Effects of Factor Adjustment Costs in the Japanese Economy

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Abstract

We investigate the dynamics of labor and capital adjustments using aggregate Japanese firm data. The intertemporal decision in the structural model depends on the existence of labor and capital adjustment costs, and we allow these two factors to interact. From the estimation, we find the following results. 1. The estimated value of labor and capital adjustment costs is small. 2. The marginal cost of adjustment is higher in capital rather than in labor. 3. The marginal labor adjustment costs are equivalent to 1.6 weeks of wages in manufacturing sector, and 1.8 weeks of wages in nonmanufacturing sector. 4. The interaction term in adjustment costs function is positively signed in manufacturing sector, implying the substitution between hiring and investment.

Key Words: business cycles, gross investment, gross hiring, adjustment costs, interaction, substitution

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