

# Information Frictions in Labor Markets: Cross Country Evidence from Employment Durations <sup>☆</sup>

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## Abstract

This paper builds a database of individual labor market outcomes for 50 countries to measure how labor market turnover varies with income across countries. We show that average employment duration is increasing with aggregate income: labor market turnover is higher and job stability lower in low income countries. We analyze this stylized fact through the lens of an experience good model of labor market turnover to understand to what extent imperfect information about employee-employer match quality, i.e. informational frictions, explains the cross-country variation in the distribution of employment durations.

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Urban labor markets in low income countries are characterized by low rates of wage employment (Poschke, 2018), and high rates of self-employment (Gollin, 2008; Poschke, 2013b,a). To explain this, a large literature focusses on the determinants of labor demand by firms, and in particular the potential negative effect of distortions on labor demand. A more recent literature suggests that labor market frictions can also lead to low wage employment rates: experiments suggest that job search is costly (Abebe et al., 2017a,b), and that information frictions impede matching (Abebe et al., 2017c; Alfonsi et al., 2017; Bassi and Nansamba, 2018). Labor market frictions are also consistent with the cross-country variation in self-employment, wage-employment rates (Poschke, 2018) and returns to experience (Lagakos et al., 2018). While this literature points to the importance of labor market frictions, it is silent about their precise nature, except in some specific experimental contexts.

Our project aims to fill this gap in knowledge by shedding light on the nature of labor market frictions in low income countries. In principle, these frictions can take many forms, for example, search costs on the worker or firm side, coordination costs, and information frictions. Our analysis focusses on the latter, and especially on the fact that matches between workers and jobs are *experience goods*, i.e., the quality of a match is hard to assess ex ante, and is only revealed over time. The seminal formulation of this mechanism is in Jovanovic (1979). Evidence from the United States supports the importance of this type of friction (Topel and Ward, 1992; Farber, 1994; Nagypal, 2007; Moscarini, 2005). In these environments, the informational friction affects employees and employers symmetrically: before the match is formed, they both observe a noisy signal about the quality of the match. Our hypothesis is that the signal about match quality is particularly noisy in low-income economies. This hypothesis is in line with recent findings by Donovan et al. (2018), who document high levels of churn in the labor markets of low-income economies, suggesting that experience goods frictions are indeed important. Such frictions matter, because they imply that match formation is slow and reduces the level of wage employment.

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