Abstract:
The decline in the US labor share has gained much attention, though existing theories struggle to explain some key patterns of the trend: why did it drop sharply during the 2000s and rebounded in recent years; why did it concentrate in materials-intensive sectors, primarily in manufacturing; and why was it weaker in Europe. We suggest that rising relative intermediate input prices, induced by the commodity price boom of the 2000s, can help to explain these patterns. We show that a higher price of intermediate inputs can decrease the labor share, not only through substitution from labor to capital in a neoclassical environment, but also through a higher share of profits in value-added under conditions of imperfect competition. The latter effect shrinks the shares of both labor and capital, without requiring a rise in price-cost markups, and relies on complementarities between materials and non-materials in production. We instrument industry-level material cost indices with an industry-specific measure of exposure to global commodity prices, establishing a robust and quantitatively strong effect of relative intermediate prices on the labor share. Finally, we provide theory and evidence that this mechanism can account for the observed heterogeneity across countries, despite the global nature of the shock.