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“Trade and Labor Market Outcomes with Entry\Exit of Heterogeneous Firms and on-the-job Search"

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Abstract

Shaping the entry and exit of firms over the business cycle, trade has an impact on the labor market. This paper develops a dynamic stochastic general equilibrium open economy model to investigate this channel.

Shocks hit aggregate labor productivity and individual firm efficiency. Conditional on that information, firms hiring workers in a country decide to stay or exit the local market, whereas potential entrants decide to enter and run production in a country or remain inactive. After this choice, incumbent firms sell in the local goods market and decide whether to export or not.

Entry, production and export activities require a fixed amount of physical capital, while labor is the variable factor. In the labor market, workers randomly search for a job and employers post wage offers. Under this framework, (i) the number of employers in a country is endogenously bounded because of fixed costs; (ii) on the job search in the labor market generates wage dispersion, (iii) exporters are more productive, pay better wages, hire more workers and absorb more fixed factor than non exporters; (iv) unemployment is caused by labor market frictions and it is inversely related with the number of employers located in a country.

In a two countries framework, we obtain the laws of motion for physical capital and the number of employers. These are the two endogenous state variables conditional on which we determine output, price, employment and wage distributions across firms and over time. The model provides testable implications on how wage and employment distributions across firms and income inequality across workers evolve with the business cycle and co-move between trade partners: (1) an increase in the employment share due to exporters rises the average wage. But at the same time, (2) more exporters restrict the room for new entrants and (3) exporters that become larger and larger strengthen the selection effect and put more and more small inefficient firms out of local markets. At the aggregate level, if we do not allow for a resource reallocation across industries (4) more export in steady state leads to higher average wage and increases unemployment. Moreover, (5) as trade intensifies between countries, more national labor market variables are correlated over the cycle.

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