Business Dynamism and Responsiveness:

Cross-country evidence from Europe

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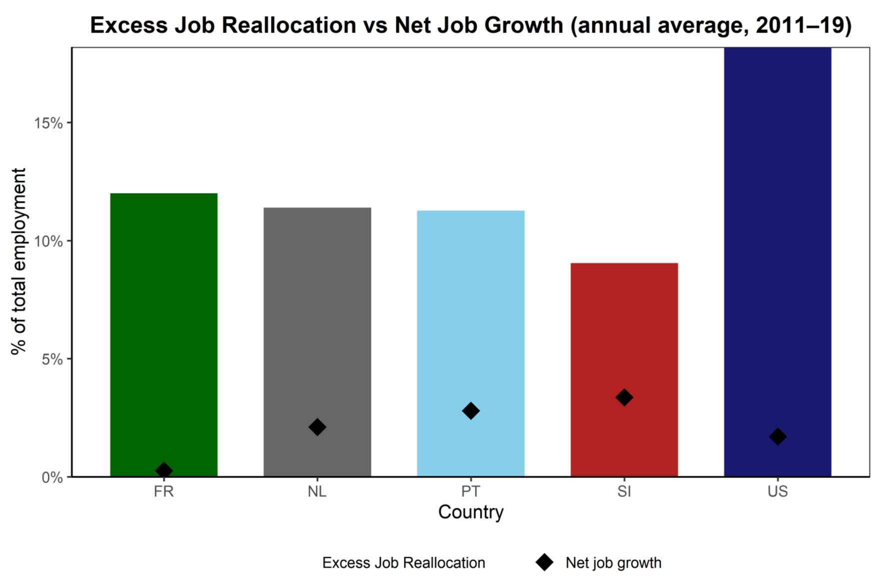
Measuring business dynamism in European economies through firm-level labour decisions

- Using firm-level job growth rates, we document a significant gap in labour market dynamism between US and Europe, with much less churn in Europe. Strikingly, **the most high-churn labour markets in Europe seem to be the ones creating the fewest jobs** in net terms (like FR) – *dynamism without growth*. SI, on the other hand, exhibits the strongest net job creation but the weakest dynamism – *growth without dynamism*.
- **Labour decisions are characterised by inaction:** about 45% of firms in PT and SI do not hire nor fire on an average year. FR firms show more flexibility in firing/hiring, but exhibit very small adjustment rates when doing so.
- Firm-level responsiveness analysis suggests **strong cross-country and business cycle heterogeneity** underlying Europe's weak dynamism.

Labour market dynamism - *churn* vs *net growth*

- **Data**: all our analysis comprises the universe of manufacturing firms [NACE 10-33] in FR, PT, NL, and SI (unbalanced panel – with entry/exit), between 2010 and 2019. We use the BS and BR datasets from MDI.
- As in Davis et al (1992), we use 2 micro-aggregated measures of dynamism:
  - **Net job growth:** new jobs added, per year (in % of tot. employment).
  - **Excess Job Reallocation rate (XR)**: how much job churning there is per year in excess of net jobs created/destroyed.

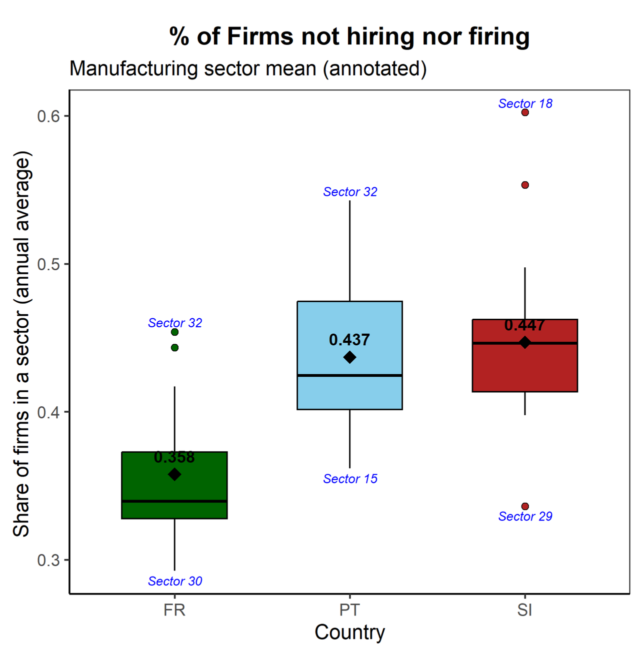


Obs: US value is an approximation based on BLS statistics.

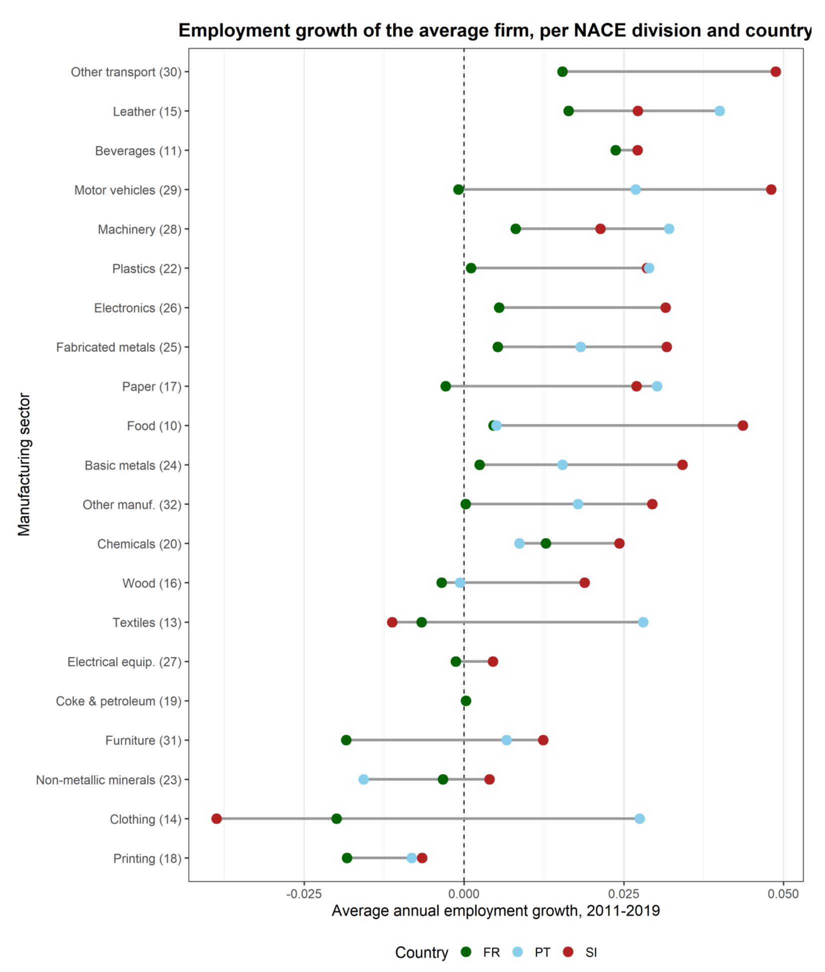
1. **European labour dynamism (XR) remains ~1/3 below US.**
2. Within Europe, while FR and NL experienced the highest labour market churn, the **PT and SI firms were the ones expanding the most** (with higher net job growth).
3. **FR net job creation was stagnant**, in spite of significant reallocation dynamics.

Heterogeneity in labour dynamism

- We distinguish the **extensive** (hire/fire or not) from the **intensive** margin (how much to hire/fire) in labour decisions by firms.
- While FR firms show less inertia in the extensive margin, **they adjust by a smaller magnitude when they do so**. This pattern is consistent across NACE divisions, and maps to the high XR /low net job creation finding.



Strong inaction pattern. Approximately 43.7% and 44.7% of manufacturing firms in PT and SI did not hire nor fire, in a year.



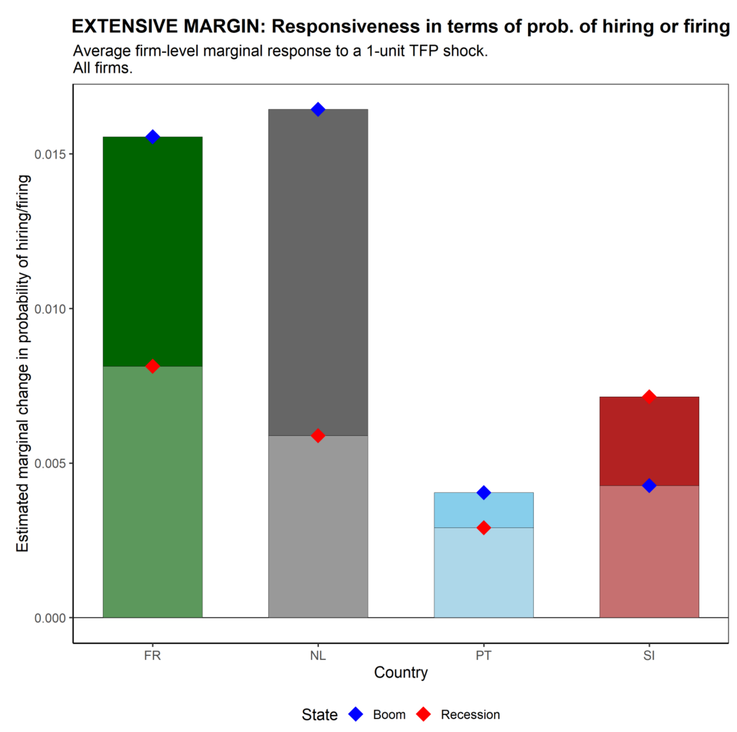
1. **FR firms hire and fire more often,** but do so in a smaller scale.
2. **The SI average firm experienced strongest employment growth, among PT and SI, in most divisions.**
3. Other Transport (30) and Leather (15) are among the sectors where the average firm grew the most, across the 3 countries.

Responsiveness: dynamism at the firm level

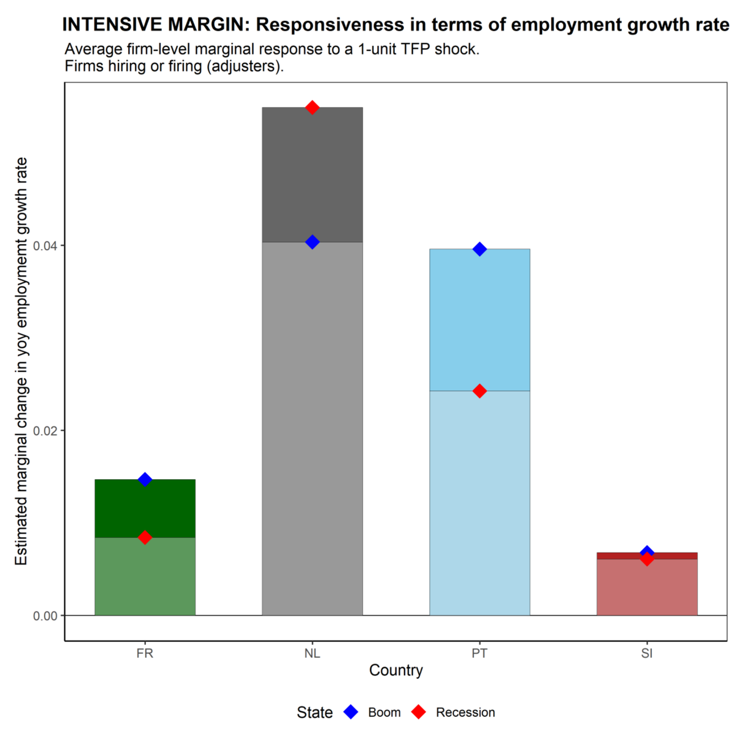
We employ a responsiveness regression framework (Decker et al (2020)) to measure the average firm's flexibility in adjusting labour input in face of TFP shocks, in booms vs recessions:

- Idiosyncratic TFP shocks ($\eta_{i,t-1}$) estimated via a control function approach (Ackerberg et al (2015)) under a Normal AR(1) process and a one-period time-to-build assumption, consistent with labour adjustment costs. Controls $X'_{i,t}$ include lagged capital stock, labour, and NACE division FE. D_t is a dummy for boom/recession.
- We study marginal linear responsiveness in booms vs crisis ($\beta_1 \; vs \; \beta_1 + \beta_3$):

y^l_{it}: 1 if firm hired/fired, 0 otherwise



y^l_{it}: yoy employment growth rate



1. **FR and NL firms respond similarly along the extensive margin**, but NL firms adjust significantly more on the intensive margin.
2. Cross-country heterogeneity in extensive margin responsiveness is largely **reduced** during recessions.
3. **PT exhibits the lowest extensive margin responsiveness**, but a relatively high intensive margin responsiveness (opposite of FR).

Conclusions and Future Work

1. The 4 economies analysed show an **inverse relationship between labour market dynamism and net job creation**.
2. The least dynamic labour markets (SI, PT) are characterised by **high inaction rates** (~45%).
3. Responsiveness analysis suggests **country-specific obstacles to business dynamism along different margins**: for instance, PT firms seem more constrained on the extensive margin, while FR firms seem less agile along the intensive margin.

Future analysis will link these findings with indicators of country and industry labour market flexibility and misallocation.

References

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