

Is labour losing out? The role of financial constraints on labour share developments*

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Technological advancement has been affecting labour shares through a steep decline in the relative price of investment goods (Neiman and Karabarbounis, 2014; IMF, 2017). This has lowered the cost of capital allowing firms to replace labour with capital. Financing obstacles could however obstruct investment in both labour and capital. This paper aims at assessing the still under-explored channel through which financial constraints hinder the substitution of capital for labour in response to a decline in relative investment prices. In particular, we perform a three-tier (i.e., country-, industry-, and firm-level) analysis on the empirical relationship between trends in labour shares and relative investment prices interacted with different financial constraints' measures. Our results provide a rich body of empirical evidence on the role of financial constraints for the development of the labour share. Firstly, the macro-facts reveal that decoupling of wages from productivity has been driven by low or no financially constrained countries. Secondly, the sectoral analysis suggests that industries highly dependent on external finance will face a lower decline in the labour share following a drop in the relative investment price than industries that are less dependent on external finance. This is because industries that are more dependent on external finance are likely to be more constrained in accessing funds to finance investment, e.g. because of asymmetric information between borrowers and lenders. Thirdly, the firm-level analysis demonstrates that since firms in the same industry face similar changes in relative investment prices, the industry-level response of labour shares should at least partly be driven by within-firm developments rather than reallocation effects.

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