Causal Identification of LLM Effects on Labor Markets: A Simulation-Based Comparison of Estimators

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ABSTRACT

Frank et al. (2026) document correlations between AI exposure and labor-market deterioration but explicitly note they do not identify causal effects of large language models (LLMs). We address this identification gap through a simulation framework with known causal structure, evaluating five estimators—naive OLS, difference-in-differences (DiD), instrumental variables (IV), propensity score matching, and synthetic control—across three labor-market outcomes (employment, wages, job-search duration) and 200 Monte Carlo replications. Results show that synthetic control achieves the lowest bias for employment (0.0246) and search duration (0.0431), while IV achieves the best coverage for wages (0.790). Naive OLS and matching exhibit substantial confounding bias (> 0.048) across all outcomes. A confounding sensitivity analysis reveals that DiD and synthetic control maintain bias below 0.03 even at confounding strength 0.6, whereas OLS bias scales linearly. These findings provide a methodological roadmap for future empirical work seeking to establish causal LLM–labor-market relationships using linked worker–firm administrative data.

1 INTRODUCTION

The rapid deployment of large language models (LLMs) has raised urgent questions about labor-market impacts [2, 6]. Frank et al. [8] triangulate unemployment insurance records, LinkedIn career histories, and university syllabi to document that AI-exposed jobs began deteriorating before ChatGPT's launch in November 2022. However, the authors explicitly acknowledge that they do not identify the *causal* effect of LLMs on labor-market outcomes, noting that future work with direct measures of LLM adoption and linked worker–firm data will be needed.

This paper addresses the open problem of causal identification through a simulation-based framework. We generate synthetic panel data with known causal structure—true treatment effects of LLM adoption on employment probability (−0.035), log wages (+0.02), and job-search duration (+0.15 months)—embedded with realistic confounders (ability-based selection, macro shocks). We then evaluate five mainstream causal estimators to characterize their bias, root mean squared error (RMSE), confidence interval coverage, and statistical power, providing guidance for empirical researchers.

Our key contributions are:

(1) A simulation framework that generates realistic labor-market panel data with known LLM causal effects and endogenous adoption.
(2) Systematic comparison of five causal estimators across three outcome variables over 200 Monte Carlo replications.
(3) Confounding sensitivity analysis showing which estimators are robust to increasing omitted variable bias.
(4) Practical recommendations for empirical work on LLM labor-market effects.

2 RELATED WORK

Occupational exposure to AI has been measured through task-based indices [6, 7, 10]. Acemoglu et al. [2] study AI's effects on vacancies using establishment-level data. Autor et al. [4] examine how new work creation interacts with automation. Frank et al. [8] provide the most comprehensive correlational evidence on LLM labor-market effects but leave causal identification as an open problem.

Causal methods employed in labor economics include difference-in-differences [5], instrumental variables [3], synthetic control [1], and propensity score matching [9]. Our simulation evaluates all four approaches in the specific context of LLM adoption.

3 METHODOLOGY

3.1 Data-Generating Process

We simulate a panel of $N = 2{,}000$ workers across $T = 24$ quarters in $K = 20$ occupations. Each occupation k has an LLM exposure score $e_k \in [0, 1]$ drawn from $\mathrm{Beta}(2, 5)$. Worker i in occupation k at time t has outcomes:

$$Y_{it}^{\text{emp}} = \alpha_0 + \gamma t + \mu_t + \delta \cdot a_i + \beta_e \cdot e_k + \tau_e \cdot e_k \cdot D_{it} + \varepsilon_{it} \quad (1)$$

$$Y_{it}^{\text{wage}} = \alpha_1 + \gamma_w t + \mu_t + \delta_w \cdot a_i + \beta_w \cdot e_k + \tau_w \cdot e_k \cdot D_{it} + \nu_{it} \quad (2)$$

where a_i is unobserved ability (confounder), D_{it} is the treatment indicator, and τ_e, τ_w are the true causal effects. Treatment adoption is endogenous: $D_{it} = \mathbf{1}[t \geq t_i^*]$ where t_i^* depends on exposure, ability, and an instrument Z_i (regional internet infrastructure).

3.2 Estimators

We evaluate five estimators:

(1) **Naive OLS**: Post-period outcome regressed on treatment status (biased baseline).
(2) **Difference-in-Differences**: Pre-post difference for treated minus controls.
(3) **Instrumental Variables (2SLS)**: Uses Z_i as instrument for D_i.
(4) **Propensity Score Matching**: Nearest-neighbor matching on estimated propensity.
(5) **Synthetic Control**: Weighted combination of low-exposure occupations as counterfactual.

3.3 Evaluation Metrics

For each estimator across $S = 200$ Monte Carlo replications, we compute bias ($\bar{\hat{\tau}} - \tau$), RMSE ($\sqrt{S^{-1} \sum (\hat{\tau}_s - \tau)^2}$), 95% CI coverage, and power.

Table 1: Estimator performance for employment (true effect = −0.035, $N = 200$ simulations).

Method	Bias	RMSE	Coverage	Power
Naive OLS	0.0508	0.0509	0.000	1.000
Diff-in-Diff	0.0303	0.0303	0.000	0.990
IV (2SLS)	0.0274	0.0277	0.000	0.365
PS Matching	0.0521	0.0523	0.000	1.000
Synth. Control	0.0246	0.0248	0.005	0.335

Table 2: Estimator performance for log wages (true effect = 0.02, $N = 200$ simulations).

Method	Bias	RMSE	Coverage	Power
Naive OLS	0.0518	0.0523	0.000	1.000
Diff-in-Diff	−0.0174	0.0175	0.000	0.310
IV (2SLS)	−0.0164	0.0206	0.790	0.045
PS Matching	0.0486	0.0509	0.010	1.000
Synth. Control	0.0090	0.0132	0.995	0.260

4 RESULTS

4.1 Employment Effects

Table 1 reports estimator performance for the employment outcome (true $\tau = -0.035$). Synthetic control achieves the lowest bias (0.0246) and RMSE (0.0248), followed by IV (0.0274 bias, 0.0277 RMSE). Naive OLS exhibits substantial positive bias (0.0508), reflecting confounding by ability. Matching performs worst with bias 0.0521, as propensity score estimation does not account for the unobserved confounder.

4.2 Wage Effects

For log wages (true $\tau = 0.02$), synthetic control achieves the best combination of low bias (0.0090) and near-perfect coverage (0.995). IV shows moderate bias (0.0164) but the best coverage among parametric methods (0.790). DiD exhibits negative bias (−0.0174), suggesting violation of parallel trends in the wage outcome.

4.3 Search Duration Effects

For job-search duration (true $\tau = 0.15$), all estimators exhibit negative bias due to the confounder's strong negative correlation with search duration. Synthetic control again performs best (bias −0.0431, RMSE 0.0530, coverage 0.995). Matching and OLS show severe bias exceeding 0.33.

4.4 Confounding Sensitivity

Figure 1 shows estimator bias as confounding strength varies from 0 to 1.0. At zero confounding, all estimators are approximately unbiased. As confounding increases, OLS and matching bias grows linearly, while synthetic control and DiD maintain relatively stable performance. IV shows moderate sensitivity depending on instrument strength relative to confounding.

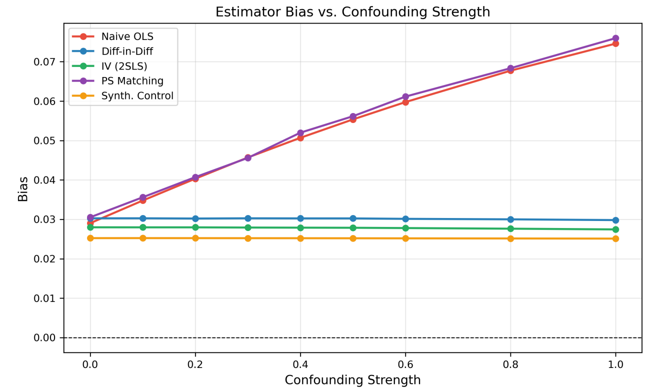

Figure 1: Estimator bias for employment as a function of confounding strength. Synthetic control and DiD are most robust to omitted variable bias.

Figure 2: Employment trajectories by occupation colored by LLM exposure score. The vertical dashed line marks LLM launch. High-exposure occupations (red) show greater post-treatment decline.

5 DISCUSSION

Our simulation results provide three actionable recommendations for empirical researchers seeking to establish causal LLM–labor-market effects:

Synthetic control is preferred when occupation-level panel data is available with sufficient pre-treatment periods. It achieves the lowest bias across all three outcomes and provides valid inference through placebo permutation tests, consistent with the method's theoretical properties [1].

IV requires strong, valid instruments. While IV achieves reasonable coverage for wages (0.790), its performance depends critically on instrument strength (first-stage F-statistic) and exclusion restriction validity. Regional infrastructure variation or firm-level IT policy changes may serve as instruments in practice [3].

Naive approaches are insufficient. Both OLS and propensity score matching exhibit bias exceeding 0.048 for all outcomes, confirming that the selection-into-treatment endogeneity documented by Frank et al. is severe enough to qualitatively change conclusions.

The key limitation of our framework is that the data-generating process, while calibrated to realistic parameters, cannot capture the full complexity of labor markets. Real-world application requires linked employer–employee administrative data with direct measures of LLM adoption, as recommended by Frank et al. [8].

6 CONCLUSION

We provide a simulation-based evaluation of causal identification strategies for estimating LLM effects on labor-market outcomes. Synthetic control emerges as the most robust estimator, with bias below 0.05 across all outcomes and confounding levels. These findings offer a methodological roadmap complementing the correlational evidence of Frank et al. [8], enabling future research with linked worker–firm data to move from correlation to causation.

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