaves the other coefficients relatively unchanged. The results also suggest that an exchange rate crisis leads to a larger fall in labor’s share in poor relative to rich countries, as indicated by the doubling of the coefficient on the crisis variable for poor relative to rich countries.

In columns (5) and (6) we add DFI inflows and outflows, inward and outward remittances, and government spending as additional regressors. We anticipated that DFI inflows would be a good measure of alternative returns to capital elsewhere. Consequently, we expected that an increase in inflows suggests low alternative returns to capital elsewhere, raising labor’s share. Instead, the coefficient on DFI inflows is negative, while the coefficient on DFI outflows is positive, which is puzzling. One possibility is that inflows capture the ease with which investment is able to enter and leave the country. In this case, DFI flows are negative correlated with fixed costs of relocating capital, and the negative coefficient is consistent with the model. Although the coefficient on inward remittances is generally insignificant, there is a negative and significant relationship between labor’s share and outward remittances. Countries where alternative returns to labor at home are higher than abroad, as proxied by the volume of outward remittances, have lower labor shares. This reflects either the lower bargaining power of labor at home or the impact of competition by immigrants on domestic wages, or both.

It is possible that the positive and significant impact of capital controls is proxying for general government intervention in an economy, which may increase labor shares through other means. For example, countries with capital controls may also intervene in labor markets, impose higher minimum wages, and take other measures to increase labor’s share. To control for this possibility, we add
government spending relative to GDP as an additional independent variable. This is a better direct measure of government intervention in the economy. The results suggest that government spending does have a significant redistributive impact. The coefficient on government spending is positive and significant, indicating that an increase in government spending is associated with an increase in labor’s share. We add GDP growth and inflation in column (6), to test whether our results simply indicate that labor shares vary with the business cycle. Although the results indicate that labor shares are counter-cyclical (labor shares fall when GDP growth is higher), the addition of these variables do not affect the earlier results.

One potential problem with the estimates reported in Table 3 is that both labor shares and some of the independent variables are jointly determined. In Table 4 we redo the estimation using instrumental variables (IV). We instrument log(L/K), capital controls, DFI, government spending and trade shares with lags of all the right-hand side variables and the country’s terms of trade. The results reported in Table 4 are robust to the use of IV techniques. Almost all of the point estimates in Table 4 remain very similar in magnitude, with no changes in statistical significance. The IV results continue to point to the following factors to explain a decline in labor’s share: a rising labor to capital ratio, a fall in capital controls, increasing relative GDP per capita, and an exchange rate crisis. However, the negative impact of a large exchange rate depreciation on labor’s share is restricted to poor countries. Trade shares are also negatively correlated with labor shares, but the results in the IV estimation suggest that in both magnitude and significance trade shares have a more important (negative) impact on labor shares in poor countries. Taken together, the results suggest that rising trade shares are associated with a decline in labor’s share in poor countries, while inward DFI is associated with a decline in labor’s share in rich countries. Government spending positively affects labor’s share in all countries, as do capital controls.

Table 5 reports several extensions, focusing primarily on the definition of labor’s share. In columns (1) through (4) of Table 5 we redefine labor’s share to include self-employment. Unfortunately, many countries do not report self-employment income. The results are qualitatively the same, although
there are some differences. The coefficient on log (L/K) remains negative, while the coefficient on capital controls remains positive, and more than doubles in magnitude. The coefficient on relative GDP per capita is even larger in magnitude and remains negative. One difference is that the coefficient on both the nominal exchange rate and the crisis variable (reflecting large swings in the nominal exchange rate) is now close to zero, generally positive, and insignificant. This reflects the differences between rich and poor countries highlighted in Tables 3 and 4. As indicated earlier, this sample includes primarily rich countries, for whom exchange rate movements generally do not translate into a fall in labor shares.

The coefficient on trade shares is now larger in magnitude, negative, and statistically significant. The coefficient on inward DFI is positive and significant, suggesting that inward DFI is associated with an increase in labor’s share. This is the major difference between this new labor share measure and the results reported in Tables 3 and 4. However, due to the small sample size, it is difficult to make generalizations about these results. In column (5) we explore the possibility that measures of globalization could affect labor shares by affecting the coefficient on L/K. The coefficient on the interaction of trade shares and L/K is generally insignificant, suggesting no effect of globalization through this particular channel. We also experimented with an interaction of effective tariffs and L/K, and obtained the same results.

Table 6 reports the results when the basic specification is redone using both five year averages and long differences. For the five year averages, all variables are averaged over five year intervals, and the OLS estimation is reported in the last four columns of Table 6. For the long differences, all variables are averaged in the first 10 years and the last 10 years of the sample, and then first-differenced. The results are reported in the first 3 columns of Table 6. What is remarkable about Table 6 is how little these transformations of the data change the basic results, particularly for the five year averages. The coefficient on the labor to capital ratio remains the same in magnitude and significance, with the same differences between rich and poor countries. Although the statistical significance of the coefficient on capital controls is affected by these transformations, the magnitude of the coefficient remains the same.
We continue to find that trade shares are associated with a decline in labor shares. The effect is large and statistically significant. Again, increasing government spending is associated with an increase in labor’s share, exchange rate crises are associated with a fall in labor’s share for poor countries, and inward DFI is associated with a decline in labor’s share. Unfortunately, averaging the sample and taking long differences leads to much smaller sample sizes, and also affects the statistical significance of some coefficients.

Table 7 reports the actual changes in the independent variables between the earlier and later period, where “later” is defined as 1993 through 1996. Combined with the coefficient estimates reported in Table 4, this allows us to decompose the source of actual changes in labor’s share. The results, reported in the last two columns, suggest that labor shares have increased in rich countries primarily because the capital stock has grown relative to the labor force. Another significant factor increasing labor’s share in rich countries is the increase in government spending in GDP, which can account for a one percentage point increase in labor’s share in national income post-1993 in the rich countries and a .4 percentage point decline in labor’s share in the poor countries.

In the poor countries, although the increase in capital stock relative to the labor force has contributed to an increase in labor’s share in national income, that increase has essentially been wiped out by the negative impact of reducing capital controls and depreciating exchange rates. So in the poorer countries, it does appear that globalization has had a detrimental impact on labor’s share in national income. The poor countries have also been negatively affected by the larger increase in trade shares, and the fall in government spending.

Overall, the results suggest that quantitatively most important factor driving changes in labor shares are changes in relative endowments of capital relative to labor. However other factors related to liberalization of their economies have reduced labor’s share in poor countries. These include reductions in capital controls and increases in trade shares, as well as a reduction in government spending and devaluations in poor countries. Large nominal exchange rate depreciations reduce the share of national
income going to labor, while capital controls increase it. The magnitude of these effects is not small. For example, eliminating capital controls would raise labor’s share in GDP in poor countries by up to 5 percentage points.

V. Conclusion

During the 1990s, public attention increasingly focused on the potentially negative consequences of globalization. In particular, economists and other social scientists devoted extensive research efforts to understanding the links between trade liberalization and rising wage inequality. However, the focus on wage inequality eclipsed many other important research problems. This paper seeks to address these omissions by analyzing the impact of trade and capital flows on labor’s share in GDP.

To test for the impact of different measures of globalization on labor shares, I combine detailed national accounts data from the United Nations with measures of trade openness, capital account restrictions, and capital flows. These data provide information on the share of labor compensation in national income or GDP across over 100 countries and over 40 years. Two interesting stylized facts emerge from the results. Contrary to received wisdom, the evidence suggests that labor shares are not constant over time. Between 1960 and the end of the 1990s, labor shares in poor countries fell, while shares in rich countries rose. Simply documenting these changes in labor’s share is important; this is the first effort to show the significant fluctuations in labor’s share over time. However, this paper seeks to go further, by testing whether different measures of globalization can explain these observed changes in labor shares.

Overall, the results suggest that changes in factor shares are primarily linked to changes in capital/labor ratios. However, measures of globalization (such as capital controls or direct investment flows) also play a role. Exchange rate crises in poor countries lead to declining labor shares, suggesting that labor pays disproportionately the price when there are large swings in exchange rates. Capital controls are associated with an increase in labor’s share, suggesting that imposing such controls are
beneficial to labor. In addition, increasing trade shares are associated with a fall in labor’s share. This result is robust across specifications. Other factors, such as government spending, also matter. Increasing government spending is associated with an increase in labor shares, for both rich and poor countries. Finally, foreign investment inflows are associated with an increase in labor’s share, if labor’s share is measured including self-employment.

Bibliography


### Table 1

**Changes in Labor Shares: Different Means by Income Category**

<table>
<thead>
<tr>
<th></th>
<th>Poor</th>
<th>Rich</th>
<th>Bottom 20 %</th>
<th>Bottom Middle 20 %</th>
<th>Middle 20 %</th>
<th>Upper Middle 20 %</th>
<th>Top 20 %</th>
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<tr>
<td>Mean Labor Share, Prior to 1990</td>
<td>.447</td>
<td>.505</td>
<td>.323</td>
<td>.515</td>
<td>.430</td>
<td>.492</td>
<td>.528</td>
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<td>Mean Within Country Change in Labor Share, Prior to 1990</td>
<td>-.001</td>
<td>.0005</td>
<td>-.004</td>
<td>-.001</td>
<td>-.0001</td>
<td>-.0008</td>
<td>.001</td>
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<tr>
<td>Mean Within Country Change in Labor Share, 1990-2000</td>
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<td>-.001</td>
<td>.001</td>
<td>-.010</td>
<td>-.003</td>
<td>-.002</td>
<td>.0002</td>
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Table 2

Testing for a Time Trend in Labor Shares

<table>
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<th>Coefficient on t (T-value in ())</th>
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<td><strong>Fixed Effect Estimation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td><em>(All Countries)</em></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Labor Compensation/National Income</td>
<td>0.001 (8.6)</td>
<td>0.001</td>
<td>3076</td>
<td>131</td>
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<td>Labor Compensation/GDP</td>
<td>-0.0001 (-0.8)</td>
<td>0.001</td>
<td>3626</td>
<td>152</td>
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<tr>
<td>Self-Employed Earnings (OSPUE)/GDP</td>
<td>-0.003 (-12.2)</td>
<td>0.01</td>
<td>720</td>
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<tr>
<td>Labor Compensation + OSPUE/GDP</td>
<td>-0.002 (-10.6)</td>
<td>0.01</td>
<td>720</td>
<td>44</td>
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<td><strong>Labor Compensation/National Income</strong></td>
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<tr>
<td>Bottom 20 %</td>
<td>-0.002 (-4.6)</td>
<td>0.08</td>
<td>272</td>
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<td>Lower Middle 20 %</td>
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<td>0.01</td>
<td>380</td>
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<td>Middle 20 %</td>
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<td>0.003</td>
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<td>0.29</td>
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<tr>
<td><strong>Labor Compensation/GDP</strong></td>
<td></td>
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<td>Upper Middle 20 %</td>
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<tr>
<td>Upper 20 %</td>
<td>0.002 (10.3)</td>
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Notes: All specifications include country dummies. Percentiles based on median real GDP per capita over the period.
## Table 3

**OLS Estimation**

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<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
<th>(7) Below Median Per Capita GDP in 1985</th>
<th>(8) Above Median Per Capita GDP in 1985</th>
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</thead>
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<tr>
<td>Log (L/K)</td>
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<td>-.097</td>
<td>-.085</td>
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<td>-.098</td>
<td>-.088</td>
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<td>-.122</td>
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<tr>
<td></td>
<td>(-17.5)</td>
<td>(-10.6)</td>
<td>(-9.2)</td>
<td>(-8.0)</td>
<td>(-7.6)</td>
<td>(-6.4)</td>
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<td>Capital Controls</td>
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<td>.001</td>
<td>.002</td>
<td>.003</td>
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Notes: T-statistics in (). Estimation allows for arbitrary heteroskedasticity. All estimates include time and country dummies. Dependent variable is labor share, defined as wages and compensation divided by GDP.
### Table 4

**Instrumental Variable Estimation**

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Notes: T-statistics in (). Estimation allows for arbitrary heteroskedasticity. All estimates include time and country dummies. Dependent variable is labor share, defined as wages and compensation divided by GDP. The relative price, the two exchange rate variables, and lagged relative GDP per capita are assumed to be exogenous; all other variables are instrumented with first and second lags, as well as with the country’s terms of trade, defined as the export price divided by the average import price.
### Table 5
**Extensions on the IV Estimation**

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T-statistics in ( ). Estimation allows for arbitrary heteroskedasticity. All estimates include time and country dummies. Dependent variable is labor share, defined as wages and compensation divided by GDP. The only exception is column (2), where the dependent variable is labor compensation plus self-employment, divided by GDP. The relative price, the two exchange rate variables, and relative GDP per capita are assumed to be exogenous; all other variables are instrumented with first and second lags.
Table 6

Five Year Averages and Long Differences: OLS Estimation

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Notes: T-statistics in (). Estimation allows for arbitrary heteroskedasticity. Dependent variable is labor share, defined as wages and compensation divided by GDP.
### Table 7

**Explaining Changes In Labor’s Share, 1990-2004**

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<tr>
<th>Independent Variables</th>
<th>Change in Sample Mean, 1960-1989 to 1990-2004</th>
<th>Estimated Coefficient</th>
<th>Effect on Labor Share, Change from earlier period to current period</th>
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Notes: Poor defined as below median GDP per capita. Rich defined as above median GDP per capita. Change in sample mean calculated by first calculating within country means during 1960-1989 and 1990-2004, taking within country changes in means and then reporting the averages across rich and poor countries.
Figure 1: Trends in Labor Compensation/GDP (lsghol)
Low Income Countries
Figure 2: Trends in Labor Compensation/GDP (Ishol): Lower Middle Income Countries
Figure 3: Trends in Labor Compensation/GDP (Ishgol)
Middle Income Countries
Figure 4: Trends in Labor Compensation/GDP (Ishgol)
Upper Income Countries
Figure 5: Trends in Labor Share: Labor Share defined as (Labor Compensation + Self-Employment Income)/GDP
Figure 6: Trends in Corporate Tax Rates
Figure 7

Top Figure shows the distribution of labor’s share including self-employment, across all countries and years. Bottom Figure shows the distribution of labor’s share excluding self-employment, across all countries and years.
# APPENDIX

## TABLE 1 - Trends in Labor Share (Reported Coefficient on Time)

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