# IAB-Colloquium

## zur Arbeitsmarkt- und Berufsforschung

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# Macroeconomic Volatilities and the Labor Market: First Results from the Euro Experiment

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The paper analyzes the impact of different labor market rigidities on macroeconomic volatilities, both from a theoretical and an empirical point of view. In a New Keynesian model with imperfect labor markets, differences in labor market rigidities change the volatility of macroeconomic variables such as output or inflation. However, as economic policies and shocks are rarely the same across countries, cross-country studies have trouble verifying these results. In this regard, the Eurozone offers an unprecedented and largely unexplored experiment: as member states share the same monetary policy, partly harmonized fiscal policies and similar macroeconomic shocks, different labor market institutions can be expected to be an important driver for differences in macroeconomic volatilities. We find that labor turnover costs (i.e., hiring and firing costs) have an important and significant negative effect on both the volatility of inflation and output. The unemployment benefit replacement rate has the expected positive impact, but is only borderline significant in some specifications. Finally, our indicators for real wage rigidities turn out to be almost completely insignificant. These results may offer lessons for the recent debate on the ability of different labor market models to generate sufficiently high macroeconomic volatilities (see Hall 2005, Shimer 2005, Hagedorn/Manovskii 2008) and the type of labor market rigidities that should be integrated into macroeconomic models.

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