

Entry Costs and Employment Fluctuations in Frictional Labor Markets

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Firms pay fixed costs upon entering labor markets and before recruiting workers. Modern theory of unemployment such as Pissarides (1985, 2000) posits that no firms pay such costs upon entry and vacant firms pay flow recruiting costs after entry. I explore the implications of introducing such fixed entry costs into otherwise standard matching models of unemployment. I find that the model with entry costs can deliver the larger impacts of productivity changes on vacancies and unemployment than the ones without. Moreover, the model with entry costs delivers larger impacts of productivity changes on vacancy creation when vacant positions are less likely to break than filled jobs. Literature considers only the case of no entry costs, under which much smaller impacts of productivity on vacancy creation than data are generated. Both steady state and the models with aggregate shocks to productivity are examined. Implications of this new mechanism for the way in which productivity changes affect time-consuming schooling are also examined.