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Liquidity constraints and labor supply

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Abstract

In this paper we shed some light on how restrictions in financial markets, the so called liquidity constraints, might act in affecting labour supply decisions of Italian workers. One way to neutralize the existence of binding liquidity constraints is simply by supplying additional labor, instead of reducing consumption. We estimate whether resorting to additional labor supply as a smoothing consumption device is at work by using the Survey of Households Income and Wealth (SHIW). The longitudinal dimension of the SHIW dataset allows to control for individual unobserved heterogeneity. We also develop an IV strategy to address the endogeneity of our measure for credit constraints in labor supply equations due to time varying factors.

Our results show that liquidity constraints increase the intensity in the supply of men's labor. Constrained men work, on average, 4 hours more than their unconstrained counterpart. Self-employed workers turn out to be more sensitive to binding liquidity constraints, possibly because they are more flexible in adjusting the intensity of their labor supply.

Keywords: Labor supply, liquidity constraints, life cycle, panel data.
JEL: D1, JE.

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