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Hiring Policies and Labor Costs in New Establishments

Abstract:

This paper investigates heterogeneity in hiring policies and labor costs between young and old establishments. I show that wages for similar workers in newly founded establishments are 12 percent higher than wages in older establishments. I estimate the age - wage relationship using a unique linked employer-employee panel dataset from Germany that follows workers and establishments over time. The effect of establishment age on wage remains strongly negative after controlling for a wealth of detailed establishment and worker characteristics. About 35 percent of the differential is explained by selection of more productive workers into younger establishments. The remaining differential is likely compensating for the high risk of unemployment in young establishment. This is consistent with the effect being strongest in manufacturing where firm specific capital is most important and job loss very costly. The findings imply that the existing literature overstates total factor productivity of new establishments when labor input is measured in hours, while underestimating productivity when labor input is measured as the total wage bill.