Banking Crises and the Labor Share of Income

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Abstract

In this paper, I empirically identify that banking crises have a negative effect on the labor share of income by using cross-country data. Next, I specify the mechanism of this decline of the labor share of income after banking crises by using Japanese industry level data. I find that compositional shifts between industries and between firms can not explain this decrease of the labor share of income. After banking crises, each individual firm tries to reduce the labor share of income uniformly, and as a result the aggregate labor share of income declines after banking crises. Furthermore, by using cash position data across Japanese industries, I present an additional empirical evidence of this negative effect of banking crises on the labor share of income. Finally, I show that these empirical findings can be explained by a DSGE model with working capital.

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