The impact of labor market conditions on job creation: evidence from firm level data.

Job Market Paper

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Abstract

Changes in labor market conditions make hiring more expensive during expansions and cheaper during recessions, creating counter-cyclical incentives for job creation. In this paper, I study how much changes in labor market conditions reduce employment fluctuations over the business cycle. First, I estimate firm level elasticities of labor demand with respect to changes in labor market conditions, allowing for heterogeneous response both across firms and across regions. I consider two margins: changes in labor market tightness and changes in wages. Using the employer-employee matched data from Brazil, I find that low-paying firms are slightly more responsive to the both margins compared to high-paying firms, and there is substantial heterogeneity in labor demand elasticity across regions. Next, I demonstrate that changes in labor market conditions reduce the variance of employment growth over the business cycle by 40% in a median region, and most of this effect is driven by changes in labor market tightness rather than changes in wages. Moreover, I show that wages do not decline during downturns, even in real terms, and thus cancel out some of the counter-cyclical stimulus generated by changes in labor market tightness. My paper contributes to the literature on the regional response to shocks and provides new evidence on differential sensitivity to labor market conditions across firms.

JEL Classification: J23, E24, J64

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