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Factor Adjustment Costs: a Structural Investigation*

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Abstract

This paper assesses various capital and labor adjustment costs functions estimating a general equilibrium framework with Bayesian methods using US aggregate data. The estimation finds that the adjustment costs are convex in both capital and labor and allowing for their joint interaction is important. The structural model enables us to identify the response of factor adjustment costs to exogenous disturbances, and to establish that shocks to technology and the job separation rate are key drivers of adjustment costs. The analysis shows that factor adjustment costs enable the model to explain fluctuations in the firm's market value in the data.

JEL Classification: C32, E22, E23, E24, E32.

Keywords: Adjustment costs, DSGE models, labor market frictions, Bayesian estimation.

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