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WORKING PAPER

Business Cycle Evidence on Firm Entry *

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Business cycle models with sticky prices and endogenous firm entry make novel predictions on the transmission of shocks through the extensive margin of investment. I test some of these predictions using a vector autoregression with model-based sign restrictions. I find a positive and significant response of firm entry to expansionary shocks to productivity, aggregate spending, monetary policy and entry costs. The estimated response to a monetary expansion does not support the monetary policy transmission mechanism proposed by the model. Insofar as firm startups require labour services, wage stickiness is needed to make the *signs* of the model responses consistent with the estimated ones. The *shapes* of the empirical responses suggest that congestion effects in entry make it harder for new firms to survive when the number of startups rises.

Keywords: firm entry, business cycles, VAR