Discussion of "Start-ups, Credit and the Jobless Recovery" by Immo Schott

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Motivation

- US economy has shown positive GDP growth since the third quarter of 2009
- However the unemployment rate is showing a very slow decline.

Jobless Recovery

Message

- Start-ups (firm of age 0) create a disproportionate fraction of new jobs compared to the share of workers they employ.
- On average they create 20% of new jobs while they account for 3% of employment
- MAIN POINT of the PAPER: The jobless recovery is driven by missing job creation by young firms and start-ups.

At the Basis of this Phenomenon

- **Startups and young firms** don't have access to commercial paper corporate bonds,
  or even an established credit record but rather **rely on personal sources of finance including home equity to establish credit lines;**
- During the 2008/09 recession credit supply by commercial banks decreased and real estate value fell⇒This implied a deterioration of the financing environment for start-ups

Variation in housing prices during the last decade is potentially especially relevant for startups and young firms.

A Model Consistent with these Observations

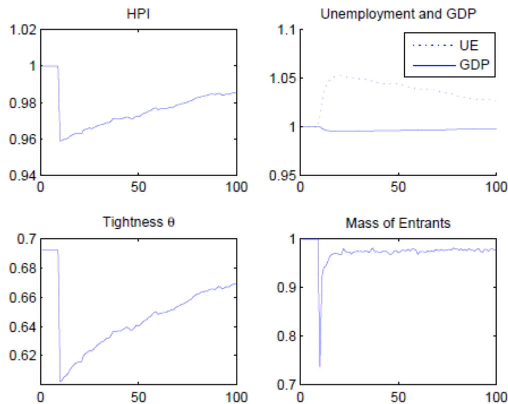
- A model of industry dynamics in the spirit of Hoppenayn (1992), characterized by
  1. endogenous Entry and Exit of firms;
  2. aggregate shocks;
  3. idiosincratic shocks that lead to firms heterogeneity;
  4. search frictions in the labor market;
  5. labor adjustment costs;
  6. start-ups must borrow entry cost from a bank. To do so entrepreneurs use houses as collateral. This implies that entry depends on credit conditions.

A computational Challenge

- Firms differ in size and age;
- Entry and exit decision are endogenous;
- State contingent employment contracts between workers and entrepreneurs;
- Size distribution of firms evolves over time and becomes a state variable;

$\Rightarrow$ Solving the model is challenging

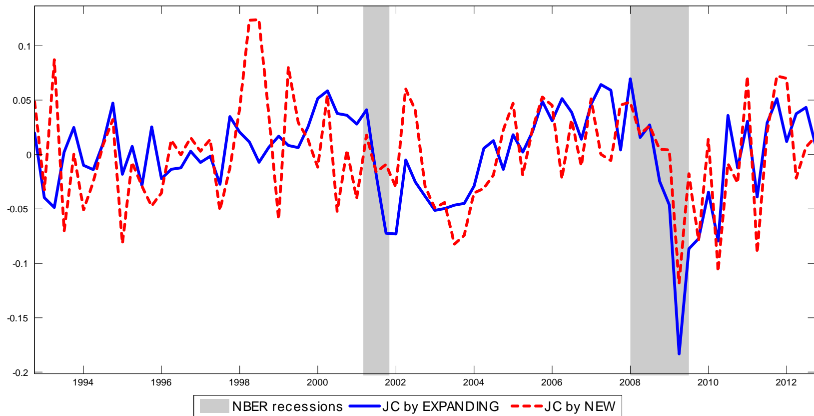
Main result: shock to house prices



Comment 1

- The shock to house price affects uniquely start-ups. Incumbent firms are not subject to financial frictions.
- The shock leads to a reduction in job market tightness. This implies that for incumbent firms is easier to hire new workers.
- As a result JC (Job Creation) by Incumbent and New firms could move in opposite directions.
- It would be interesting to a have a panel with the JC of Incumbent Vs that of new firms

In the data (BED 1992q3-2011q4)



- JC by New Establishments has a contemporaneous, unconditional, correlation with HP filtered real GDP of 0.76, that of JC by new firms is 0.36.
- Would be interesting to have conditional cyclicality (in response to a house price shock) between the JC of the two categories (see the VAR approach in Haltiwanger et al 2012)

Possible solution

- Incumbent firms may also be subject to financial frictions
- For example they may need to borrow to create vacancies or be subject to a working capital requirement (work in progress by the author)
- In this case also incumbent firms would be affected by a financial shock.

Comment 2

- The price of houses is exogenous;
- there is no feedback from model dynamics to house prices;
- House price dynamics is key to address the dynamics of the number of start-ups and their job creation;
- Housing sector or housing in utility of workers could help having some feedback from model dynamics to house prices;

Praise

- Great paper: would have liked to write it...
- solution is challenging, thus I find it a bit unfair suggesting extensions;
- This is a job Market paper⇒Good luck!