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# Capital-Labor Substitution, Structural Change and the Labor Income Share\*

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## Abstract

Recent work has documented declines in the labor income share in the United States and beyond. This paper documents that this decline was more pronounced in manufacturing than in services in the U.S. and in a broad set of other industrialized economies, and shows that a model with cross-sectoral differences in productivity growth and in the degree of capital-labor substitutability is consistent with these trends. We calibrate the model exploiting additional information on the pace of structural change from manufacturing to services, on which the model also has predictions. We then conduct a decomposition to establish the relative importance of several potential drivers of changes in factor income shares and structural change that have been proposed in the literature. This exercise reveals that differences in the degree of capital bias of technical change across sectors, combined with differences in substitution possibilities, are key determinants of the observed patterns.

JEL Classification: O40, O41, O30

Keywords: Labor income share, biased technical change, capital-labor substitution, structural change

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