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Cross country differences in job reallocation: the role of industry, firm size and regulations

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Summary

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 harmonised measures of job reallocation. A related problem is that there may be unobserved measurement or other factors accounting for differences in job reallocation across countries. This paper overcomes these challenges by using harmonised measures of job creation and destruction in a sample of 16 developed and emerging economies (including four transition 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 labour market regulations. We use the harmonised 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.

Keywords: gross job flows, firm dynamics, firm size, product and labour market regulations.

JEL Classification: J23, J53, K31.

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1 Introduction

Over the past decade, a growing body of evidence has accumulated suggesting that the reallocation of factors of production – including labour – plays a major role in driving productivity growth (see, for example, Olley and Pakes (1996), Griliches and Regev (1995), Foster et al. (2001), Foster et al. (2002) and 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, for example, 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 more dynamic, in part because they tend to be young ventures and adjust through a learning-by-doing process (Dunne et al. (1988), Dunne et al. (1989)). 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. (2002) report that job flows in the US retail sector are 1.5 times higher than in the manufacturing sector).

Standard models (see, for example, 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 reallocation will in turn lower productivity as the dampening of job reallocation reduces the extent to which an economy is allocating activity to the most productive producers. However, the empirical evidence on labour regulations and job flows is inconclusive – countries with different types of labour regulations are observed to have fairly similar gross job flows (see, for example, Bartelsman et al. (2009), Bertola and Rogerson (1997), Boeri (1999)).¹

The lack of a strong empirical relationship between labour flexibility regulations and gross job flows at the aggregate level may be due to various elements. Stringent labour 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 labour 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

¹There is some evidence that labour 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) summarises 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.

cut-off points in the enterprise surveys from which job flows data are obtained. In this paper, we overcome these obstacles by using detailed indicators of job flows drawn from harmonised and integrated 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 characterised 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 per cent of the variation in job reallocation rates across country, industry and size classes, while firm size effects alone account for about 47 per cent 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 business operations. We use a difference-in-difference approach in which we identify an industry and size class's baseline job reallocation from the US data. 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 minimising the problems of omitted variable bias and other misspecifications. We find support for the general hypothesis that hiring and firing costs reduce turnover, especially in those industries and size classes that require more frequent labour adjustment. Moreover, stringent labour regulations have a stronger effect on the labour reallocation that is originated by the entry and exit of firms than that due to reallocation among incumbents.

Before proceeding, it is useful to discuss two recent papers that exploit job flows across industries within countries 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.² The paper that is closest to ours in terms of questions and approach is Micco and Pages (2007). The latter paper exploits industry level gross job flows data for manufacturing for 18 countries and uses a difference-in-difference specification close to the specification we consider in this paper. Our analysis differs from this study along a number

²Messina and Vallanti (2007)'s focus on cyclical and secular variation is different from our cross-sectional focus but their paper is in many ways in the spirit of this paper by exploiting within country variation to identify the role of employment protection. Their finding that countries with tighter employment protection exhibit less cyclical volatility in job destruction is complementary to our finding that countries with tighter employment protection have fewer differences in job reallocation across industry and size classes. The Amadeus dataset they use is less suitable to explore cross sectional variation 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 our findings, both firm size and firm entry and exit play critical roles in the variation in job flows and in the role of employment protection in influencing that variation. While both the Messina and Vallanti (2007) and the current paper find a role for employment protection in dampening job flows on some dimension, an interesting open question is the productivity and welfare implications across the different 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.

of related key dimensions. First, our indicators are drawn from a harmonised firm-level database that covers all firms with at least one employee for both manufacturing and non-manufacturing sectors. Second, our indicators allow exploiting country, industry and firm size variation in the data, while previous studies tend to concentrate on country and industry variation. Interestingly, 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 but also that distortions to job flows across countries may very well interact with the flow and firm size relationship. Indeed, evidence from enterprise surveys suggests that policy-induced distortions tend to affect firms of different size very differently.³ Lastly, our data allow distinguishing between job flows generated by the entry and exit of firms and those generated by the reallocation of labour by incumbent firms. As shown in the paper, this sheds additional light on labour reallocation and the role of regulations in labour and product markets.

The remainder of the paper is organised as follows. Section 2 presents our harmonised firm-level dataset and discusses the different concepts we have used to characterise labour reallocation. Section 3 analyses the main features of job flows, highlighting the role of firm dynamics, industry and size compositions. Section 4 introduces the difference-in-difference approach used in the econometric analysis and discusses the empirical results for the baseline and policy-augmented specifications of the job flow equations. It also describes a battery of robustness tests. Lastly, section 5 presents concluding remarks.

³See , for example, World Bank (2004), Pages et al. (2009)

2 Data

Our analysis of job flows is based on detailed indicators drawn from a harmonised firm-level database that includes 16 industrial, emerging and transition economies (Argentina, Brazil, Chile, Colombia, Estonia, Finland, France, Germany, Hungary, Italy, Latvia, Mexico, Portugal, Slovenia, the United Kingdom and the US) and covers the 1990s (the time period covered varies by country - see Table A.1).⁴ Beyond the country dimension, the job flow indicators vary across detailed industry and size classes and over time. They have been extracted from country firm-level datasets with an active participation of local experts in each of the countries, and involved the harmonisation of key concepts to the extent possible (such as entry and exit of firms, job creation and destruction, and the unit of measurement), as well as the definition of common methods to compute the indicators (see Bartelsman et al. (2009) for details).⁵

The key features of the micro data underlying the analysis are as follows:

Unit of observation: Data used tend to conform to the following definition: “an organisational unit producing goods or services which benefits from a certain degree of autonomy in decision-making, especially for the allocation of its current resources” (EUROSTAT (1998)). Generally, this will be above the establishment level.

Size threshold: While some registers include even single-person businesses (firms without employees), others omit firms smaller than a certain size, usually in terms of the number of employees (businesses without employees), but sometimes in terms of other measures such as sales (as is the case in the data for France). Data used in this study exclude single-person businesses. However, because smaller firms tend to have more volatile firm dynamics, remaining differences in the threshold across different country datasets should be taken into account in the international comparison.

Industry coverage: Special efforts have been made to organise the data along a common industry classification (ISIC Rev.3) that matches the OECD-Structural database (STAN). In the panel datasets constructed to generate the tabulations, firms were allocated to the single STAN industry that most closely fit their operations over the complete time-span.

The firm-level and job flows data come from business registers (Estonia, Finland, Latvia, Slovenia, the United Kingdom and the US), social security databases (Germany, Italy, Mexico) or corporate tax rolls (Argentina, France, Hungary). Annual industry surveys are generally not the best source for firm demographics, due to sampling and reporting issues, but have been used

⁴The database also includes Indonesia, South Korea and Taiwan (China) as well as Canada, Denmark, the Netherlands, Romania and Venezuela, but annual data on job flows are not available for these countries or are not fully reliable.

⁵Micco and Pages (2007) compiled a dataset from different country sources covering 2-digit manufacturing sector information for 18 countries. Their dataset does not include transition countries, and does not allow differentiating job flows by firm status and firm size for all the countries.

nonetheless for Brazil, Chile, and Colombia. Data for Portugal are drawn from an employment-based register containing information on both establishments and firms. All these databases allow firms and jobs to be tracked over time because addition or removal of firms from the registers reflects the actual entry and exit of firms.

We define four size classes based on the number of firm employees: 1- 19 workers, 20-49 workers, 50-99 workers, and 100 or more workers. The job reallocation rate (*sum*) is defined as the sum of job creation (*pos*) and job destruction (*neg*) rates,⁶ and we allow those to vary by the type of firm: entering, exiting or continuing firms. Job creation rate is defined as $pos_{sict} = \frac{\sum_{i \in SC^+} \Delta E_{sict}}{0.5(E_{sict} + E_{sict,t-1})}$ and job destruction rate as $neg_{sict} = \frac{\sum_{i \in SC^-} \Delta E_{sict}}{0.5(E_{sict} + E_{sict,t-1})}$, where *i* represents industry, *s* represents size class, *c* represents country, *t* represents time (year) and *E* denotes employment. Capital letters *S* and *C* refer to a set of size classes or countries, respectively, SC^+ denotes positive changes in employment and SC^- negative changes in employment. The symbol Δ denotes the first-difference operator, $\Delta E_t = E_t - E_{t-1}$.⁷ The job flows are calculated on a yearly basis. In all our empirical analysis, we use time averages to reduce the possible impact of business cycle fluctuations in the years for which we have the data and the possibility that such fluctuations were not synchronised across countries and thus not captured by the use of common time fixed effects.

⁶We take averages of *pos* and *neg*, and then calculate *sum*.

⁷See also Davis et al. (1996).

3 Basic facts about job turnover in industrial and emerging economies of Latin America and central and eastern Europe

In this section, we highlight the key stylised facts emerging from our analysis of job flows across countries, industries and firm size.⁸ These stylised facts are used in the following sections to guide our multivariate analysis.⁹

1. Large job turnover in all countries

The first stylised fact emerging from the data is the large magnitude of gross job flows (the sum of job creation and job destruction) in all countries compared with net employment changes, both at the level of total economy and in manufacturing (see Table B.1 in the appendix and Haltiwanger et al. (2006)). Gross job flows range from about 25 per cent of total employment on average in the OECD countries, to about 30 per cent in Latin America and the transition economies. By contrast, *net* employment changes tend to be very modest if not nil in the OECD and Latin America over the sample period, while the transition economies recorded a significant net job growth in the period covered by the data, after the substantial job losses of the early phases of the transition.

Taken at face value, the observed high pace of job reallocation in all countries may suggest a high degree of dynamism in virtually all economies. However, even at the aggregate level there are significant cross-country differences and, in addition, many different country-specific factors tend to influence the pace of job reallocation, within each country, across industries and size classes. Accordingly, the identification of the impact of regulations requires exploiting more than simply cross-country variation.

2. Firm turnover plays a major role in total job flows

The second stylised fact is the strong contribution of firm creation and destruction to job flows. Entering and exiting firms account for about 30-40 per cent of total job flows (see Table B.1 in the appendix). In the transition countries, entry was even more important in the early years of transition to a market economy, while the exit of obsolete firms became more predominant in the second half of the 1990s, both for the total economy and in manufacturing, when market contestability strengthened.¹⁰

3. Small firms contribute disproportionately to job flows

Small firms account disproportionately for job flows and firm turnover in all countries of our sample. Figure 1 presents job reallocation rates by firm size classes and countries. In general, job reallocation is highest in firms with less than 20 employees, and the lowest in firms with 100+ employees. In the US, job turnover declines monotonically with firm size, and the decline

⁸See Geroski (1995) for a summary of the basic facts characterising firm demographics.

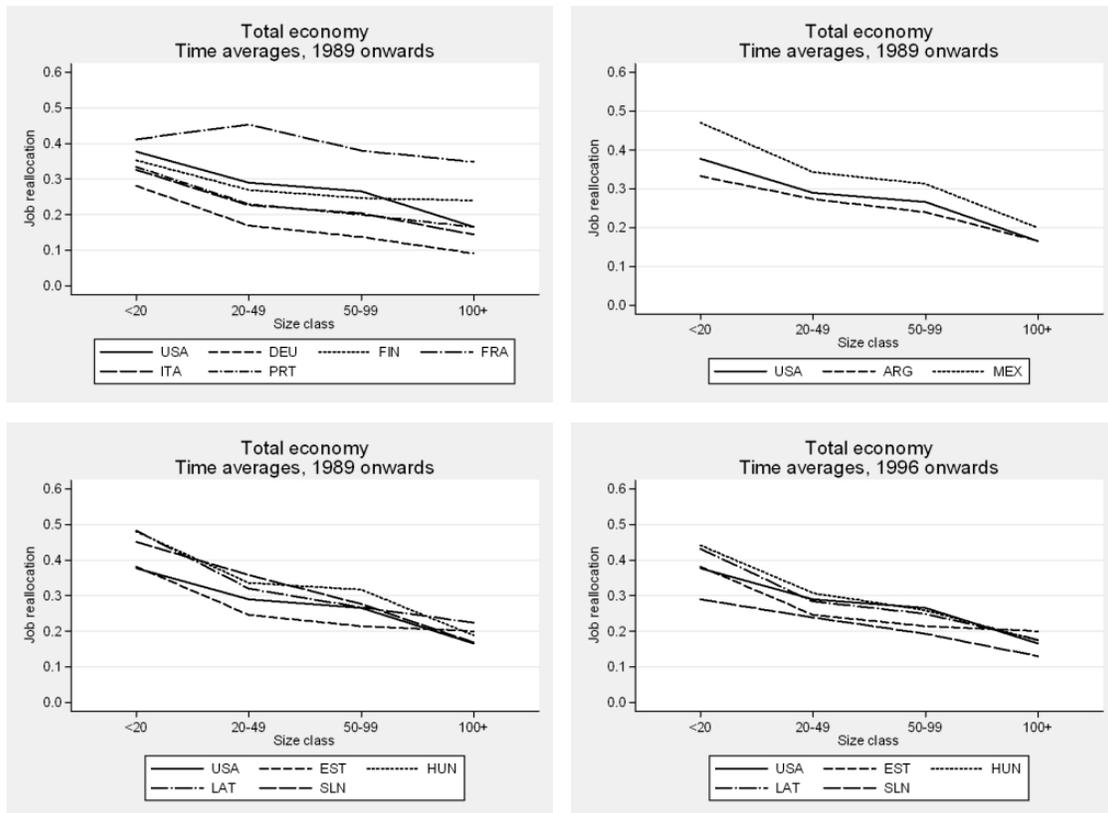
⁹A slightly longer list of the basic facts as well as their more detailed description can be found in Haltiwanger et al. (2006).

¹⁰The large job flows in the transition countries are not surprising. The process of transition started in the early 1990s and it included downsizing or exit of existing firms as well as the entry of many new firms as the economies progressed toward a market economy.

is particularly marked among large units (100+). Latin American countries follow similar patterns to those of the US, while the European countries, with the exception of France, have a less marked drop of job reallocation among larger units. The transition countries, on the other hand, show a steeper slope in smaller size classes, especially in the early years of transition.¹¹ It is this variation of job flows by size class as well as the variation across industries and countries that we exploit in our empirical analysis.

The analysis of size-specific job reallocation rates should be complemented with a decomposition of the overall job reallocation into that due to firms of different sizes. We find small firms account for the largest share of firm turnover and also for a significant, albeit less dominant, share of total job flows. In terms of shares of job reallocation by size class, we find a U-shaped relationship that reflects two offsetting effects – first, job flows are higher for small firms as evidenced in Figure 1 and second, employment is concentrated in larger firms.

Figure 1: Job reallocation across firms of different sizes, total economy



Source: Own calculations based on harmonised firm-level database; see main text for details.

¹¹Our data also suggest similar patterns for firm turnover by size class and country (results not presented here).

4. Analysis of variance

The next step is to assess the relative importance of the different dimensions – country, industry and size – in explaining the overall variance in job flows. Table 1 presents the analysis of variance of job flows, for the unbalanced total economy and manufacturing samples.¹² We consider different indicators of job flows - gross job reallocation, job reallocation from entry and exit and job reallocation for continuers. We also assess the contribution to the total variance of industry, size, country and industry×size effects separately and, in addition, differentiate the analysis of variance by region (OECD, transition economies and Latin America).¹³

It is noticeable that technological and market structure characteristics that are reflected in the industry-specific effects explain only 5.1 per cent of the overall variation in gross job reallocation across industry, size and country classes, although they account for a higher share in Latin America (18.4 per cent). They explain much less of the overall variation in the manufacturing sample. By contrast, differences in the size structure of firms explain as much as 47.0 per cent of the total variation in cross-country gross job reallocation overall, and even more in the manufacturing sample only (51.8 per cent). Even country effects explain more of the variation in gross job reallocation than the industry effects (except in Latin America for the total economy sample). Hence, even though there are similarities among countries within a region, there is still significant variation across them. Overall, the combined industry×size effects explain the bulk of the variation in gross job reallocation: 52.2 per cent overall, 46.9 per cent in OECD countries, 64.3 per cent in Latin American countries and 55.8 per cent in transition countries in the second half of the 1990s.

Size heterogeneity plays a particularly strong role in explaining the variation of job creation by new firms and job destruction by exiting firms. Size heterogeneity is particularly important in Latin America, where it accounts for 70.2 per cent of the heterogeneity in job reallocation from entry and exit. In the OECD countries, size heterogeneity plays a smaller role in both job reallocation from entering and exiting firms.¹⁴ It is also interesting that size and industry×size effects account for a substantially larger fraction of entry and exit variation than for continuers. Apparently, a key component that accounts for variation in job reallocation across industry×size and size classes is differences in the pace of entry and exit. Put differently, this result suggests that firm entry and exit is a key margin in driving job flows and, as such, our working hypothesis is that it may be this variation that is especially sensitive to distortions.

¹²The total economy sample is unbalanced in the sense that it covers manufacturing only for Brazil, Chile, Colombia and the United Kingdom - see Table A.1 for details.

¹³Mexico became a member of the OECD in 1994 and Hungary became a member in 1996, but for the purposes of this paper, they are classified as a Latin American economy and a transition economy, respectively.

¹⁴In unreported results, we have examined the analysis of variance separately for entry and exit. The most interesting aspect of this latter exercise is the finding that in the transition economies there is a strong difference between the factors accounting for variation in job creation and destruction. The variation of job creation by entrants is strongly influenced by size heterogeneity, while the importance of size effects for variation in job destruction by exiters is relatively small. The reason for the latter is that there are offsetting forces influencing exit in the transition economies. As in most countries, many young businesses fail in the early phases of their life, but in the transition economies (particularly in the early phases of their economic transformation) structural changes also involved the exit of many large, state-owned enterprises.

Table 1: Analysis of variance, total economy (unbalanced panel) and manufacturing

	Total economy			Manufacturing		
	Gross job reallocation	Job reallocation - entry and exit	Job reallocation - continuers	Gross job reallocation	Job reallocation - entry and exit	Job reallocation - continuers
INDUSTRY EFFECTS						
All	0.0511	0.0074	0.0924	0.0057	0.0069	0.0167
OECD	0.0730	-0.0386	0.1660	-0.0014	-0.0067	0.0388
LAC	0.1836	0.0580	0.2585	-0.0113	-0.0166	-0.0102
Transition	-0.0274	-0.0386	-0.0008	-0.0348	-0.0351	-0.0192
SIZE EFFECTS						
All	0.4690	0.5008	0.1924	0.5177	0.5094	0.2444
OECD	0.4100	0.4226	0.1750	0.5209	0.3968	0.3473
LAC	0.4724	0.7023	0.1169	0.5897	0.7764	0.1507
Transition	0.5220	0.4557	0.2966	0.5045	0.4055	0.2901
COUNTRY EFFECTS						
All	0.1527	0.1342	0.2172	0.1672	0.1548	0.2435
OECD	0.1910	0.2115	0.2015	0.1829	0.2794	0.1569
LAC	0.1474	0.0382	0.3640	0.2030	0.0613	0.5073
Transition	0.0758	0.1020	0.1232	0.0625	0.0950	0.1044
INDUSTRY × SIZE EFFECTS						
All	0.5215	0.5069	0.2805	0.5331	0.5200	0.2626
OECD	0.4688	0.3762	0.3157	0.5167	0.3522	0.3845
LAC	0.6430	0.7958	0.2737	0.5631	0.7833	0.0307
Transition	0.5584	0.4236	0.3328	0.5495	0.3849	0.3188

Adjusted R-squared is reported. Late 1990s data are used for transition countries.

Source: Own calculations based on harmonised firm-level database.

Table 2: Rank correlations with the US job flows, total economy (unbalanced panel) and manufacturing

	Total economy			Manufacturing		
	Gross job reallocation	Job reallocation - entry and exit	Job reallocation - continuers	Gross job reallocation	Job reallocation - entry and exit	Job reallocation - continuers
OECD	0.7515	0.7223	0.6254	0.7220	0.7189	0.6620
Germany	0.8468	0.9191	0.7214	0.9098	0.9153	0.9234
Finland	0.6946	0.3532	0.7742	0.6714	0.4301	0.7530
France	0.5418	0.7385	0.1762	0.6562	0.7732	0.2892
United Kingdom	0.8994	0.8229	0.6565	0.8994	0.8229	0.6565
Italy	0.6901	0.6896	0.6628	0.6366	0.5772	0.6932
Portugal	0.8363	0.8106	0.7611	0.8015	0.7948	0.6565
LAC	0.8528	0.8542	0.5622	0.8606	0.8705	0.5608
Argentina	0.8844	0.8421	0.7316	0.8847	0.8486	0.6677
Brazil	0.8987	0.9095	0.8135	0.8987	0.9095	0.8135
Chile	0.6787	0.7543	-0.1212	0.6787	0.7543	-0.1212
Colombia	0.9170	0.8975	0.6062	0.9170	0.8975	0.6062
Mexico	0.8853	0.8676	0.7807	0.9237	0.9425	0.8379
TRANSITION	0.7556	0.6905	0.5903	0.7767	0.6832	0.6599
Estonia	0.7364	0.6236	0.6338	0.7460	0.5866	0.7145
Hungary	0.8321	0.8560	0.6897	0.8996	0.8985	0.8064
Latvia	0.7005	0.7215	0.4204	0.6638	0.7000	0.4053
Slovenia	0.7534	0.5609	0.6171	0.7972	0.5477	0.7133

Late 1990s data are used for transition countries.

Source: Own calculations based on harmonised firm-level database.

Table 3: Job flows - US versus other countries

	Total economy			Manufacturing		
	(1)	(2)	(3)	(4)	(5)	(6)
USA SUM	0.6699*** [0.0396]			0.6121*** [0.0372]		
USA SUM×EU		0.5726*** [0.0521]			0.4849*** [0.0353]	
USA SUM×Transition		0.7795*** [0.0676]			0.7467*** [0.0581]	
USA SUM×LAC		0.8542*** [0.0514]			0.7987*** [0.0461]	
USA SUM×<20 workers			0.5711*** [0.0430]			0.4744*** [0.0601]
USA SUM×20-49 workers			0.4360*** [0.0573]			0.3048*** [0.0688]
USA SUM×50-99 workers			0.3890*** [0.0676]			0.2201*** [0.0769]
USA SUM×100+ workers			0.2918*** [0.1019]			0.0207 [0.1435]
Country effects	YES	YES	YES	YES	YES	YES
Observations	940	940	940	709	709	709
Adjusted R-squared	0.78	0.79	0.81	0.81	0.85	0.85

All regressions are weighted by the total employment in each country, industry and size cell and include an intercept. Robust standard errors in brackets. * = significant at 10%, ** = significant at 5%, *** = significant at 1%. USA SUM: industry×size job reallocation in the US. EU denotes the OECD European countries. Transition denotes the countries in central and eastern Europe. LAC denotes the countries in Latin America.

Source: Own calculations based on harmonised firm-level database.

5. The correlation of industry \times size job flows across countries

It is also of importance to assess the correlation of industry job flows across countries. If market-driven and technological factors were the only factor at play, we should observe a strong correlation across countries. However, industry-level job flows in each country are also influenced by the institutional environment in which firms operate. Lack of correlation may accordingly be associated with policies and institutions that distort job flows. Job flows are part-and-parcel of the creative destruction process, and an unfavourable institutional environment will cause this process to be distorted (Caballero and Hammour (2000)). For this descriptive evidence, we use the rank correlation as it is more robust to measurement error but the findings are robust to using Pearson correlation statistics.

Industry \times size-level correlations with the US are particularly strong for most Latin American countries in the sample, despite the very different degree of economic development, as well as for United Kingdom (Table 2). In general, correlations are on average slightly higher if we focus only on manufacturing. Some of the lowest correlations are found for some EU countries, in particular France (0.54). It is also interesting to see that transition economies had a much stronger correlation of their job flow patterns by industry and size class with the US in the sample that covers the entire 1990s than in the sample used in this paper that focuses on the 1996-2001 period (see Haltiwanger et al. (2006)). This might seem surprising, since the early phases of the transition were characterised by massive job reallocation and the unique need to change the structure of the economy. One working hypothesis that we develop later in the paper is that after the initial phases of transition, these countries have moved toward the job flow patterns observed in EU countries, with whom they share several policy and institutional factors.

6. The US versus other countries in the “slope” of the industry \times size reallocation relationship

The findings from the previous two subsections suggest that industry \times size effects account for a large fraction of the variation in job flows across industry, size and country classes, and also strong correlations between the rank order of job flows by industry and size in any given country with that in the US. These findings help motivate our empirical analysis of regulations below since they clearly indicate that there are common factors underlining the patterns of job flows across countries and across industry and size classes. As discussed above, these patterns plausibly reflect technology, demand and cost fundamentals (including the distribution of idiosyncratic shocks and the costs of reallocation) that vary across industry and size classes. Before going to a more formal empirical analysis of the effects of policy-induced distortions on job flows, we run a simple descriptive regression in which we quantify how the “slope” of the industry \times size relationship varies between the US and the rest of the world. We take the US as our benchmark because it is the country with arguably relatively low policy-induced distortions. In particular, we estimate the following regression:

$$JFlow_{sic} = \beta_0 + \beta_1 USJFlow_{si} + \sum_{c=1}^C \gamma_c D_c + \epsilon_{sic} \quad (1)$$

where D_c are country c ($c = 1, \dots, C$) dummies, $USJFlow_{si}$ is the US job flow variable in size class s and industry i , and ϵ is the *iid* error term. We estimate weighted regressions, using total employment in each country, size and industry cell as weights in order to take into account the

differences in the employment that each cell represents. This specification enables us to quantify the relationship, or slope, between cross-industry \times size differences in gross job flows between the US and other countries in our sample. In this descriptive analysis, we start with a baseline specification in which we only include the US job flow benchmark and the country dummies (equation (1)). We then allow the coefficient of the US job flow variable to vary by region and by firm size class.¹⁵

As expected, the estimated coefficient on the US job flow in column (1) in Table 3 is positive and highly significant, confirming the bivariate correlation analysis discussed above. However, the estimated coefficient is significantly less than one, suggesting that, other things being equal, the responsiveness to market and technologically-driven factors that affect reallocation in the US is less than one in the other countries. Indeed, if we take the US job flow rate as the benchmark for the propensity for the industry \times size class to reallocate labour as a result to technology and market fundamentals, this finding suggests that an increase in the propensity that leads to a 10 percentage points increase in job reallocation from one industry \times size class to another in the US, only leads to an increase of 6.7 percentage points from the same industry \times size class to the other in other countries in the sample. In a suggestive sense, the coefficient being less than one is consistent with the view that the sample of EU, Latin America and transition economies have factors that distort the reallocation process.¹⁶

If we then allow the coefficient on US job flows to vary by region (EU, transition countries and Latin America) (column (2)), we notice that there is a closer link between cross-industry \times size differences in gross job flows between the US and the Latin American countries than between the US and the European Union countries.

However, the coefficients are significantly less than one in all regions. Moreover, the coefficients on US job flow for the EU countries and for transition countries are not significantly different from each other at 1 per cent significance level (but they are different at 5 per cent significance level). The Wald test for the equality of the coefficients on US job flow for transition countries and for Latin American countries cannot be rejected at any of the usual significance levels.

Next, we allow the coefficient on US job flows to vary by firm size (column (3)) and we find - perhaps not surprisingly - that the coefficient is the highest for the smallest size class (1-19 employees) and declines monotonically for the larger size classes. In other words, the patterns of cross industry job flows in the US and other countries are more similar among small firms than among larger firms, possibly because small firms are exempt from certain regulations and/or can more easily avoid other regulations. Hence, small firms show a degree of dynamism that is closer to that of the non-distorted (US) economy. For larger firms, regulations are likely to be more binding, especially in those industries that are inherently more volatile. The equality of all pairs with the coefficient for the smallest size class can be rejected at 1 per cent significance level, indicating that the coefficient for the smallest size class is highly significantly

¹⁵The measure of job flows is the sum of job creation and job destruction rates (*sum*) and all variables are time averages over the available annual observations (see the next section for more details).

¹⁶Appropriate caution needs to be used in interpreting the magnitude of the coefficient since measurement errors can drive the coefficient below one. However, it is noticeable that this coefficient is always less than one, and that the pattern of variation in the magnitude of this coefficient across regions and size classes is consistent with our interpretation.

different from those of larger size classes. The equality of the coefficients cannot be rejected for the coefficients for the 20-49 and 50-99 size class pair at any of the usual significance levels, while the equality of the coefficient for the 20-49 and 100+ size class pair and for the 50-99 and 100+ size class pair can be rejected at the 5 per cent significance level.

4 Empirical analysis

4.1 The framework

In this section, we develop an empirical analysis of the determinants of the observed differences in job flows across countries, industries and size classes. We base our empirical analysis on three important results discussed in the previous section: (i) a significant share of the total variance in job flows observed in the data is explained by industry \times size effects, (ii) there is a high correlation of industry \times size job flows across countries, and (iii) the other countries in the sample tend to have less variation across industry \times size classes in the magnitude of reallocation than the US. The first two results are consistent with the hypothesis that the distribution of idiosyncratic profit shocks affecting desired employment and the costs that influence the adjustment to such shocks vary systematically by industry and size class. For example, demand characteristics in some industries imply that firms in these industries face higher volatility in their product demand than other industries.¹⁷ Likewise, technological characteristics may require more frequent re-tooling of the production process with the associated need to adjust the workforce. Alternatively, certain technological characteristics may require firms to use highly specialised workers and thus make them less likely to frequently adjust their workforce to respond to idiosyncratic shocks. Demand and technological characteristics also affect the composition of firms within each industry and their response to shocks. For example, some industries are characterised by the presence of small firms, which tend to be more volatile than large businesses in all countries.¹⁸

As discussed in the previous section, the third result suggests that there are factors that reduce reallocation differences across industry \times size classes in other countries relative to the US. Our empirical analysis is designed to identify and quantify such factors. Before proceeding to that empirical analysis, it is instructive to review the insights from the recent literature on adjustment costs and reallocation (see, for example, Caballero et al. (1997)).

Adjustment costs governing responses to idiosyncratic shocks vary not only by industry and size, due to underlying market and technological factors, but also across countries, due to differences in institutions and policy settings. To the extent that institutions vary more by country than industry and size, our working hypothesis is that the impact of institutions that hinder adjustment in any given country will be more binding on industry \times size cells with the greatest propensity for reallocation in that country. The amount of job reallocation in a particular sector hence depends on the distribution of productivity shocks and adjustment costs.

While these considerations tend to apply to incumbent firms, it is straightforward to extend the

¹⁷This microeconomic evidence is also consistent with an extensive literature that has highlighted the importance of sector-specific shocks to aggregate fluctuations, for example, Long and Plosser (1987), Horvath (1998).

¹⁸Different factors contribute to a different volatility of employment across firms of different size. On the one hand, fixed adjustment costs that are unrelated to firm size may make the area of inaction larger for small firms compared with larger ones (see, for example, Nilsen et al. (2007)). On the other hand, distortions, such as for example credit market imperfections, may force small firms to react more swiftly to shocks (see, for example, Gertler and Gilchrist (1994)).

argument to include the entry and exit of firms. Indeed, standard models of entry and exit (for example, Jovanovic (1982), Hopenhayn and Rogerson (1993), Melitz (2003), Asplund and Nocke (2006)) posit that new entrant firms do not know, *ex ante*, their productivity type and must pay an entry fee before learning their type. Firms enter the market until the expected present discounted value of profits from entry is just equal to the entry cost. Firms with low productivity draw exit *ex post*. Higher adjustment costs – including labour adjustment costs – reduce the present discounted value of *ex ante* profits, especially for sectors with a high variance of productivity shocks (for the reasons discussed above). This yields a lower pace of entry as well as an implied lower pace of exit in the steady state. The theoretical model that illustrates this effect most directly is Hopenhayn and Rogerson (1993) who show that policy-induced higher employment adjustment costs lead to a lower pace of job and firm turnover.

4.2 The estimation model

We explore the links between the regulatory environment in which firms operate and job turnover by exploiting the observed industry \times size variations through a difference-in-difference approach (see Rajan and Zingales (1998)).¹⁹ The test is constructed as follows: we identify an industry \times size propensity for job reallocation from the US data. Under the assumption that regulations in the labour and goods markets in the US are among the least restrictive in our sample, variation in job reallocation across industry \times size cells in the US should proxy for the technological and market-driven differences in job reallocation in the absence of policy-induced adjustment costs. Under the additional assumption that these technological and market-driven differences in the demand for job reallocation carry over to other countries, we assess whether industry \times size cells that have a greater propensity for job reallocation are disproportionately affected by regulations that raise adjustment costs. This would imply that, *ceteris paribus*, industry \times size cells with more volatile idiosyncratic profit shocks and more frequent adjustment of factors should be more strongly affected by regulations raising adjustment costs than those industry \times size cells with less volatile idiosyncratic profit shocks and less frequent adjustment. The advantage of our approach compared with standard cross-country/cross-industry empirical studies is that we exploit within-country differences between industry \times size cells based on the interaction between country and industry \times size characteristics. Thus, we can also control for country and industry \times size effects, thereby minimising problems of omitted variable bias and other misspecifications.

The core model specifications used in our empirical analysis can be summarised as follows:

$$JFlow_{sic} = \beta_0 + \sum_{si=1}^{S \times I} \gamma_{si} D_{si} + \sum_{c=1}^C \gamma_c D_c + \beta_2 (USJFlow_{si} \times R_c) + \varepsilon_{sic} \quad (2)$$

where D_{si} are industry \times size si ($si = 1, \dots, I \times S$) dummies, D_c are country c ($c = 1, \dots, C$) dummies, $USJFlow_{si}$ is the US job flow variable in size class s and industry i , R_c is the variable

¹⁹The difference-in-difference approach has already been used in the corporate literature (, for example, Classens and Laeven (2003)), in the analysis of firm dynamics (Klapper et al. (2006)) and in the analysis of output and employment growth as well as job flows (Micco and Pages (2007)).

measuring regulations in country c , and ε is the *iid* error term. Controlling for country effects sweeps out any country-specific variation, controlling for industry \times size effects sweeps out the large common factors associated with industry and size, and the key interaction term between the US flow in the industry \times size class and the country regulation allows us to identify how the measured regulatory environment affects the variation across industry \times size classes within countries. The US flow here is used to quantify the propensity for the industry \times size class to reallocate and, as discussed, reflects the fundamental driving forces underlying job reallocation across industry \times size classes.

In what follows, the measure of job flows used in the empirical analysis is the sum of job creation and job destruction rates (*sum*).²⁰ As stressed above, all our variables are time averages over the available annual observations to reduce the possible impact of non-synchronised business cycle fluctuations in the years covered in our analysis. The sample is unbalanced and covers fewer years for some countries than others (see Table A.1). We use the period from 1989 to 2001 for OECD and Latin American countries and sample from 1996 to 2001 for the transition economies. The choice of the restricted subsample for the transition economies is motivated by two interrelated factors. First and as discussed in the previous section, the initial years of the transition process (1991 to 1995) were characterised by unprecedented reallocation of labour – and other factors of production – across industries, firms and locations. The magnitude and direction of the observed flows were only temporary and, indeed, job flows declined towards the standards of the OECD countries over time, and also became more balanced within each industry \times size cell.²¹ Second, the early years of transition were characterised by major regulatory reforms to conform countries’ institutional settings to those of market economies. For these two reasons, focusing on the second half of the 1990s for the transition economies is more appropriate in our comparative analysis of job flows.²²

In addition to the core specification, we consider some closely related specifications. As a robustness check, we estimate an augmented model that also considers business sector regulations. In addition, we explore specifications that focus on, alternatively, job flows from entry and exit or continuing firms.

4.3 Regulations in labour and product markets

In the empirical analysis, we consider synthetic indicators of the stringency of regulations in the labour and product markets, as well as the degree of enforcement of laws and regulations. Our primary source for these is the “Economic Freedom of the World (EFW)” database (see Gwartney and Lawson (2004)). This database has been developed under the auspices of the Fraser Institute in Canada with the aid of a worldwide network of economists and research

²⁰The results are largely unaffected by the use of excess job reallocation, that is, the difference between the sum and the (absolute value of) net employment change. These results are available in the web appendix at www.helenasch.net.

²¹Results for the whole sample for transition economies are available in the Web appendix at www.helenasch.net.

²²In any event, in the sensitivity analysis in section 4.5, we exclude each country in turn to assess the robustness of our empirical results to the country sample composition.

institutes. In particular, we use indicators referring to hiring and firing regulations, regulation of business activities and integrity of the legal system.

Other indicators of the stringency of labour regulations in developing and emerging economies are available in the literature (, for example, the World Bank Doing Business database), but they generally refer to the most recent past and may thus not properly capture the regulatory environment over the period covered by our data (the 1990s). By contrast, the EFW tracks changes in regulations over time and is thus more suitable for our analysis of job flows that have indeed been influenced by policy changes over the period covered by our data (see Table C.1 for more detailed definitions of the variables used in our analysis and Table C.2 for their summary statistics).

The EFW indicator of hiring and firing regulations is measured on a scale of 0 to 10, with 10 being the worst (most restrictive). The average of this indicator is the highest in transition countries (5.70), followed by the OECD sample (5.43) and Latin America (4.68). This synthetic indicator passes simple validation tests. For example, its correlation with a similar indicator of employment protection legislation developed by the OECD is 0.85, statistically significant at the 1 per cent level.²³

In the sensitivity analysis, we also consider an EFW synthetic indicator of regulations in the product market. Regulations affecting markets for goods and services have a strong impact on the degree of competition and the pace and effectiveness of reallocation of resources, including labour. Thus, more restrictive regulations that stifle product market competition are also likely to influence job flows. The business regulation indicator is a simple average of five different indicators²⁴ that are designed to identify the extent to which regulatory restraints and bureaucratic procedures limit competition and the operation of goods and services markets. Business regulation is measured on a scale from 0 to 10, with 10 being the most restrictive. This indicator is on average the highest in Latin America (4.21), followed by transition countries (3.32) and OECD countries (3.07).

Previous research (see, for example, Caballero et al. (2004), Heckman and Pages (2004)) suggests that the degree of enforcement of labour regulations – as well as other regulations – can significantly affect their impact on the economy. Available indicators suggest a significant variation in the rules of law and the degree of enforcement of laws and regulations in our sample of OECD, Latin American and transition economies. Not only are some firms and jobs not registered in Latin America and increasingly in the transition economies and some southern European countries, registered firms may also not fully comply with the existing rules and regulations. As an indication of the different degree of enforcement of laws and regulations, we

²³We check the robustness of our results by using an alternative measure of employment protection legislation, the OECD EPL index. Since this measure is not available for Latin America and transition countries in the early 1990s, we augmented it in two ways. First, for transition countries we used data on EPL collected by Haltiwanger et al. (2003). Second, for Latin America we imputed EPL by regressing a measure of hiring and firing regulations from the Fraser Institute on EPL for transition and OECD countries and then using the estimated coefficient to calculate EPL. EPL is measured on a scale from 0 to 4, with 4 being the worst (most restrictive). It is on average the strictest in OECD (2.35) and the least strict in Latin America (1.73).

²⁴The detailed indicators used to construct the synthetic indicator are: price controls, administrative conditions and new business, time with government bureaucracy, starting a new business, and irregular payments.

consider the law and order indicator from the Fraser Institute (based on the Political Risk Component I (Law and Order) from the International Country Risk Guide, ranging from 0 to 10, 10 being the worst).²⁵ The indicator shows the highest compliance with laws and regulations in the OECD sample of countries (average of 0.47), followed by the transition economies (average of 1.76), and by the Latin American countries (average of 4.95).

To control for possibly differing degrees of enforcement of laws and regulations we adjust our regulatory variable as follows:²⁶

$$R_{c,adj} = \left(1 - \frac{Law\&Order}{10}\right) \times R_c. \quad (3)$$

4.4 Regulations and job flows

Table 4: Job flows and the role of labour regulations (difference-in-difference analysis)

	(1)	(2)
USA SUM×EPL (Adj)	-0.1052*** [0.0149]	
USA SUM×EPL (Adj)×EU		-0.0890*** [0.0128]
USA SUM×EPL (Adj)×Transition		-0.0689*** [0.0206]
USA SUM×EPL (Adj)×LAC		-0.0561*** [0.0237]
Country effects	YES	YES
Industry×size effects	YES	YES
Observations	940	940
Adjusted R-squared	0.87	0.87

All regressions are weighted by the total employment in each country, industry and size cell and include an intercept. Robust standard errors in brackets. * = significant at 10%, ** = significant at 5%, *** = significant at 1%. USA SUM: industry×size job reallocation in the US. EU denotes the OECD European countries. Transition denotes the countries in central and eastern Europe. LAC denotes the countries in Latin America. EPL (Adj) is an indicator of stringency of hiring and firing regulations adjusted to take into account different degrees of enforcement of regulations (see main text).

Source: Own calculations based on harmonised firm-level database.

²⁵Micco and Pages (2007) also make an attempt at controlling for different degrees of enforcement of regulations by using an indicator of rules of laws and government effectiveness (see Kaufmann et al. (2004)). We used the Fraser index of law and order because it is available for the time period for which our job flows data are available for the different countries.

²⁶There is no indication in Gwartney and Lawson (2004) that the original regulatory variables consider the enforcement of regulations in addition to the statutes.

Table 5: Job flows and the role of labour and product market regulations (difference-in-difference analysis)

	(1)	(2)
USA SUM×EPL (Adj)	-0.1067*** [0.0222]	
USA SUM×EPL (Adj)×EU		-0.0774*** [0.0239]
USA SUM×EPL (Adj)×Transition		-0.1463*** [0.0328]
USA SUM×EPL (Adj)×LAC		-0.1644*** [0.0622]
USA SUM×Bus. Reg. (Adj)	0.0399 [0.0323]	
USA SUM×Bus. Reg. (Adj)×EU		0.0201 [0.0385]
USA SUM×Bus. Reg. (Adj)×Transition		0.0301 [0.0725]
USA SUM×Bus. Reg. (Adj)×LAC		0.2918** [0.1153]
Country effects	YES	YES
Industry×size effects	YES	YES
Observations	940	940
Adjusted R-squared	0.87	0.87

All regressions are weighted by the total employment in each country, industry and size cell and include an intercept. Robust standard errors in brackets. *= significant at 10%, **= significant at 5%, ***= significant at 1%. USA SUM: industry×size job reallocation in the US. EU denotes the OECD European countries. Transition denotes the countries in central and eastern Europe. LAC denotes the countries in Latin America. EPL (Adj) is an indicator of stringency of hiring and firing regulations adjusted to take into account different degrees of enforcement of regulations. Bus. Reg. (Adj) is an indicator of stringency of business regulations adjusted to take into account different degrees of enforcement of regulations (see main text).

Source: Own calculations based on harmonised firm-level database.

Tables 4 and 5 present the empirical results of our policy-augmented job flow regressions. We use a difference-in-difference analysis by focusing on the variation of job flows across industry×size classes within each country. The estimated coefficient on the interaction between the US job flow and the adjusted labour regulation (Table 4) is strongly significant overall, and in each of the subregions when we allow the coefficient of the interaction to vary. Intrinsically more volatile industries and size classes present lower levels of gross job turnover relative to the less volatile industries and size classes in countries with more stringent hiring and firing regulations.

How sizeable is the estimated impact of labour regulation on job flows? Using the coefficient on the interaction term in column (1) of Table 4, we estimate that the difference in the job reallocation in the industry \times size cells with a high flexibility requirement (90th percentile of the flexibility distribution in the US, corresponding to a gross job turnover of 40.2 per cent) and industry \times size cells with a low flexibility requirement (10th percentile of the same distribution, corresponding to a gross job turnover of 13.2 per cent) will be cut by about one half (14.3 percentage points) in a country at the 90th percentile of the index of hiring and firing regulations compared with a country at the 10th percentile of the hiring and firing regulations.²⁷

There are a number of reasons why it is important to assess the robustness of our results on labour regulations to the inclusion of regulations in product markets. First, the exclusion of product market regulations may lead to an omitted variable bias insofar as regulations in different markets tend to be highly correlated, that is, countries that impose strict rules of hiring and firing also tend to impose more restrictive regulations on the goods and services markets.²⁸ There are also specific aspects of product market regulations that can influence job flows over and above labour regulations. For example, since a significant fraction of overall job flows is due to the entry and exit of firms, regulations affecting the start-up of a new business, as well as bankruptcy rules that affect the exit of low performing units, may affect job flows directly and the way incumbents react to strict labour regulations. Koeniger and Prat (2007), for example, argue that product and labour market regulations are complementary: by isolating incumbents from the competition of potential entrants, barriers to entry allow incumbents to bear the firing costs more easily. Likewise, regulations affecting price-setting by firms and their relations with the public administration and their clients can all influence incentives for firms to expand, adopt new technologies and adjust their workforce.

To assess the robustness of our empirical results we thus augment our job flows specification by adding a synthetic indicator of the stringency of business sector regulations. As for labour regulations, we adjust this variable for the degree of enforcement (Table 5) and interact it with the US gross job reallocation.²⁹ The estimated effects of labour regulations on job flows remain strongly significant overall and in the different regions. By contrast, the estimated coefficient of business regulations is estimated with a large standard error overall. When we differentiate the coefficient by region, we find that the estimated effect of business regulations is even positive

²⁷The estimated value is obtained as follows:

$$\beta [(USJFlow_{90^{th}} - USJFlow_{10^{th}}) (HF_{90^{th}} - HF_{10^{th}})]$$

where β is the estimated coefficient, *USJFlow* and *HF* are the job reallocation in the US and the indicator of hiring and firing regulations corrected for the degree of enforcement, respectively. Micco and Pages (2007), using a difference-in difference-approach, also estimated a similar effect; that is to say a cut by about one half of the difference between the job flows of the industries with high flexibility requirements and those with low flexibility requirements by moving from a country with low to a country with high hiring and firing regulations. Their country sample and period of observation are different from ours.

²⁸There is also ample evidence that regulations in product and labour market tend to be correlated across countries (see, for example, Nicoletti and Scarpetta (2005)).

²⁹We have also used US employment-weighted firm turnover rather than US job flows as the industry \times size interacting factor: the results are largely similar to those reported in the paper and are available on request. We find some sensitivity in the specifications that also interact with region but the robustness of the labour regulations holds in this alternative.

and significant for Latin American countries.³⁰

So far we have focused on the effects of labour regulations on overall job reallocation. It is also interesting to shed some light on whether such regulations have a different impact on the different margins of reallocation, namely on job flows due to the entry and exit of firms in the market and those due to reallocation among incumbents (see Table 6).³¹

Table 6: Job flows by entering, exiting and continuing firms - the role of labour market regulations (difference-in-difference analysis)

	Entry and exit	Continuers
	(1)	(2)
USA SUM (Entry and exit) × EPL (Adj)	-0.1100*** [0.0165]	
USA SUM (Continuers) × EPL (Adj)		-0.0513** [0.0252]
Country effects	YES	YES
Industry × size effects	YES	YES
Observations	920	934
Adjusted R-squared	0.89	0.78

All regressions are weighted by the total employment in each country, industry and size cell and include an intercept. Robust standard errors in brackets. * = significant at 10%, ** = significant at 5%, *** = significant at 1%. USA SUM (Entry and exit): industry × size job reallocation due to entering and exiting firms in the US. USA SUM (Continuers): industry × size job reallocation due to continuing firms in the US. EPL (Adj) is an indicator of stringency of hiring and firing regulations adjusted to take into account different degrees of enforcement of regulations (see main text).

Source: Own calculations based on harmonised firm-level database.

Column (1) of Table 6 shows the results of estimating the job flow regressions for entering and exiting firms, controlling for labour market regulations corrected by the degree of enforcement. Column (2) does the same for continuing firms. The results suggest a negative and statistically significant effect of labour market regulation (interacted with US job reallocation) on labour mobility generated by both entering and exiting firms as well as continuing firms, although

³⁰There are models that yield a positive relationship between business regulations impacting entry and exit and job turnover. For example, Koeniger and Prat (2007) have a model with both intensive and extensive (that is, through firm entry and exit) margins of adjustment, and fixed and/or start-up costs imposed by product market regulations. They find that product market regulations lead to higher job turnover, as the competition for workers is alleviated by the firm selection effect, the costs of adjusting the labour force decrease and thus firms have less incentive to smooth out their labour demand schedule.

³¹We focus on the combined flows due to entry and exit of firms because of the very high correlations between entry and exit across industries in most countries. This in turn suggests that entries and exits are largely part of a creative destruction process in which entry and exit reflect within industry reallocation reflecting idiosyncratic differences across firms within industries (see Bartelsman et al. (2004) for evidence based on the same dataset used in this paper, as well as Geroski (1991), Baldwin and Gorecki (1991)).

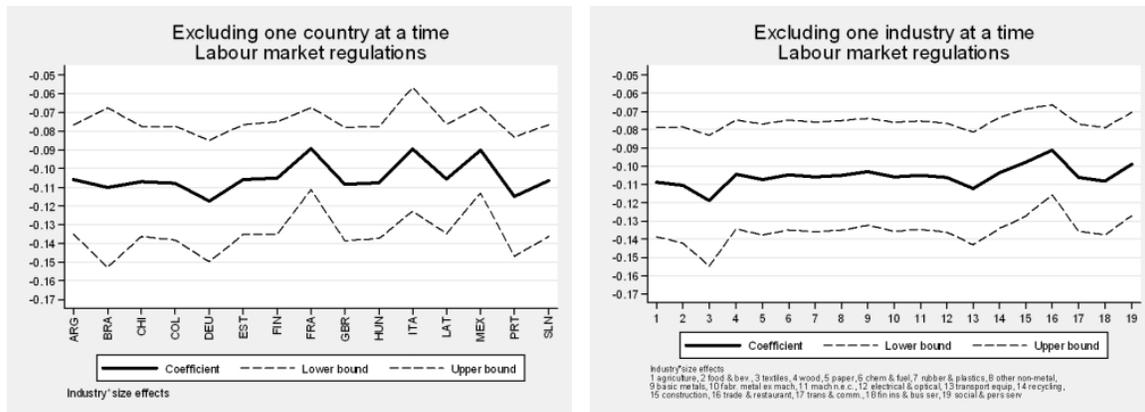
labour market regulations have a stronger estimated effect on the labour mobility generated by entry/exit than on that generated by continuers.³²

Overall, these results confirm the importance of labour market regulations in shaping labour adjustment patterns, particularly so in those industries and size classes where technological and market factors require more frequent employment changes. Controlling for other regulations influencing firm behaviour does not significantly alter the results. There is also evidence in our data that labour market regulations are more important for entering and exiting firms than for continuing firms.

4.5 Sensitivity analysis

In the empirical analysis, we control for country and industry \times size effects, as well as for unobservable effects using a difference-in-difference approach. Moreover, we test the robustness of results for hiring and firing regulations by including other regulatory variables. In addition, we test the sensitivity of our results by using excess job reallocation instead of gross job reallocation, restricting our analysis to industry \times size cells with more than five firms in a given cell and to manufacturing industries only (not reported here but available on request). However, the use of quasi panel data may still run the risk that results are affected by the inclusion of a specific country or industry in the sample that drives the results in a given direction. The use of an unbalanced panel on the industry dimension makes this risk potentially more serious.

Figure 2: Sensitivity analysis: Estimated coefficient on enforcement adjusted hiring and firing regulations interacted with US job reallocation and 95% confidence intervals, excluding one country or one industry at a time, labour market regulations (Column (1) from Table 4)



Source: Own calculations based on harmonised firm-level database.

³²In Table 6, we use the US job reallocation for entry and exit as the propensity for entering and exiting firms and the US job reallocation for continuers as the propensity for reallocation for continuers. We have also considered alternative specifications where for both propensities we use the overall job reallocation for the industry \times size class and obtain very similar results. We also estimate the job flow regressions for entering and exiting firms separately and find that labour market regulations affect both entry and exit margins.

To test for the robustness of results to changes in the sample, we re-estimate our preferred specification – column (1) in Table 4 – removing one country, or one industry, at a time from the sample. The results in Figure 2 show a remarkable stability of the estimated coefficient for the interaction term to changes in the sample along the country or the industry dimension. The point coefficient estimates for the interaction term are always negative and statistically significant. The coefficient is somewhat sensitive to the exclusion of France, Italy and Mexico among countries and the trade and restaurant sector, with all leading to a slightly weaker (but still statistically significant) estimated effect of regulations.

5 Conclusion

This paper exploits a rich, new database with harmonised indicator data on job flows across industries and size classes for 16 industrial and emerging economies over the past decade. We find that all countries in our sample exhibit sizeable annual gross job flows. Industry and size-class effects together account for a very large share of the overall variability in job flows across country, industry and size class cells (over 50 percent). Interestingly, the most important factor here is the employer size. Small businesses exhibit a substantially higher pace of job creation and destruction and this pattern is pervasive across industries and countries. Industry effects also play a significant, albeit much smaller, role in shaping job flows. Taken together, it is clear that some form of technology, cost and demand factors that are common across countries account for the bulk of the variation in job flows. Nevertheless, even after controlling for industry/technology and size factors, there remain significant differences in job flows across countries that could reflect differences in business environment conditions.

Our harmonised indicators dataset allows us to look at two factors shaping the business environment - regulations on the hiring and firing of workers and product market regulations. To minimise the possible endogeneity and omitted variable problems associated with cross-country regressions, we use a difference-in-difference approach. The empirical results suggest that stringent hiring and firing regulations (and their consistent enforcement) reduce job turnover, especially in industry and size-class cells that inherently exhibit more job turnover. To capture the latter, we use the US patterns as a benchmark to identify and quantify industry \times size class cells with inherently higher job turnover. Labour regulations also appear to distort the patterns of flows across industry and size classes within a country. Stringent labour regulations mainly affect the entry and exit of firms and their associated job creation and destruction. Controlling for product market regulations does not alter these results significantly.

Much work remains to be done to understand the implications of our findings. The results provide evidence that stringent labour regulations have an impact on reallocation dynamics. It is a much larger step to demonstrate that stringent labour regulations have an adverse impact on the efficient allocation of labour in a manner consistent with the predictions of Hopenhayn and Rogerson (1993). To explore the latter, we need to measure not only reallocation but also productivity at the micro level. A number of studies have found that allocative efficiency is important for understanding differences in the level and growth of productivity across time, industries and countries (see, for example, Foster et al. (2001) and Bartelsman et al. (2009)). Putting those findings together with those in this paper certainly suggests that stringent labour market regulations may have an important adverse impact on allocative efficiency and in turn productivity levels and growth. However, much work (including additional data infrastructure development) is needed to bring all of the pieces together to explore these important issues.

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Table A.1: Data sources used for firm demographics and job flows

Country	Source	Period	Max. industry coverage (number of industries)	Threshold
OECD				
Finland	Business register	1988-1998	All (17)	Emp \geq 1
France	Fiscal database	1989-1997	All (17)	Turnover: Man: Euro 0.58m Serv: Euro 0.17m
Germany (West)	Social security	1977-1999	All but civil service, self employed (11)	Emp \geq 1
Italy	Social security	1986-1994	All (19)	Emp \geq 1
Portugal	Employment-based register	1983-1998	All but public administration (19)	Emp \geq 1
United Kingdom	Business register	1980-1998	Manufacturing (10)	Emp \geq 1
US	Business register	1988-1997	Private businesses (19)	Emp \geq 1
LAC				
Argentina	Register, based on Integrated System of Pensions	1995-2002	All (19)	Emp \geq 1
Brazil	Census	1996-2001	Manufacturing (13)	Emp \geq 1
Chile	Annual Industry Survey (ENIA)	1979-1999	Manufacturing (13)	Emp \geq 10
Colombia	Annual Manufacturing Survey (EAM)	1982-1998	Manufacturing (13)	Emp \geq 10
Mexico	Social security	1985-2001	All (17)	Emp \geq 1
TRANSITION				
Estonia	Business register	1995-2001	All (19)	Emp \geq 1
Hungary	Fiscal register (APEH)	1992-2001	All (19)	Emp \geq 1
Latvia	Business register	1996-2002	All (18)	Emp \geq 1
Slovenia	Business register	1992-2001	All (19)	Emp \geq 1

Table B.1: Average job flows in the 1990s, overall and by region, total economy (unbalanced panel)

OVERALL					
Variable	Obs	Mean	Std. Dev.	Min	Max
Job creation rate	1048	0.147	0.067	0.000	0.647
Job destruction rate	1048	0.131	0.062	0.000	0.419
Net employment growth	1048	0.015	0.065	-0.299	0.419
Job reallocation rate	1048	0.278	0.112	0.000	0.875
Excess job reallocation rate	1048	0.231	0.098	0.000	0.732
Job creation rate (entry)	1048	0.055	0.043	0.000	0.357
Job destruction rate (exit)	1048	0.046	0.029	0.000	0.216
OECD					
Job creation rate	448	0.127	0.046	0.033	0.288
Job destruction rate	448	0.127	0.060	0.029	0.411
Net employment growth	448	0.000	0.046	-0.282	0.148
Job reallocation rate	448	0.254	0.096	0.072	0.57
Excess job reallocation rate	448	0.223	0.085	0.058	0.472
Job creation rate (entry)	448	0.045	0.030	0.003	0.195
Job destruction rate (exit)	448	0.045	0.028	0.000	0.216
LAC					
Job creation rate	300	0.148	0.061	0.033	0.431
Job destruction rate	300	0.140	0.066	0.041	0.419
Net employment growth	300	0.008	0.053	-0.214	0.286
Job reallocation rate	300	0.288	0.114	0.086	0.785
Excess job reallocation rate	300	0.248	0.103	0.066	0.732
Job creation rate (entry)	300	0.056	0.040	0.000	0.227
Job destruction rate (exit)	300	0.053	0.032	0.003	0.152
TRANSITION					
Job creation rate	300	0.174	0.088	0.000	0.647
Job destruction rate	300	0.128	0.061	0.000	0.385
Net employment growth	300	0.046	0.087	-0.299	0.419
Job reallocation rate	300	0.303	0.123	0.000	0.875
Excess job reallocation rate	300	0.227	0.109	0.000	0.608
Job creation rate (entry)	300	0.070	0.056	0.000	0.357
Job destruction rate (exit)	300	0.039	0.025	0.000	0.135

Source: Own calculations based on harmonised indicators database.

Table C.1: Definitions of institutional variables

Variable	Definition
Hiring and firing regulations	Flexibility in hiring and firing (5B(ii)) from Fraser Institute, hiring and firing restrictions of companies are determined by private contract (World Economic Forum: Global Competitiveness Report); scale [0,10], 10 being the worst.
Business regulations	Regulation of business activities (5c) from Fraser Institute (World Economic Forum: Global Competitiveness Report); scale [0,10], 10 being the worst.
Law and order	Integrity of legal system (2e) from Fraser Institute, which is based on Political Risk Component I (Law and Order) from the International Country Risk Guide; scale [0,10], 10 being the worst.

Table C.2: Institutional variables, 1990s

OVERALL				
Variable	Mean	Std. Dev.	Min	Max
Hiring and firing regulations	5.261	1.515	2.878	7.700
Law and order adj. hiring and firing regulations	4.113	2.019	0.000	7.209
Business regulations	3.490	1.389	1.100	5.900
Law and order adj. business regulations	2.490	1.233	0.000	4.600
Law and order	2.280	2.818	0.000	10.000
EU & USA				
Hiring and firing regulations	5.427	1.804	2.878	7.400
Law and order adj. hiring and firing regulations	5.084	1.559	2.878	6.600
Business regulations	3.074	1.682	1.100	5.600
Law and order adj. business regulations	2.822	1.349	0.000	4.600
Law and order	0.469	1.121	0.000	3.000
LAC				
Hiring and firing regulations	4.679	0.943	3.230	5.740
Law and order adj. hiring and firing regulations	2.249	1.642	0.000	4.431
Business regulations	4.206	1.297	2.617	5.900
Law and order adj. business regulations	1.811	1.321	0.000	3.320
Law and order	5.230	3.175	2.280	10.000
TRANSITION				
Hiring and firing regulations	5.696	1.705	3.586	7.700
Law and order adj. hiring and firing regulations	4.742	1.846	3.079	7.209
Business regulations	3.323	0.669	2.650	4.200
Law and order adj. business regulations	2.757	0.716	1.776	3.486
Law and order	1.763	1.119	0.637	3.300

Source: Own calculations based on harmonised firm-level database and Gwartney and Lawson (2004).