Discussion: "Labor Market Reform and the Cost of Business Cycles"

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Main point

Labor market reform

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Labor market reform can reduce cost of business cycles

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Labor market reform can reduce cost of business cycles

1. different angle
2. channels at play
3. numbers

Position in the literature

Lucas (1987)

$$\mathbb{E}\sum_t \beta^t U\left((1+\lambda)C_t\right) = \sum_t \beta^t U(\mathbb{E}C_t)$$

$$C_t = A\exp(\mu t)\exp(-1/2\sigma^2)\epsilon_t \qquad \log(\epsilon_t) \sim N(0,\sigma^2)$$

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Tom and Martin propose that σ is endogenous

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Reform which reduces steady state unemployment has

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- a volatility effect, i.e. affects cost of business cycle!
- works via a smaller number of affected agents

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- HP-filtered with smoothing parameter 100,000
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$$\frac{\lambda_{after}}{\lambda_{before}} \approx \left(\frac{1+4*0.074}{1+4*0.1}\right)^2 \approx 0.85$$

2. Channels at play

- the above is valid *for a given* γ
- reform is likely to change both $\overline{U}$ and γ
  - call $\Delta\overline{U}$ "level effect"
  - call $\Delta\gamma$ "elasticity effect"

2. Channels at play - "Level effect" of reform

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- directly and via search effort UE rate $\uparrow$
- $\rightarrow$ unemployment falls
- changes influence also EU rate (den Haan et al. 2005)
- easier to find jobs, separation rate increases!
- $\rightarrow$ unemployment increases

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b) $\downarrow$ unemployment insurance

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- increases search effort of both short- and long-term unemployed
- $\rightarrow \uparrow$ UE rate and unemployment falls
- as above, this affects EU rate, which falls
- $\rightarrow$ unemployment falls further

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- $\downarrow$ unemployment insurance:
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- sanity check with Costain and Reiter (2008)
- model implied elasticity $\epsilon_{u,b} \approx 1.85$

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- however, relative volatility unemployment basically identical
- not really due to increased labor market flexibility...

3. Numbers - welfare numbers

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- not clear
- at the same time, we KNOW that business cycles are costly
- drop α discussion altogether?

3. Numbers - types of jobs created

What jobs were created after reform?

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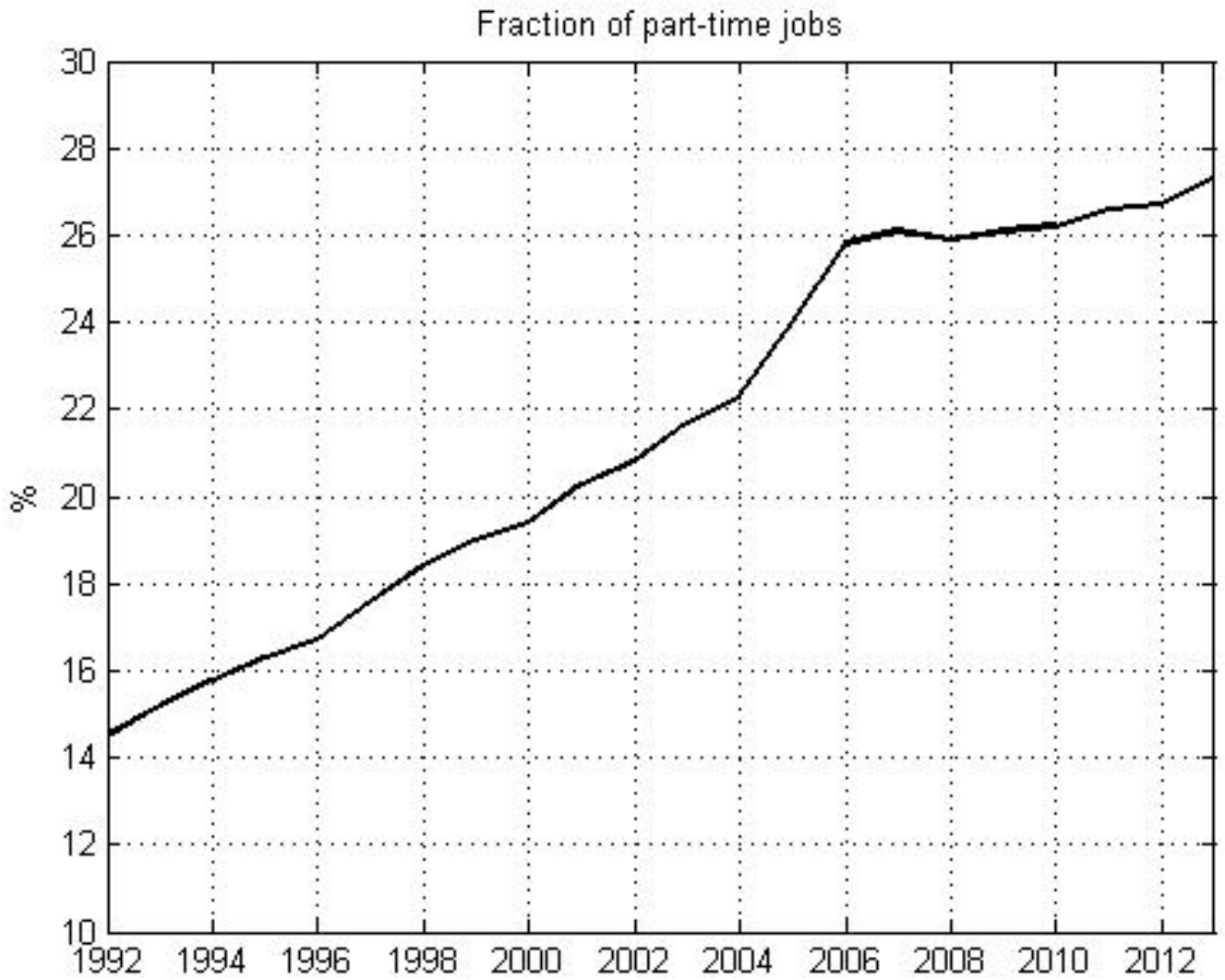

4. Other smaller stuff

- is $b(su) = w$ really a normalization? Must matter for welfare?
- what fraction of welfare is due to tax changes?
- how does ignoring Hartz I-II affect the calibration?
- employed are more productive than unemployed
- decomposition of welfare effects into "unemployment" and "valuation" effects
- why not also Hartz I-II and hiring subsidies (Jung, Kuester 2014)