HOW CREDIT CONSTRAINTS IMPACT JOB FINDING RATES, SORTING AND AGGREGATE OUTPUT

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We begin by examining the effect of consumer credit limits on job finding rates and the subsequent replacement earnings of displaced workers using new administrative data. We find that in response to an increase in credit limits equal to 10 percent of prior annual earnings, medium-tenure displaced mortgagors take .3 to 1 week longer to find a job but obtain an earnings replacement rate that is .5 to 1.5 percent greater. Compared with existing unemployment insurance (UI) studies, $1 of unused credit is approximately one-fourth to one-half as potent as $1 of UI. We then construct a labor sorting model with credit that we use for two purposes. First, we use the model to provide a structural estimate of the duration and earnings elasticities, which we find to be .8 weeks and 0 percent, respectively. Second, we use the model to assess what happens to labor sorting, productivity, and the ensuing employment recovery if consumer credit limits contract during a recession. We find that when limits tighten during a downturn, employment rises but both productivity and output exhibit weaker recoveries. The tension between recovery speed and recovery health is due to the fact that, when limits tighten, low-asset job losers are unable to self-insure. As a result, they search less thoroughly and take relatively more accessible jobs at less productive firms. Mechanically, standard measures of sorting improve.