



Cross country differences in job reallocation: The role of industry, firm size and regulations[☆]



John Haltiwanger^{a,b,c}, Stefano Scarpetta^{c,d}, Helena Schweiger^{e,*}

^a Department of Economics, University of Maryland, College Park, MD 20742, United States

^b NBER, United States

^c IZA, Germany

^d OECD, 2 Rue Andre Pascal, 75016 Paris, France

^e EBRD, One Exchange Square, London EC2A 2JN, UK

HIGHLIGHTS

- We use harmonized job flow data along country, industry and firm size dimensions.
- We document basic facts about job flows in 16 industrial and emerging economies.
- Firm size is a key factor in determining the variability in job flows.
- Strict hiring and firing regulations tend to reduce the pace of job reallocation.
- Regulations have a stronger effect on firm/industry in greater need to adapt.

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ABSTRACT

Somewhat surprisingly, cross-country empirical evidence (at least in the cross section) does not seem to support the predictions of standard models that economies with stricter regulations on hiring and firing should have a lower pace of job reallocation. One problem in exploring these issues empirically has been the difficulty of comparing countries on the basis of harmonized measures of job reallocation. A related problem is that there may be unobserved measurement errors or other factors accounting for differences in job reallocation across countries. This paper overcomes these challenges by using harmonized measures of job creation and destruction in a sample of 16 industrial and emerging economies, exploiting the country, industry and firm size dimensions. The analysis of variance in the paper shows that firm size effects are a dominant factor in accounting for the variation in the pace of job reallocation across country, industry and size cells. However, even after controlling for industry and size effects there remain significant differences in job flows across countries that could reflect differences in labor market regulations. We use the harmonized data to explore this hypothesis with a difference-in-difference approach. We find strong and robust evidence that stringent hiring and firing regulations tend to reduce the pace of job reallocation.

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1. Introduction

A growing body of evidence has accumulated suggesting that the reallocation of factors of production – including labor – plays a major role in driving productivity growth (see for example Olley and Pakes, 1996; Griliches and Regev, 1995; Foster et al., 2001, 2002; Bartelsman et al., 2004). New firms enter the market and create new jobs, while other unprofitable firms exit the market contributing to job destruction (see e.g. Sutton, 1997; Pakes and Ericson, 1998; Geroski, 1995). Incumbent firms are in a continuous process of adaptation in response to the development of new products and processes, the growth and decline in markets and changes in competitive forces (Davis and Haltiwanger, 1999). Market structure and size composition of firms play a major role in shaping the magnitude of job flows and their characteristics (Davis et al., 1996). For example, smaller businesses are inherently

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* Corresponding author.

E-mail addresses: haltiw@econ.umd.edu (J. Haltiwanger), stefano.scarpetta@oecd.org (S. Scarpetta), schweigh@ebrd.com (H. Schweiger).

more dynamic, in part because they tend to be young ventures and adjust through a learning-by-doing process (Dunne et al., 1988, 1989; Haltiwanger et al., 2013). In addition, some industries have inherently higher job flows than others in all countries, given the smaller size of their typical business and lower inherent entry costs (for example, Foster et al., 2006 report that job flows in the US retail sector are 1.5 times higher than in the manufacturing sector).

Standard models (see, e.g., Mortensen and Pissarides, 1994; Hopenhayn and Rogerson, 1993) predict that, in addition to technology and market-driven factors, the institutional and regulatory environment in which firms operate will have an impact on the pace of job flows. Moreover, consistent with the discussion above, such models imply that restrictions that dampen job reallocation will in turn lower productivity as the dampening of reallocation reduces the extent to which an economy is allocating resources to the most productive producers. However, the empirical evidence on the impact of labor regulations on job flows is inconclusive – countries with different types of labor regulations are observed to have fairly similar gross job flows (see, e.g., Bartelsman et al., 2009; Bertola and Rogerson, 1997; Boeri, 1999). In our analysis below, we confirm the weak relationship between the pace of gross job flows and summary indicators of labor regulations at the country level (see Fig. 2).¹

The lack of a strong empirical relationship between labor regulations and gross job flows at the aggregate level may be due to various elements. Stringent labor regulations may be associated with other regulatory and institutional factors that also affect job flows. For example, Bertola and Rogerson (1997) argue that the greater compression of wages in Europe than in the US can compensate the differences in labor regulations and so explain the similarity of the job turnover rates. A more fundamental problem is that cross-country analyses of job flows may be flawed by severe omitted variable problems and measurement error, including differences in the distribution of activity across industries and size of firms, as well as different business size cut-off points in the enterprise surveys from which job flows data are obtained. In this paper, we overcome these obstacles by using detailed harmonized indicators of job flows drawn from firm-level databases covering 16 developed, emerging and transition economies of central and eastern Europe. With these data, we explore in detail the industry and size dimensions of job flows, and relate them to institutional differences across countries.

To preview results, we find that countries share a number of features of job flows along the industry and size dimensions. All countries are characterized by large job flows compared with net employment changes. These vary significantly and systematically across industries, pointing to technological and market-driven factors, but they vary especially across firms of different size. To provide a perspective on the importance of firm size, we find that industry effects alone account for about 5% of the variation in job reallocation rates across country, industry and size classes, while firm size effects alone account for about 45% of the same variation. However, even after controlling for industry and size effects, there remain notable cross-country differences in job flows.

In this paper, we develop a formal test of the role that hiring and firing regulations have in explaining these differences, and also test for the robustness of our results to the inclusion of other regulations affecting

¹ There is some evidence that labor market regulations influence worker turnover (Bentolila and Bertola, 1990; Nickell and Layard, 1999) but the impact on worker turnover should also translate into patterns for job turnover which are not observed. An alternative approach has been to look at specific policy experiments within countries. Kugler (2007) summarizes a number of empirical studies that have looked at the effects of reform episodes on job flows in France, Germany, Italy, Spain and the US. These episodes provide “natural experiments” that allow comparing groups of workers targeted by the reform to groups of workers not directly affected by the reform before and after the policy change in what is otherwise the same macroeconomic and regulatory environment. The main conclusion of these studies is that increasing the strictness of employment protection legislation reduces worker flows, while the composition of employment is also swayed against young and female workers.

business operations. Following an identification strategy pioneered by Rajan and Zingales (1998), we use a difference-in-difference approach in which we identify the intrinsic need for job reallocation using data from the most flexible market economy, United States.² The advantage, compared with standard cross-country (or even cross-country/cross-industry) empirical studies, is that we exploit within-country differences across industry \times size groups based on the interaction between country and industry \times size characteristics. Thus, we can also control for country and industry \times size effects, thereby minimizing the problems of omitted variable bias and other mis-specifications. We find support for the general hypothesis that hiring and firing costs reduce job turnover, especially in those industries and size classes that require more frequent labor adjustment. Moreover, stringent labor regulations have a stronger effect on the labor reallocation that is originated by the entry and exit of firms than that due to reallocation among incumbents.

Our paper innovates along a number of related dimensions compared with the existing empirical literature. In particular, two recent papers exploit within country variation in job flows to investigate the role of employment protection: Micco and Pages (2007) and Messina and Vallanti (2007). Messina and Vallanti (2007) focus on cyclical and secular variation in job turnover and find that countries with tighter employment protection exhibit less cyclical volatility in job destruction. The authors use the Amadeus dataset (a commercially available collection of company-level accounting data), which is less suitable to explore cross sectional variation in job flows – that is the focus of our contribution – since it does not capture firm entry and exit well. Nor is the Amadeus dataset well suited to exploit differences in job flows across firm size. In addition, while both the Messina and Vallanti (2007) and the current paper find a role for employment protection in dampening job flows on some dimensions, both the mechanisms and the consequences of such dampening may be different on the time series and cross sectional dimensions. For example, the model of Hopenhayn and Rogerson (1993) has clear predictions about the adverse productivity consequences of stifling the pace of reallocation in the steady state but is silent on the consequences of dampening reallocation over the cycle. In that respect, we think it is important to determine whether employment protection has systematic effects on the average pace of reallocation.

One paper that does explore the impact of employment protection on the average pace of reallocation is Micco and Pages (2007). The latter paper exploits industry-level gross job flows for 9 manufacturing sectors for 18 countries from different data sources and uses a difference-in-difference specification close to the specification we consider in our paper. We think there are a number of factors that differentiate our analysis from this paper. First, unlike the data used in Micco and Pages (2007), our indicators are drawn from a harmonized firm-level database that covers all firms with, in most cases, at least one employee for both manufacturing and non-manufacturing sectors.³ Second, we exploit country, industry and firm size variation in the data, while Micco and Pages (2007) use only country and industry variation. We find that firm size is by far the most important factor accounting for variation in the job flows across country, industry and firm size classes. This suggests that exploiting data by firm size is important to provide greater within-country variation in job flows for our empirical identification strategy. We also think that investigating the role of employer size is important since employment protection likely directly interacts with the relationship between firm size and reallocation. Evidence from enterprise surveys suggests that policy-induced distortions tend to affect firms of different size very differently.⁴ Part of the reason is that the smallest firms are either not subject to regulations or are better

² The results are robust to using the global benchmark measure proposed by Ciccone and Papaioannou (2010) instead of US job reallocation as a measure of the intrinsic need for job reallocation.

³ In particular, our database covers 14 manufacturing sectors and 5 non-manufacturing sectors – refer to Table A.2 for details.

⁴ See e.g. World Bank (2004), Pages et al. (2009).

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