



Gap in Profits, Worker Pay Widens

CAPITAL ACCOUNT

By Greg Ip

To understand why people are so miserable about the economy, look no further than Thursday's report on gross domestic product. Not how much GDP grew, but how it was divvied up.

Worker compensation—wages and benefits—grew 0.8% in the first quarter from the fourth, while domestic corporate profits jumped 2.7%.

As a result, labor's share of gross domestic income (conceptually similar to GDP) sank to 51%, the lowest since records began in 1947. Profits' share climbed to 12.1%, the highest since 1950.

It's the latest milestone in a trend that became pronounced in the 2000s, then picked up speed after the pandemic. Adjusted for inflation, hourly wages are up 3% since the end of 2019 while profits are up 50%.

That, in a nutshell, explains the chasm between an ebullient stock market and anxious public.

The latest driver of the divergence is a generational boom buoying almost any company connected to artificial intelligence. Micron Technology, a once boring semiconductor manufacturer, now boasts a gross margin of 75% and a valuation that just topped \$1 trillion because data centers can't get enough of its memory chips.

But the trend predates the AI boom. The causes are complex and the implications sobering. You can be a red-blooded capitalist and still worry about the political stability of an economy in which ever more output flows toward shareholders instead of employees.

A backlash is already brewing. California voters will likely be asked to vote on a billionaire tax in November. Proposed taxes on AI are catching on in some corners.

Pope Leo XIV has also taken notice. "Income from capital risks replacing income from labor," he wrote in Magnifica Humanitas, his encyclical letter devoted to the effect of AI, released this week.

As happened to former President Joe Biden, President Trump has seen voter approval of his handling of the economy crater even as the stock market sets one record after another.

The story since then is not so much that labor is going backward, but that capital is on fire.

There is no sign of those trends reversing. For instance, the recent surge in energy prices left after-tax disposable income, adjusted for inflation, lower in April than in December. Meanwhile, energy company profits are expected to double this quarter from a year earlier, according to FactSet.

And the AI gold rush is still in full swing. In coming months three companies closely associated with AI—SpaceX, Anthropic and OpenAI—plan to go public. None are profitable (though Anthropic is close), but valuations of around \$1 trillion each attest to the profits investors think await. GDP and GDI are different ways of measuring the same thing: annual economic output. GDP arrives at this by adding up spending by households, governments and business. GDI arrives at it by adding up income paid to workers, businesses, and others. In theory GDP and GDI should be the same, though in practice they differ slightly because of statistical imprecision.

Besides employee compensation and profit, GDI also includes rent, interest and proprietors' income. The profit in GDI differs from stock market profit in that it includes closely held companies and excludes foreign-earned profits. Foreign-source profits fell in the first quarter, causing total profits to rise only slightly, Thursday's GDP report showed.

GDI also includes depreciation, the cost of replacing equipment and buildings. Some analysts say trends in depreciation have, for technical reasons, exaggerated the fall in the labor share.

Labor's share, however measured, is going down for several reasons. The decline of unions and the rise of offshoring, especially to China, has undermined workers' bargaining power, and automation reduced the labor needed in sectors like manufacturing.

Another possibility is corporate concentration. As a smaller number of companies dominate a sector, they may be able to charge higher prices.

A related factor is the rise of "superstar" companies that rely on proprietary processes, technology or platforms that are difficult for competitors to crack, such as Apple, Nvidia, Microsoft and Alphabet, all members of the "Magnificent 7." That group's profits were up 63% in the first quarter from a year earlier, according to FactSet.

Still, the profit boom is hardly restricted to them. Profits of the other 493 companies in the S&P 500 were up a hefty 17%. So even outside tech, capital is winning.

By the late 19th century, the industrial revolution had produced business barons commanding disproportionate wealth, a newly conscious working class, trade unions, and socialist parties. In 1891 Pope Leo XIII reflected on all this in his encyclical "Rights and Duties of Capital and Labor."

"The elements of the conflict now raging are unmistakable, in the vast expansion of industrial pursuits and the marvelous discoveries of science; in the changed relation between masters and workmen; in the enormous fortunes of some few individuals, and the utter poverty of the masses," he wrote.

Leo rejected socialism as the answer. But employers, he wrote, had a duty to pay a fair, living wage, maintain a safe workplace with limited hours, and allow workers to form unions.

Leo XIV, 135 years later, revisited similar themes in his own encyclical this week.

"The pursuit of greater profits cannot justify choices that systematically sacrifice jobs, because the human person is an end, not a means," he wrote. For AI to lead to massive unemployment would be "a true social calamity."

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