Discussion on:

"Labor Demand Management in Search Equilibrium"

by

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The World Bank

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my (overall) take

- ✓ a very interesting paper
- ✓ which presents a simple and elegant model
- ✓ at least in its stripped down version
- ✓ that sheds new light on the interrelation between firms' wage policies and labor market participation decisions
- ✓ may explain some of the features of the US wage-less recovery
- ✓ and provides a new take on the fall in the labor share of output across the world

lot of spicy food for thought

- ✓ upward wage rigidities, due to strategic complementarities, may induce low participation, a positive output gap, and (possibly) high unemployment

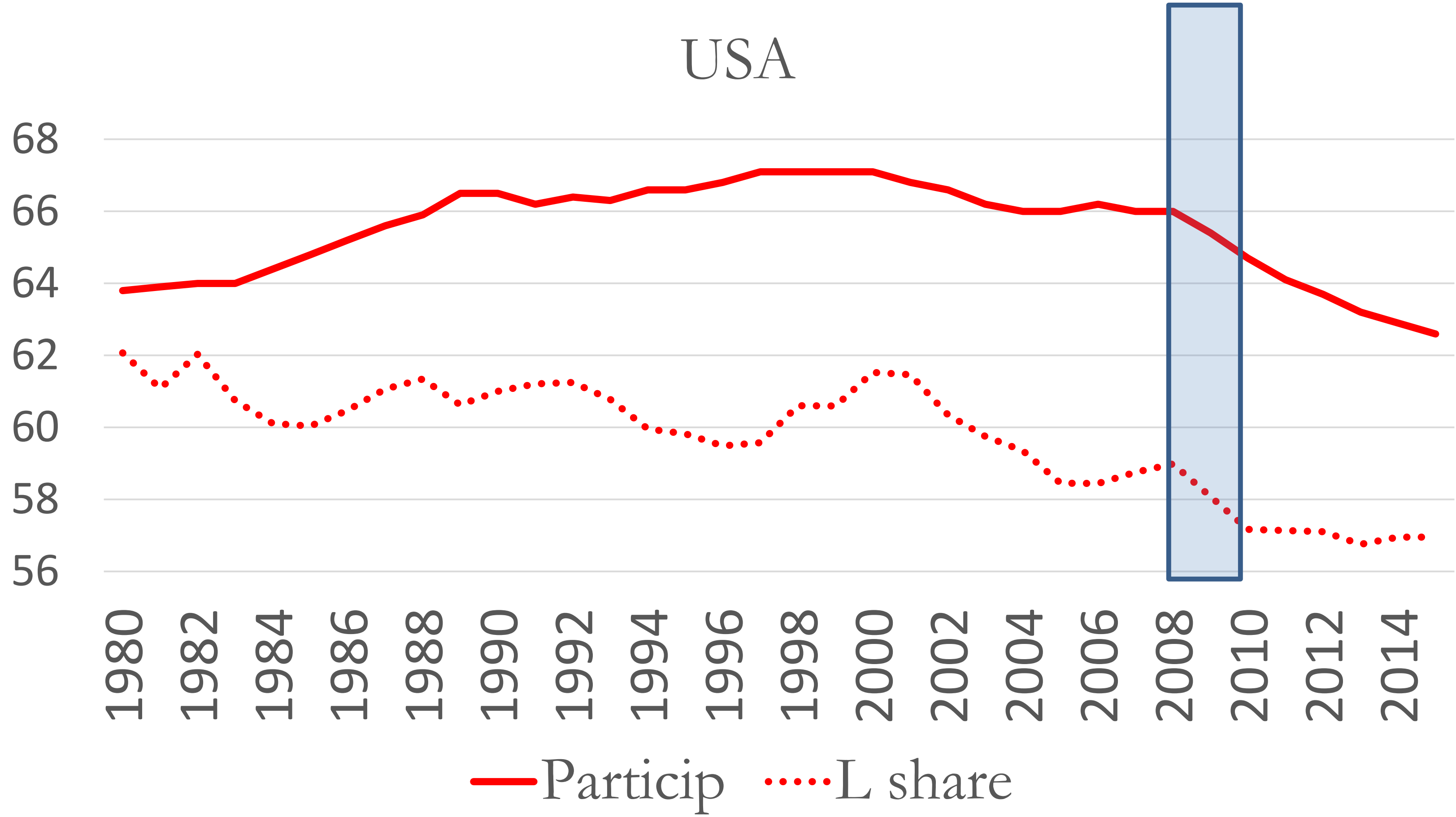
- ✓ this shakes one more of the dogmas I learned in my undergrad years, and of the European "reform agenda"

- ✓ however, if central banks have to commit to high inflation, and their success is measured in the amount of money they are able to print

- ✓ if the IMF criticizes the malfeasances of "neoliberalism"

- ✓ should we be surprised in hearing that capitalists should promote unionization to be "forced" to raise wages to increase profitability and employment?

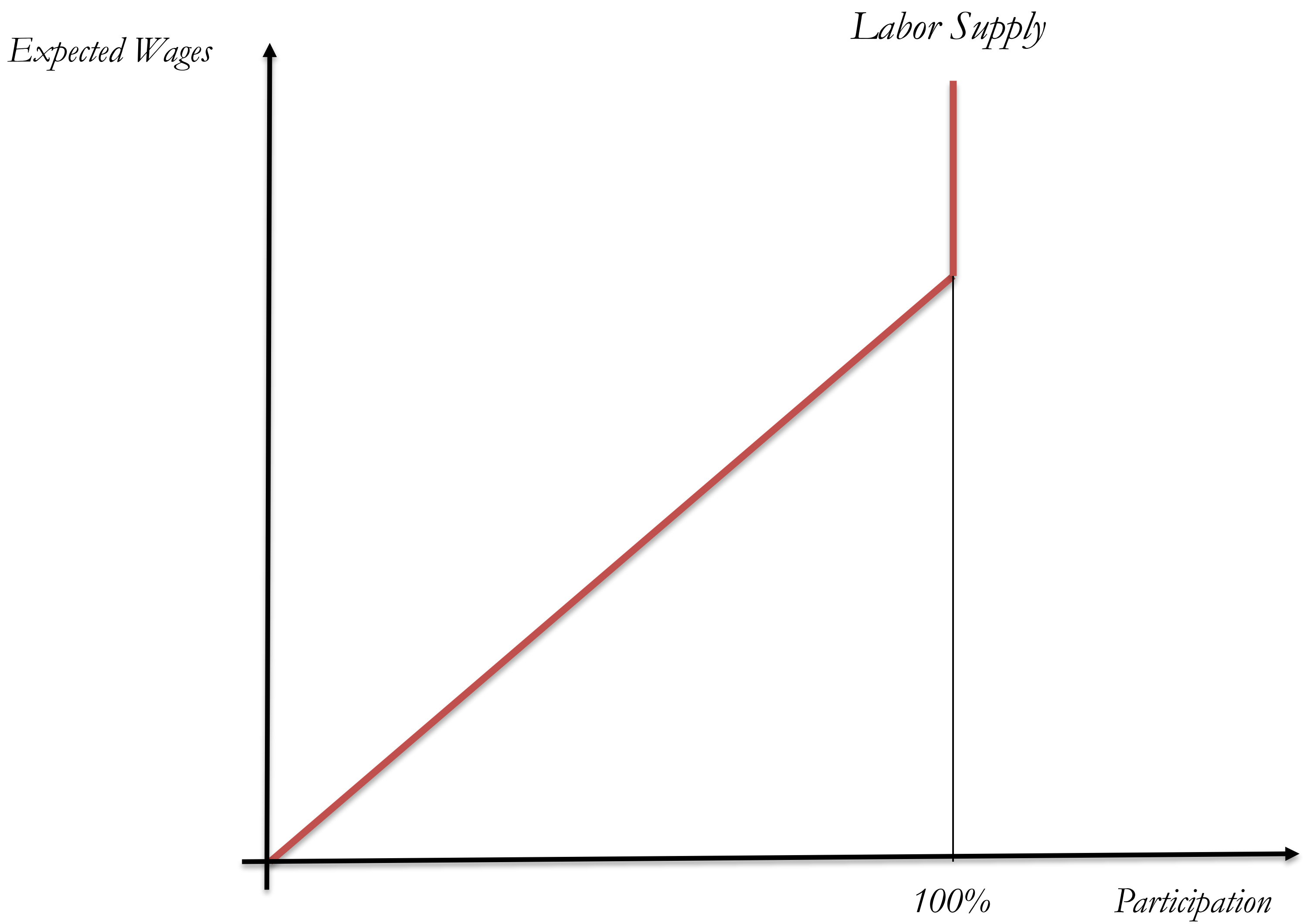
motivations of the paper



workers

- ✓ workers have to decide whether to work or to stay home taking care of their kids
- ✓ workers are equally productive but differ with respect to the child care costs they face
- ✓ they decide whether to participate or not in the labor market before knowing how much child care costs
- ✓ their participation decisions depends on expected
  - ✓ wages
  - ✓ child-care costs

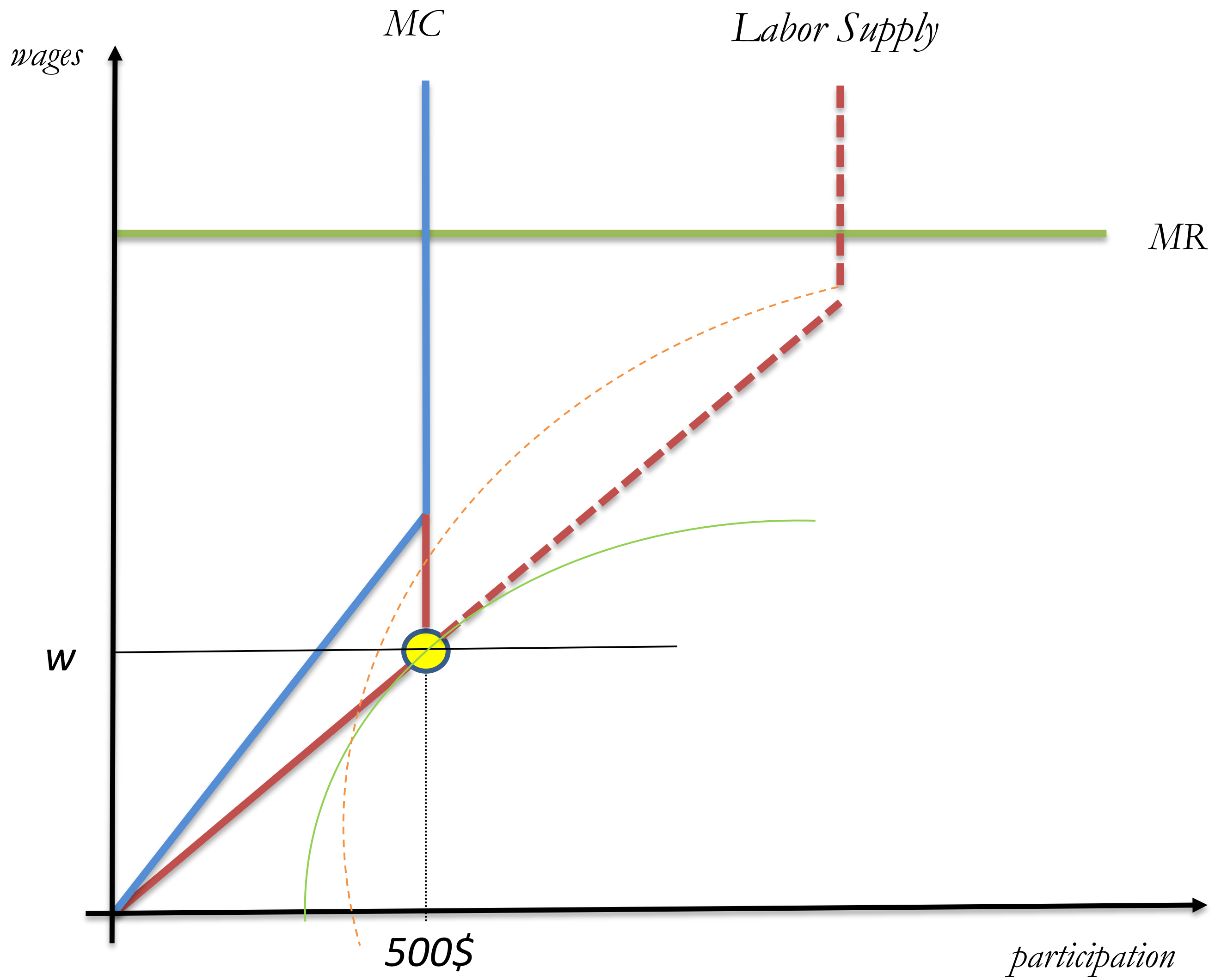
or



firms

- ✓ offer a wage that depends on productivity and their expectation of labor market participation/labor supply
- ✓ firms' wage decisions show strategic complementarities and positive spillovers
- ✓ if wages are high, participation is high, firms face a healthy elastic labor supply and can post high wages to attract workers
- ✓ if wages are low, most parents stay home, labor supply is inelastic, and firms are unable to attract more workers

or



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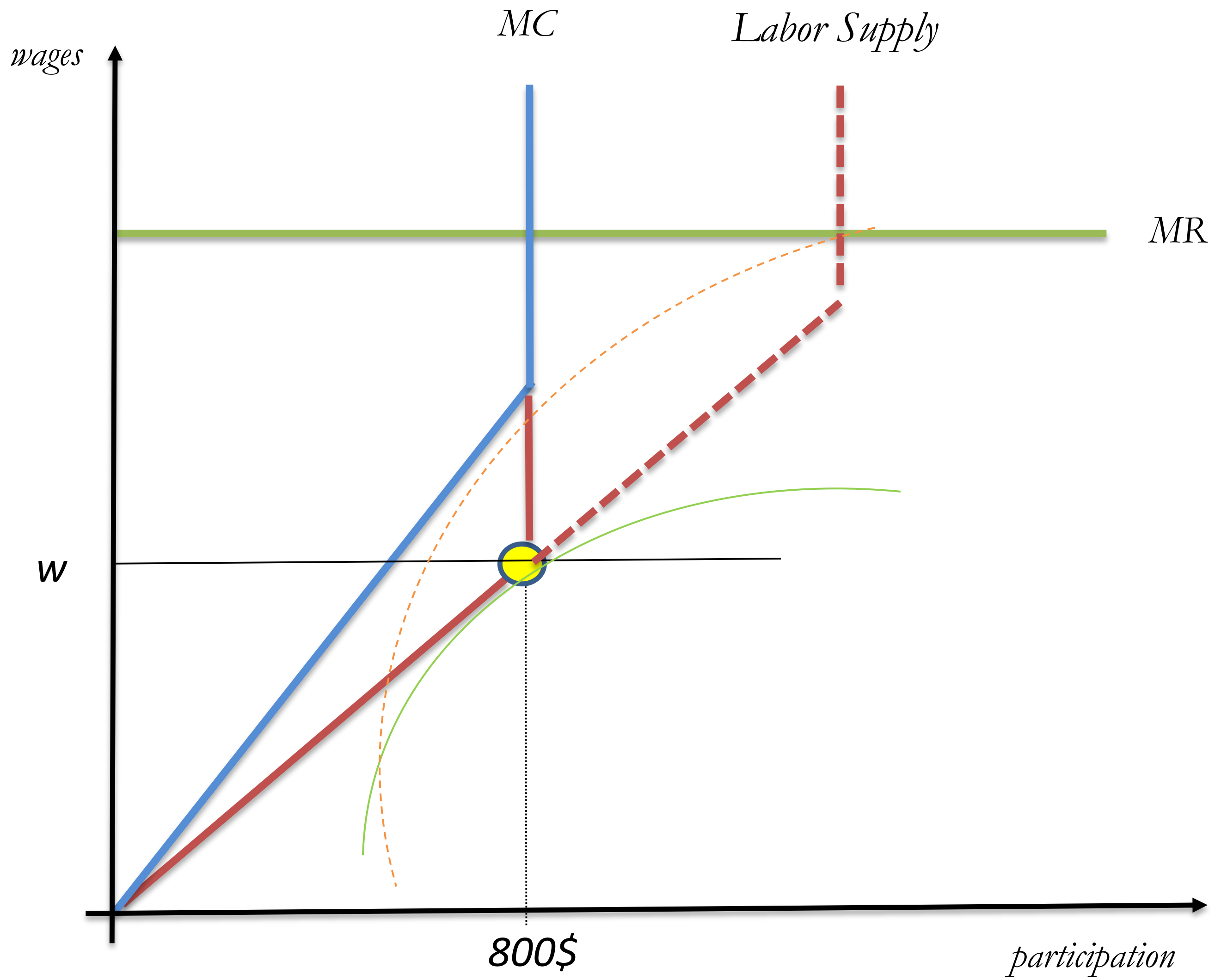

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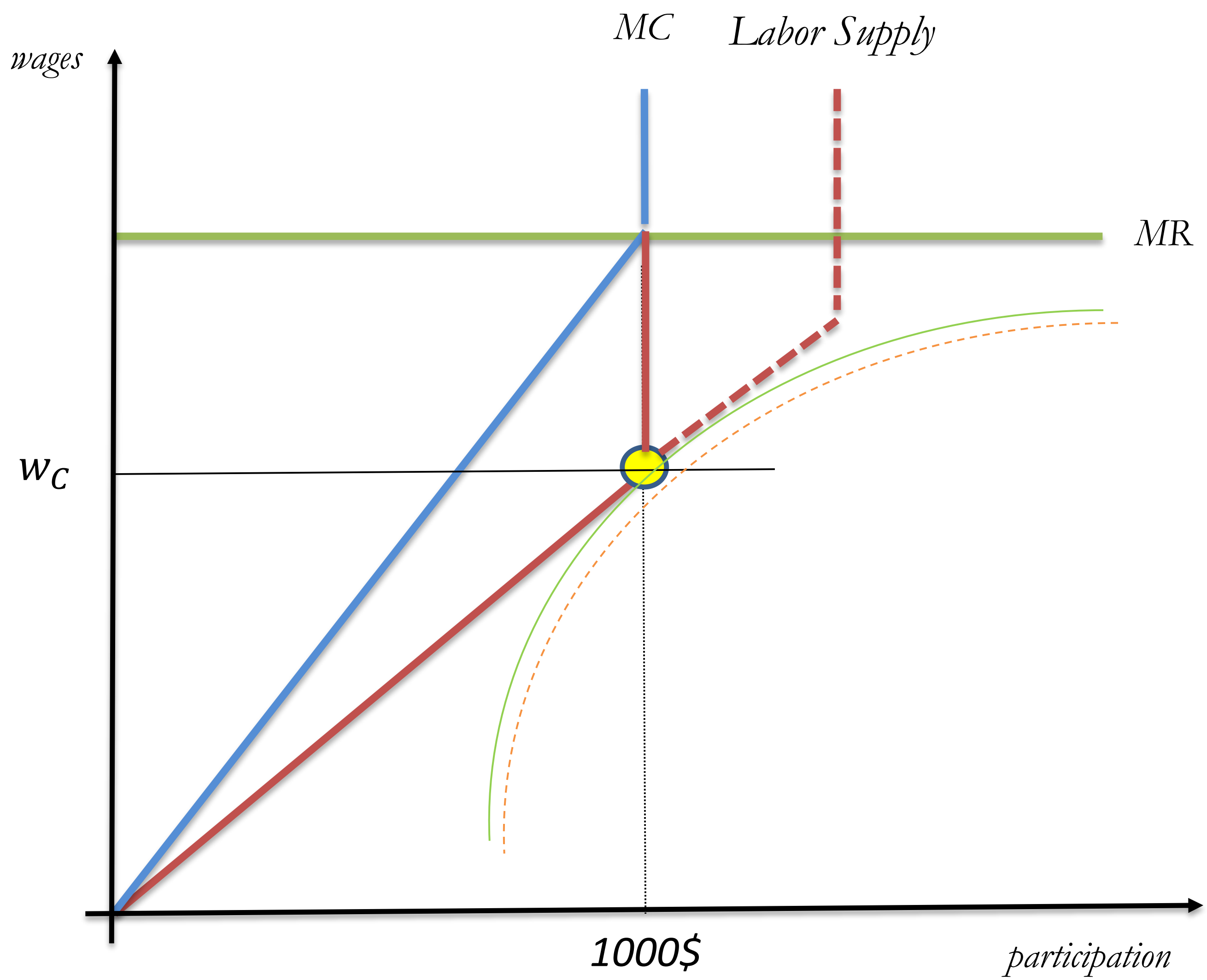
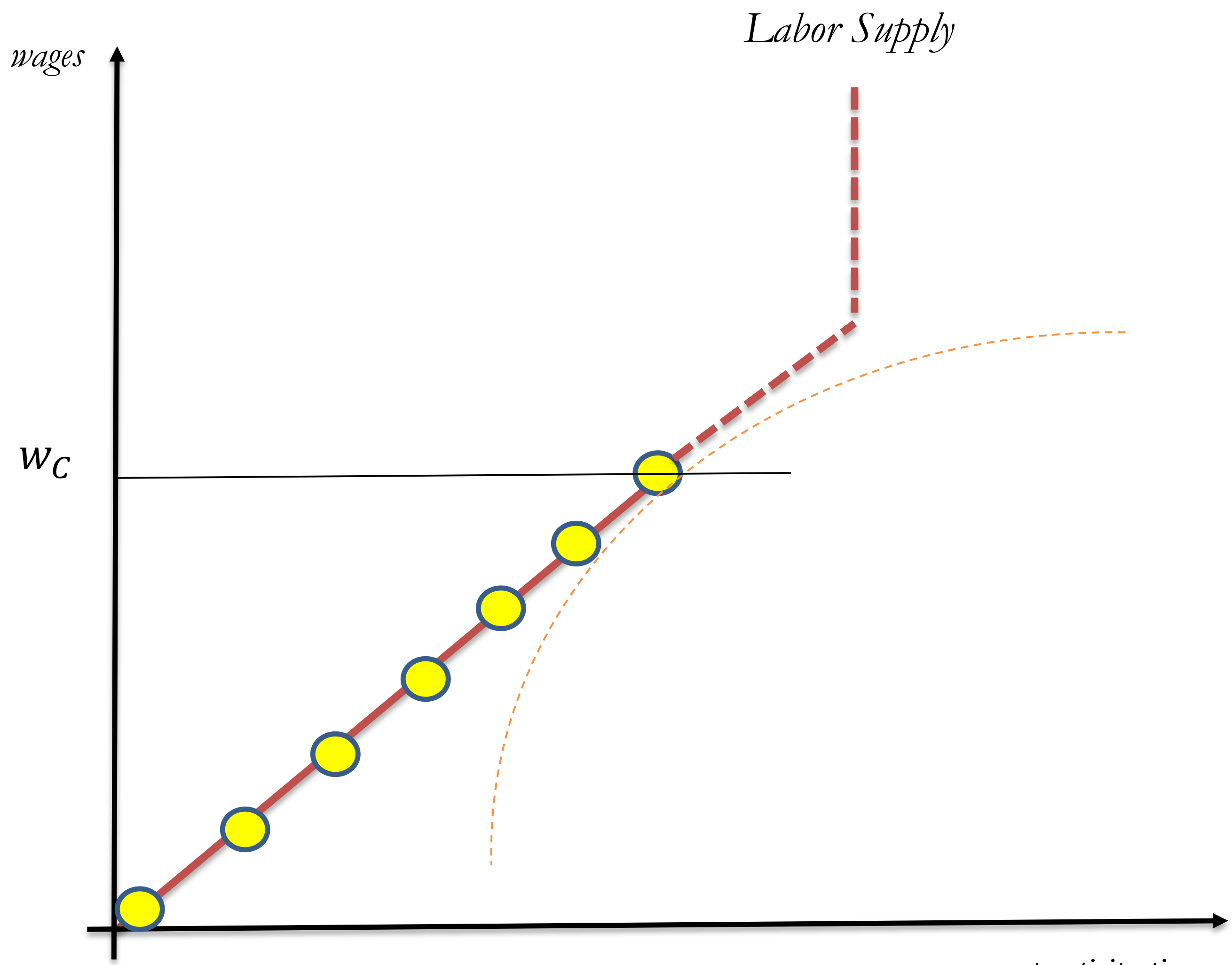


a continuum of Pareto ranked equilibria



let's take a breath

- ✓ this a labor market paper
- ✓ and a labor market paper without a matching function
- ✓ is like Hamlet without the prince
- ✓ but I am not a labor economist
- ✓ and I am thus allowed to ignore the prince
- ✓ and focus on productivity shocks
- ✓ and how they affect equilibrium outcomes

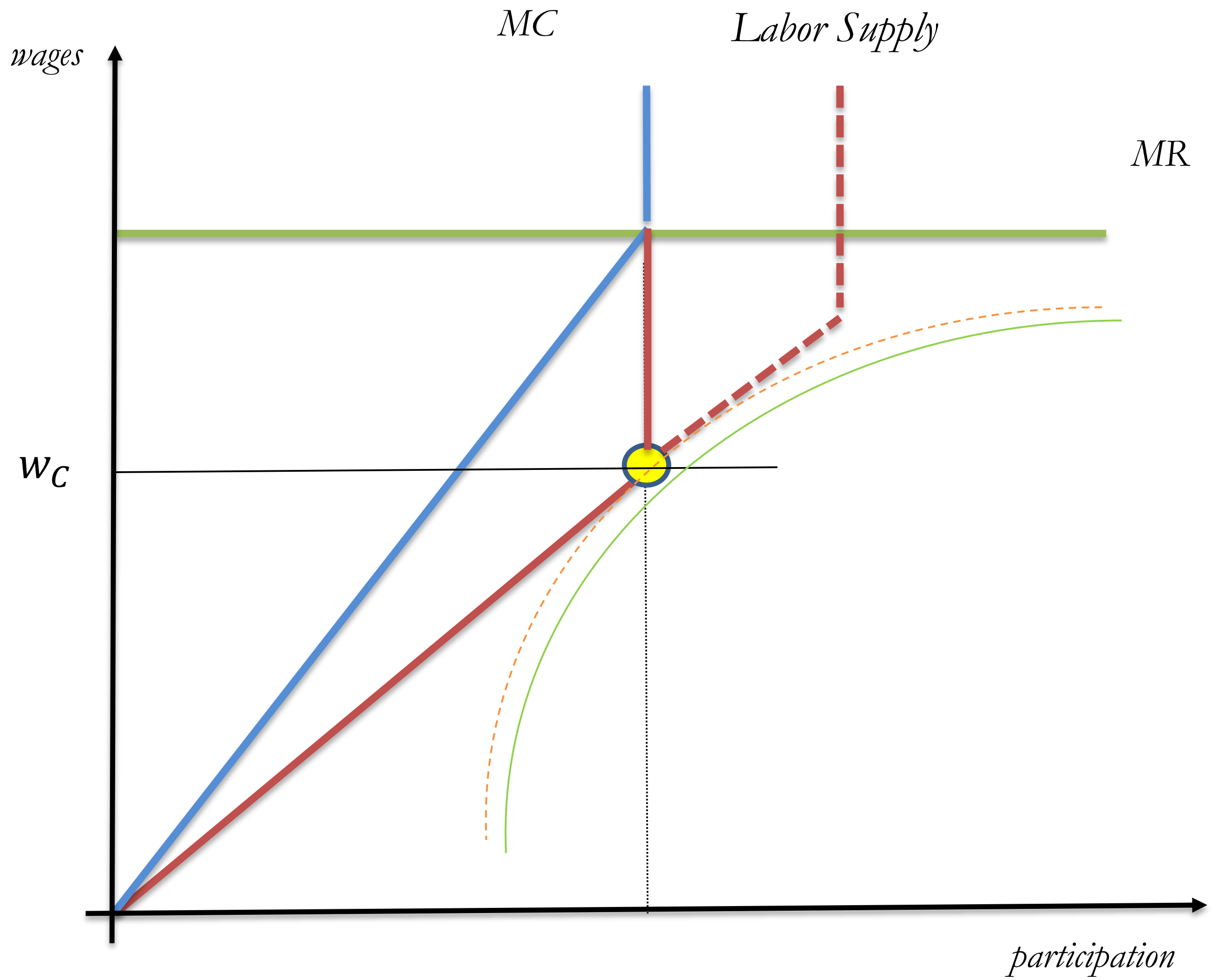
productivity shocks

- ✓ assume the economy converged on one equilibrium (e.g., the Pareto superior one)
- ✓ and is now hit by a negative shock
- ✓ how would each firm react?
- ✓ would firms be able to coordinate on the new Pareto superior equilibrium?
- ✓ more interestingly, assume that after a bad shock the economy is hit by a positive shock of equal size
- ✓ would it be able to move back to the original equilibrium?

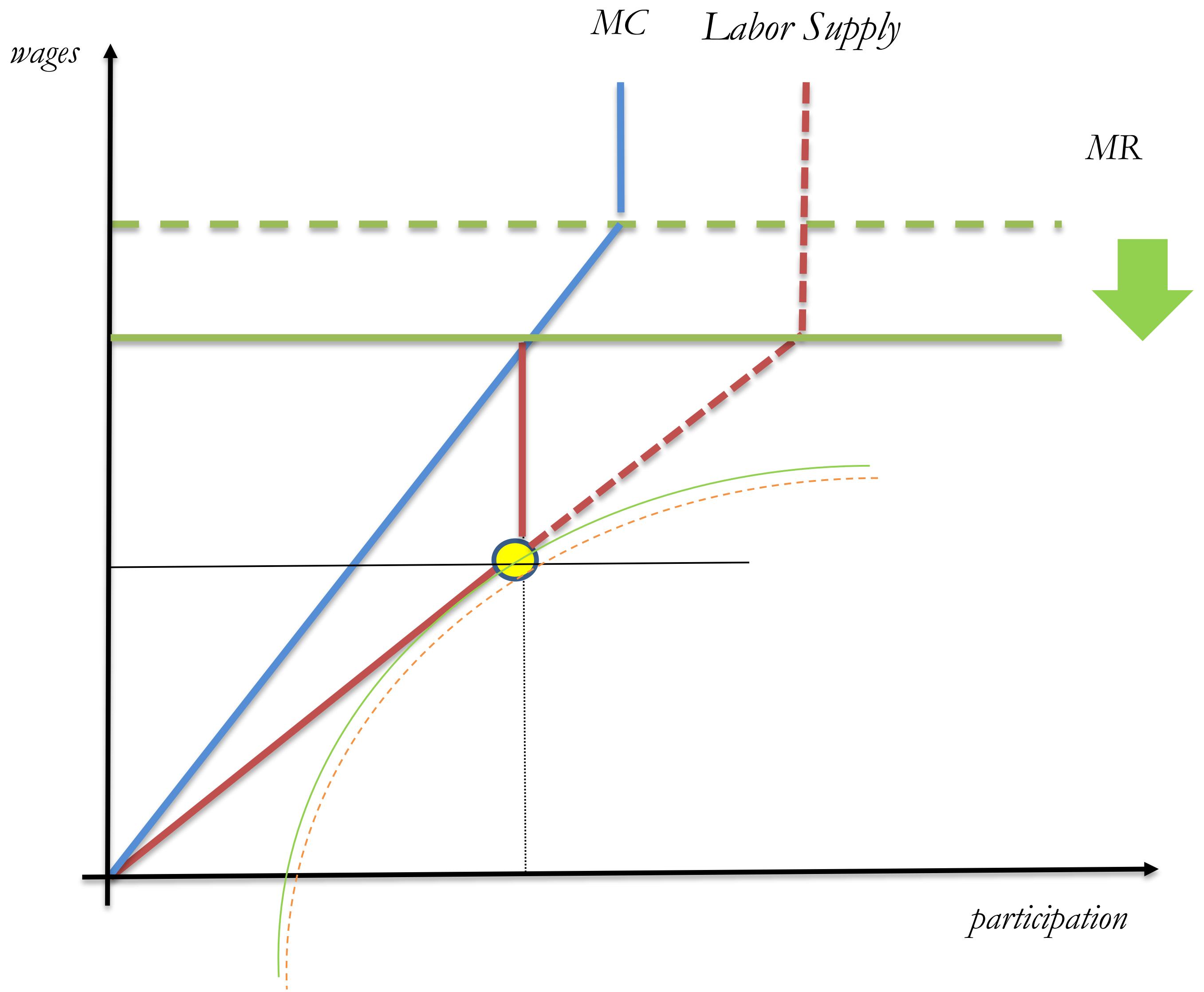
small digression on equilibria selection

- ✓ the paper does explain which equilibrium is selected
- ✓ however, it explains how the equilibrium changes if a productivity shock realizes
- ✓ using best response dynamics as a selection criterion, (Vives 1990) the new equilibrium
- ✓ "*is an optimal response for each individual firm, if no other firm deviates, but also if all other firms deviate, and expectation change accordingly*

let's start from the good equilibrium



negative productivity shock



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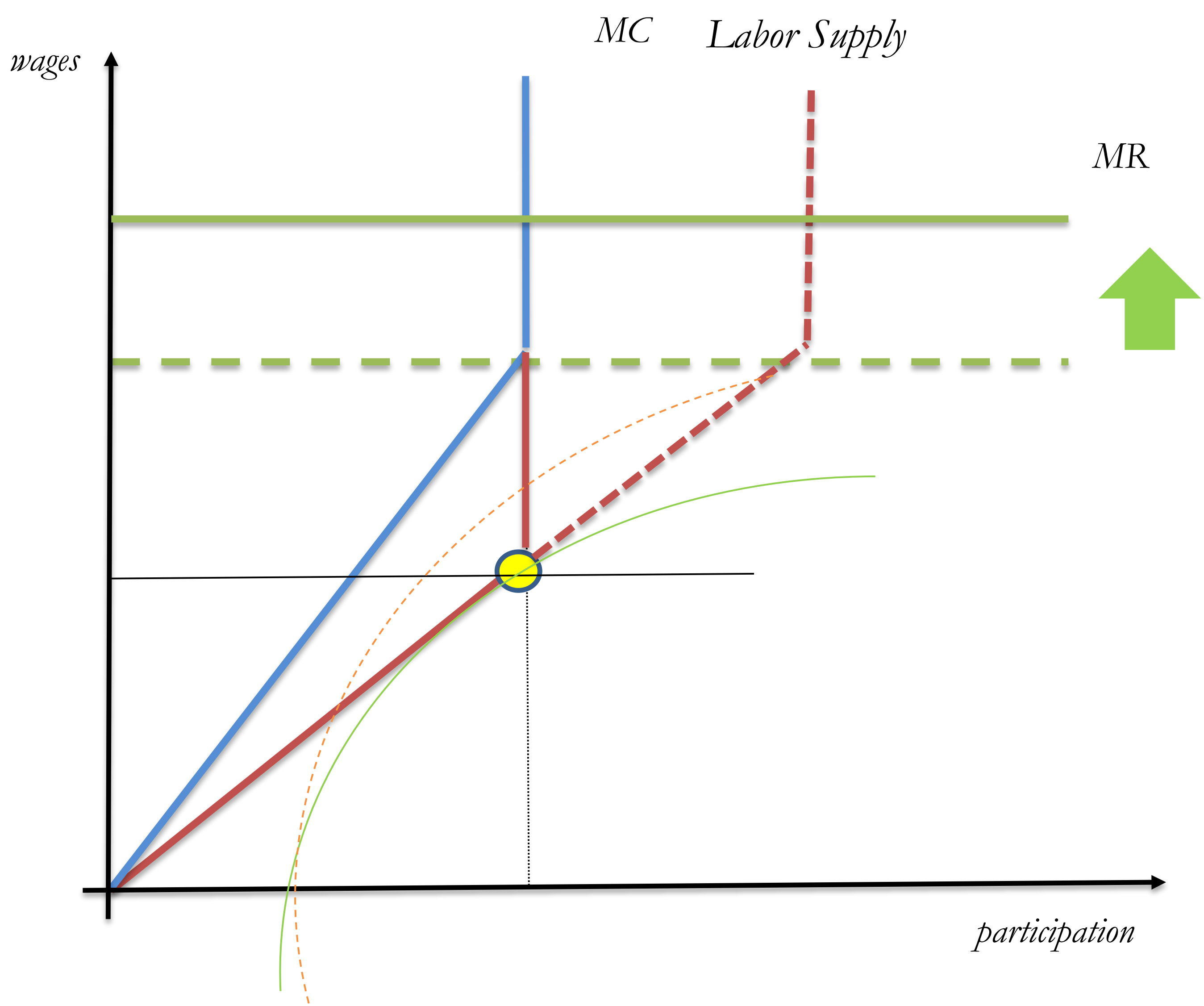

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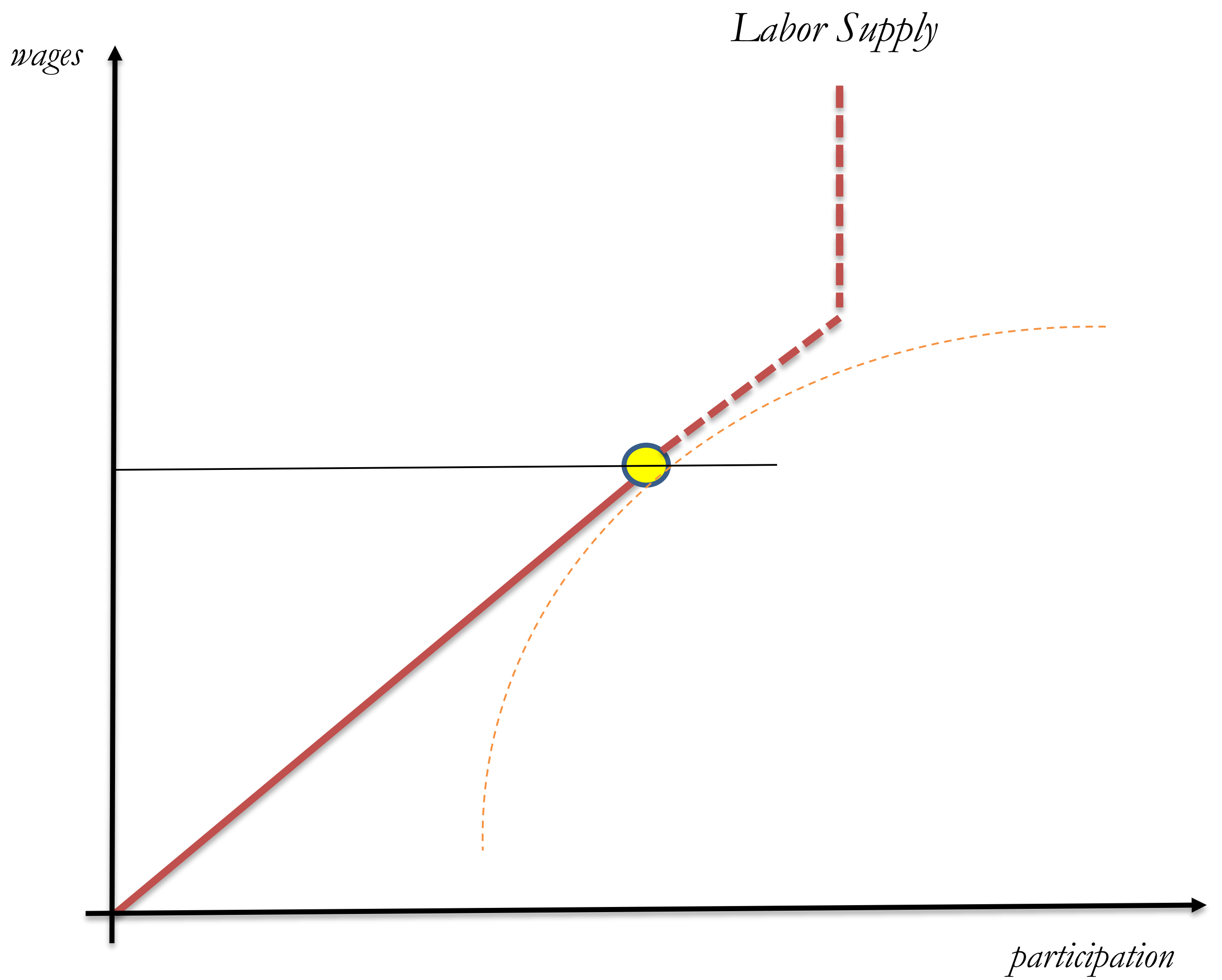

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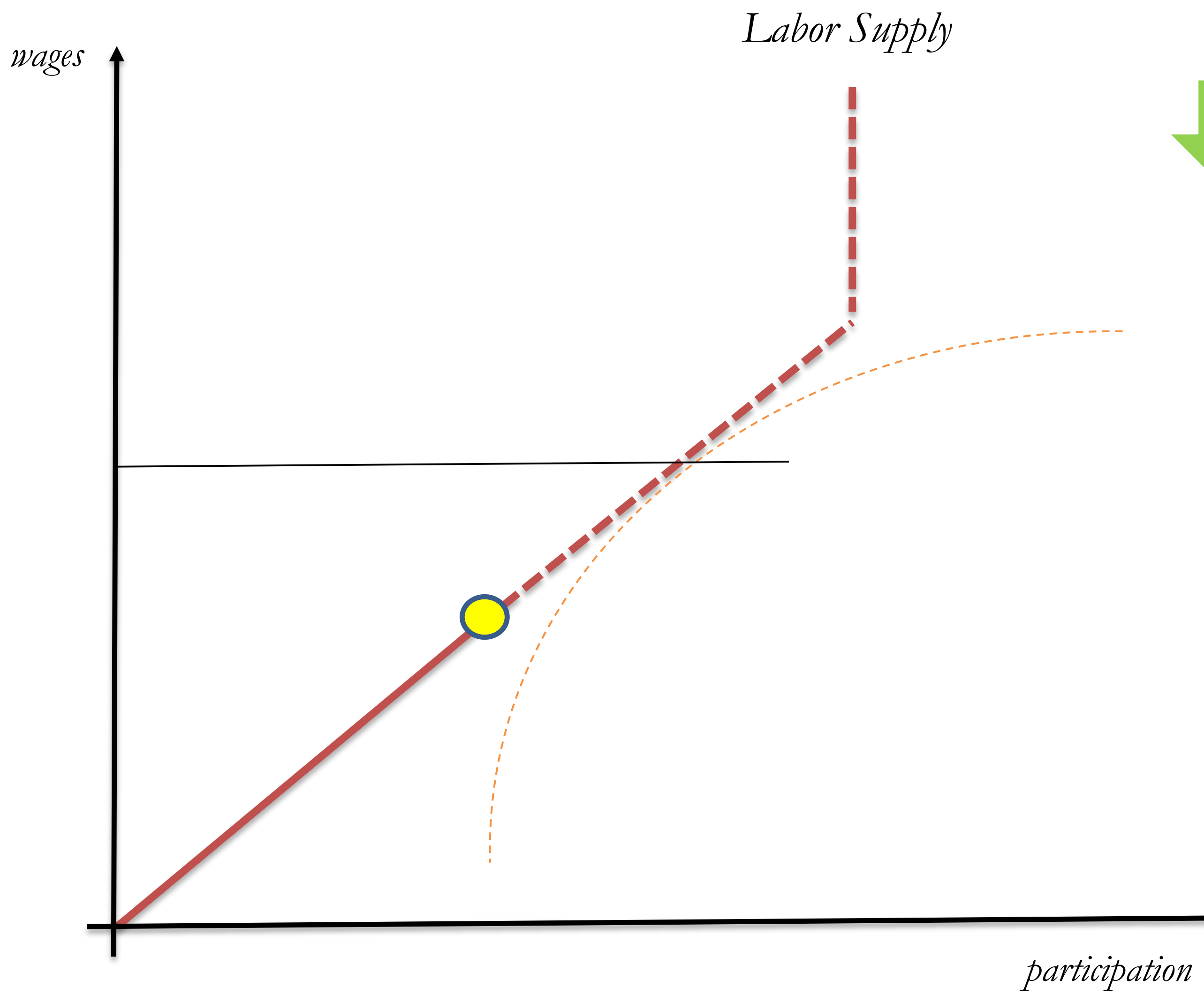
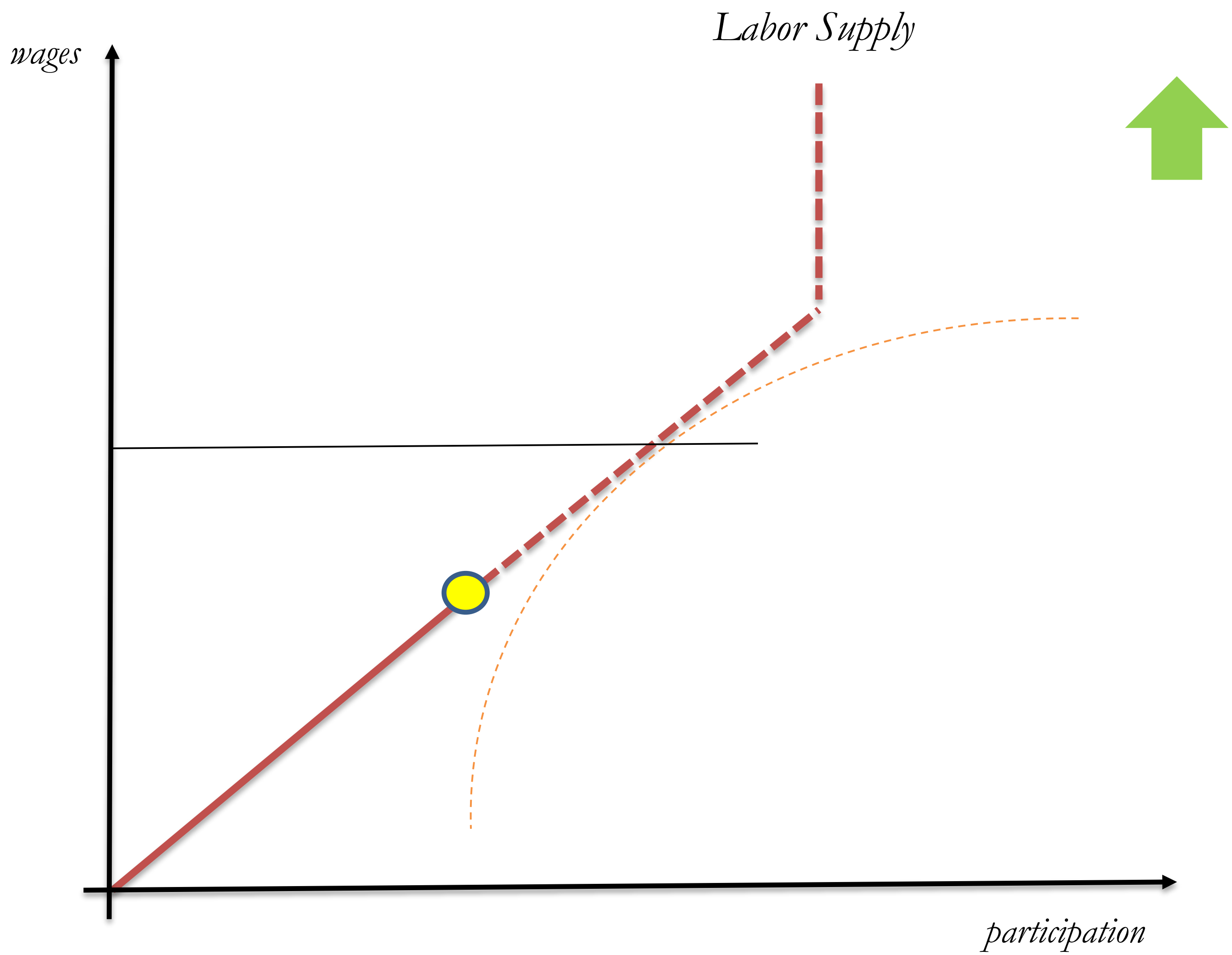
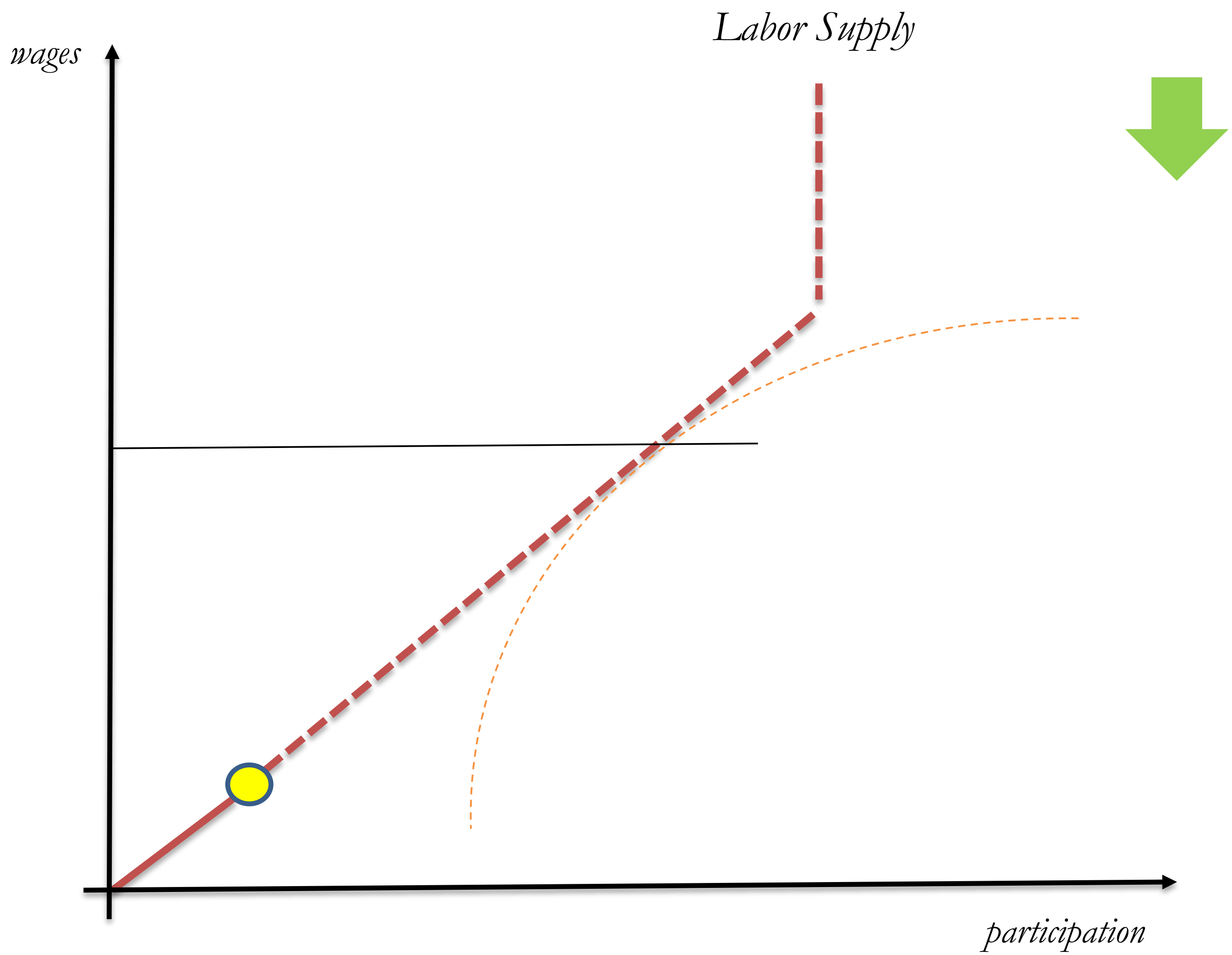


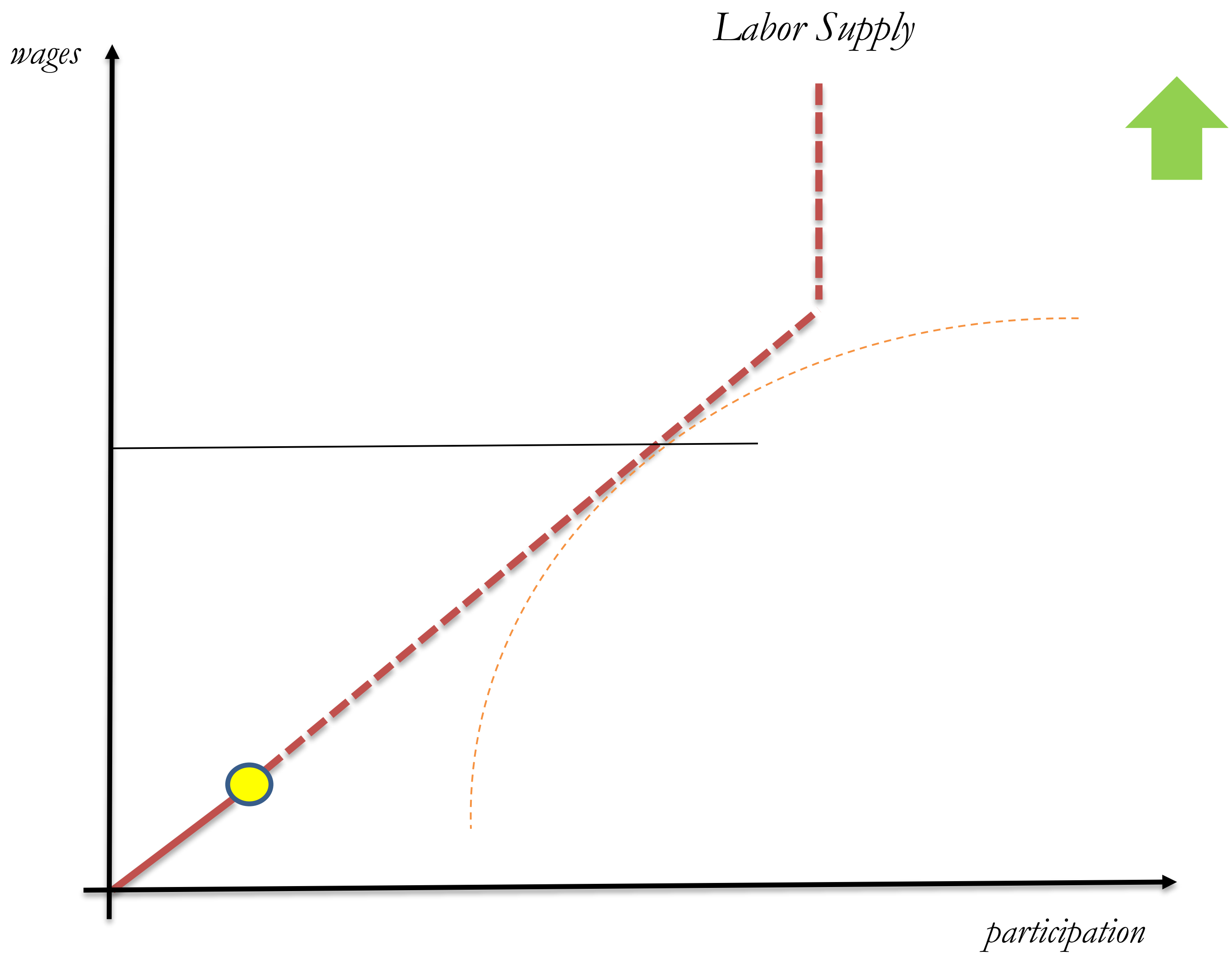
positive productivity shock



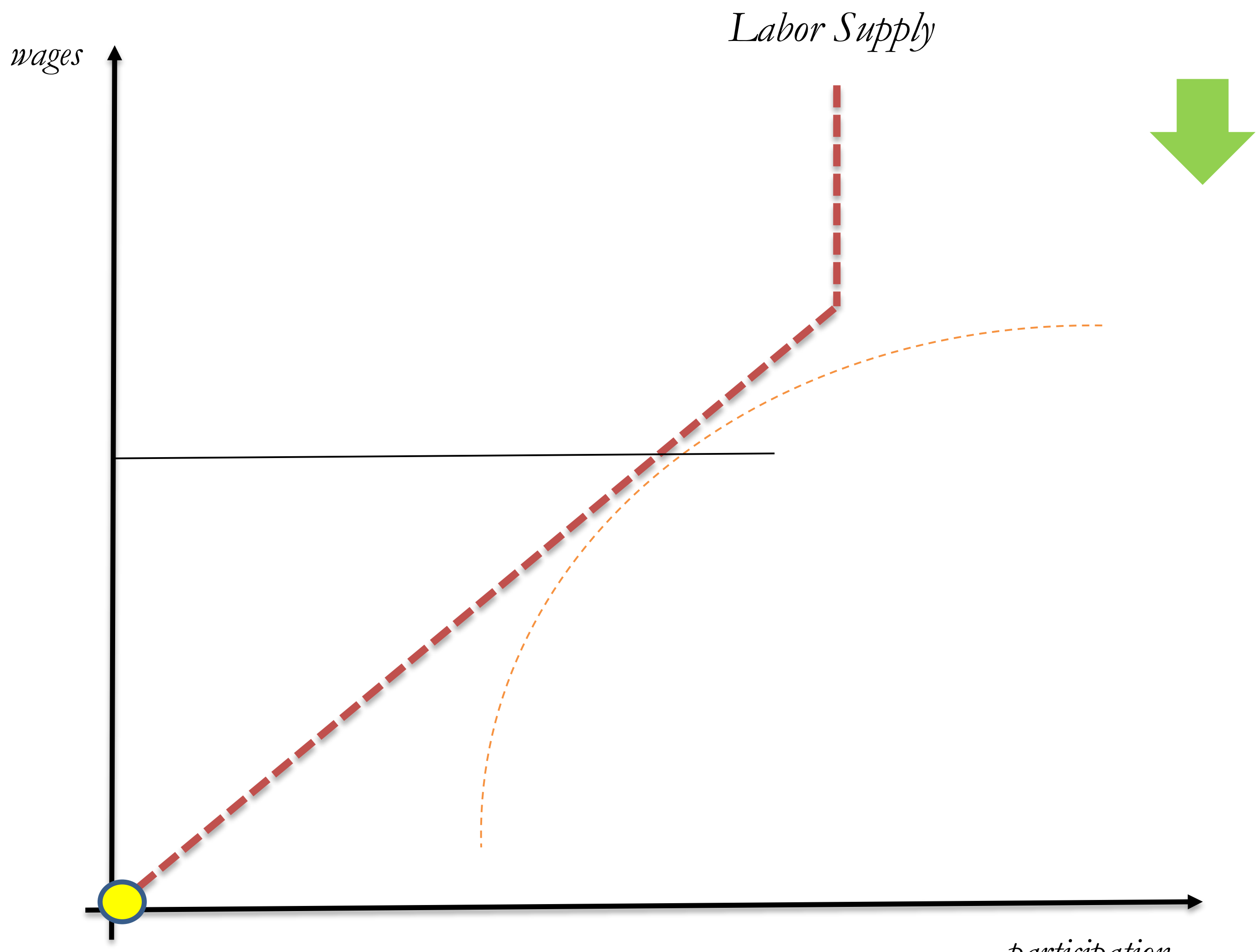
negative productivity shock



positive productivity shock



negative productivity shock



main implications for policies

- ✓ since firms cannot internalize the negative externality that their wage policy decisions impose on labor market participations
- ✓ a pro-cyclical minimum wage can be the solution
- ✓ or search contingent unemployment insurance
- ✓ such measures will increase labor market participation
- ✓ arrest the fall in the labor's share of output and make the middle class great again…☺

any fool can criticize… and most fools do

B. Franklin

- ✓ the supermodular nature of the wage/participation decisions creates upward wage rigidities
- ✓ this a neat result with important policy implications
- ✓ of course there are other forces that counterbalance it
- ✓ thus, I do not understand why the authors put so much effort in watering it down their main result
- ✓ of course, the results are unrealistic and (some) parents work in Europe
- ✓ but… the existence of insurance markets does not make Akerlof's paper less insightful

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B. Franklin

- ✓ mixed strategies in labor market participation complicate the analysis without adding much to the intuition
- ✓ the specification is non robust to the introduction of (even infinitesimal) participation costs
- ✓ if you really want to make the increase the elasticity of the labor supply in case of a positive shock wouldn't it be easier to assume that workers
  - ✓ discover their type before accepting an offer
  - ✓ and have different participation costs
- ✓ or that some of the firms are large?

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B. Franklin

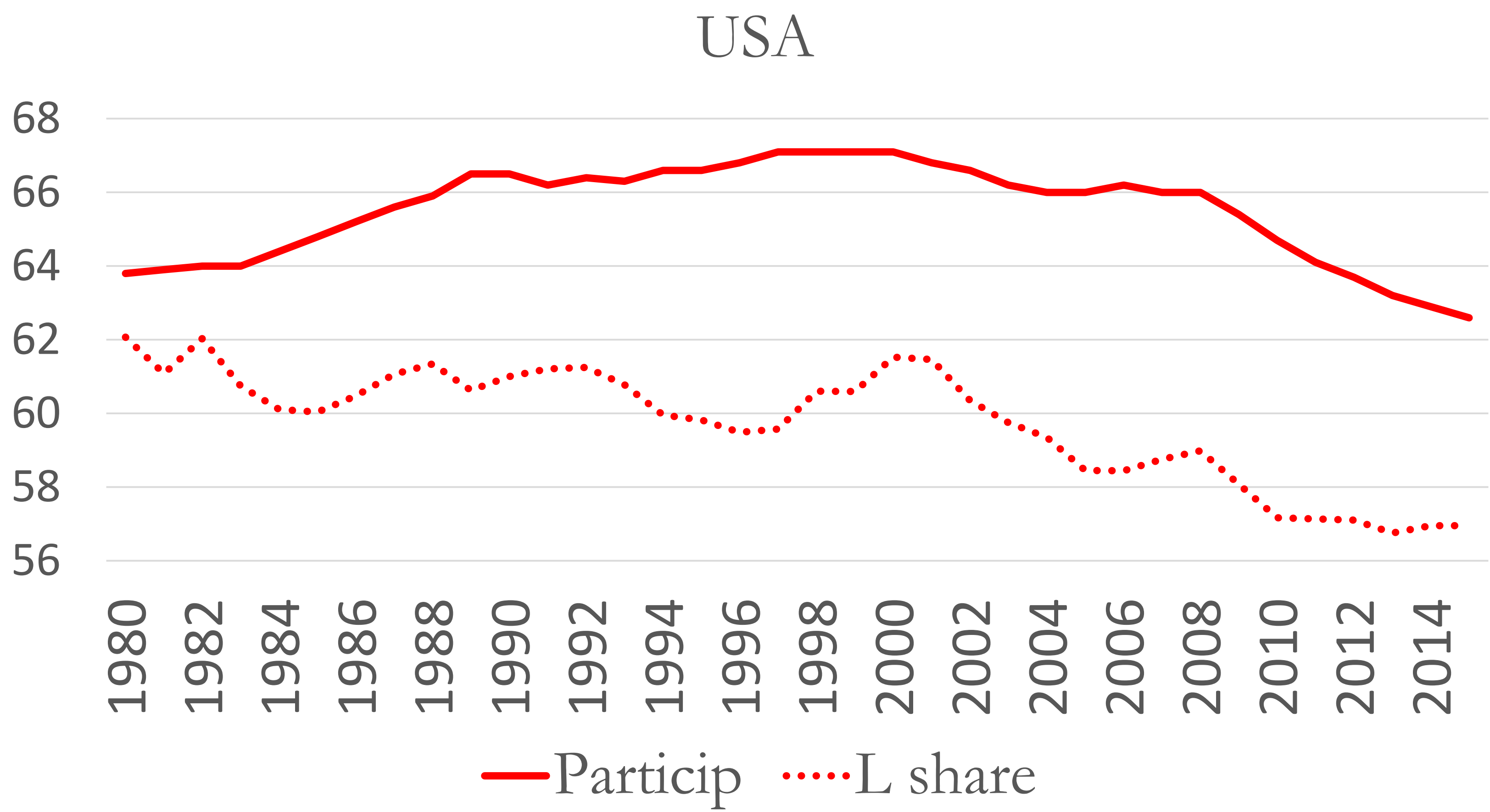
- ✓ I sort of "bought" the reason why upward wage rigidities (in the US) may create asymmetries in how the labor market reacts to booms and busts

- ✓ I also agree than procyclical minimum wages (as well as other policies aimed at increasing labor market participations) may foster long term growth

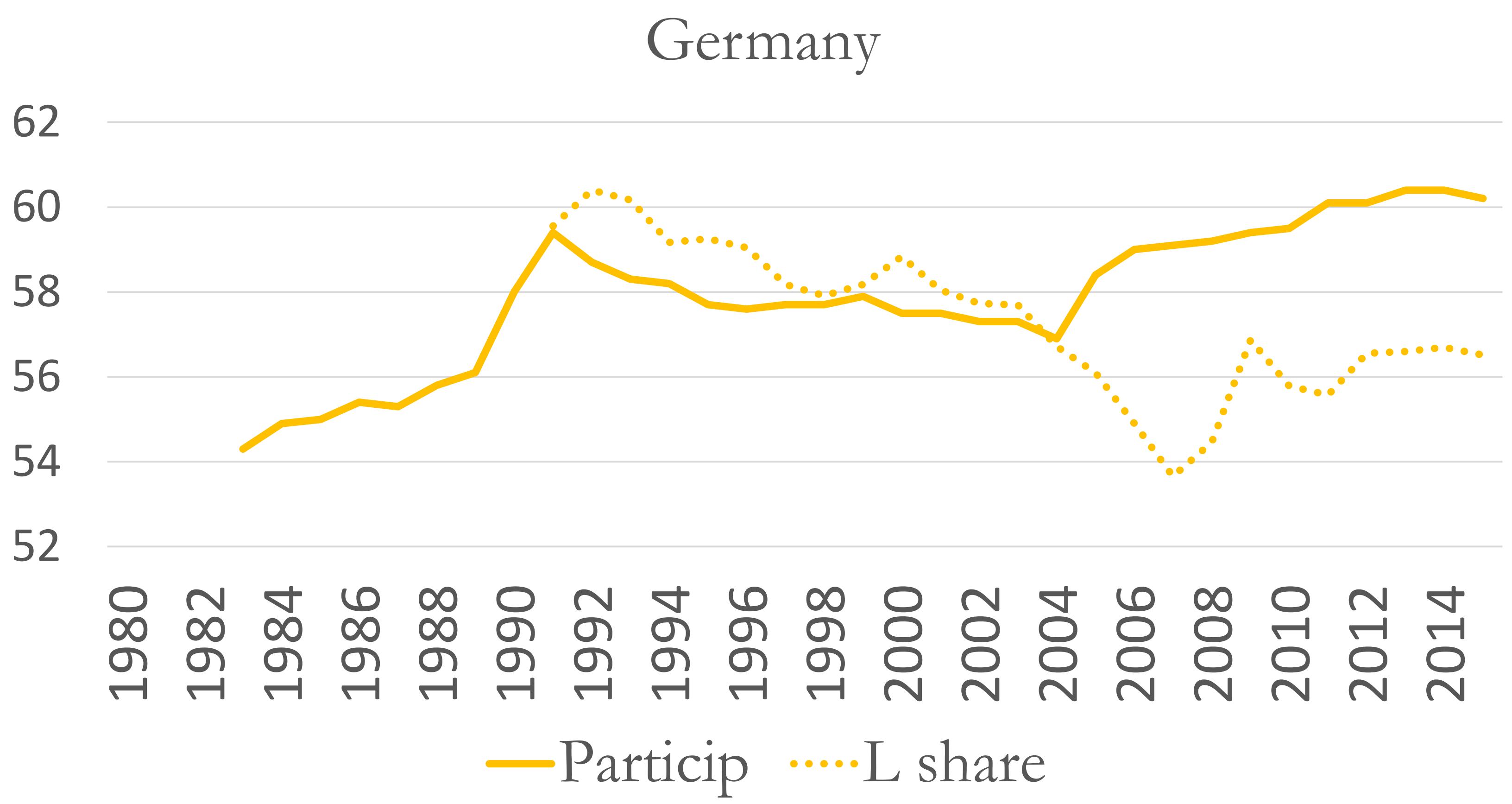
- ✓ however, I am less convinced that strategic complementarities are the main drivers of the reduction in the labor's share of output across the world

- ✓ labor market participation and the labor's share of output move together in the US but not elsewhere

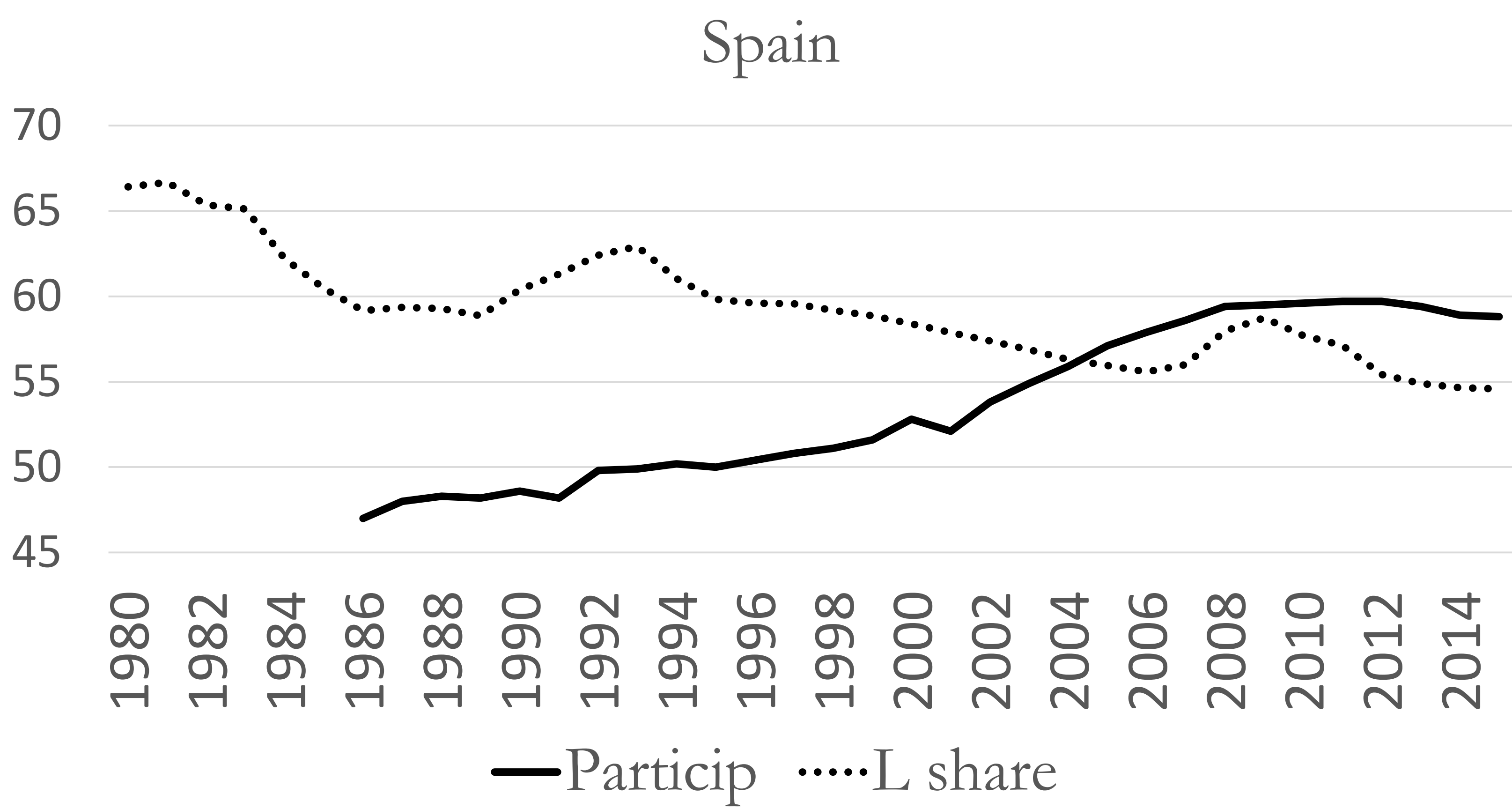
participation an labor share



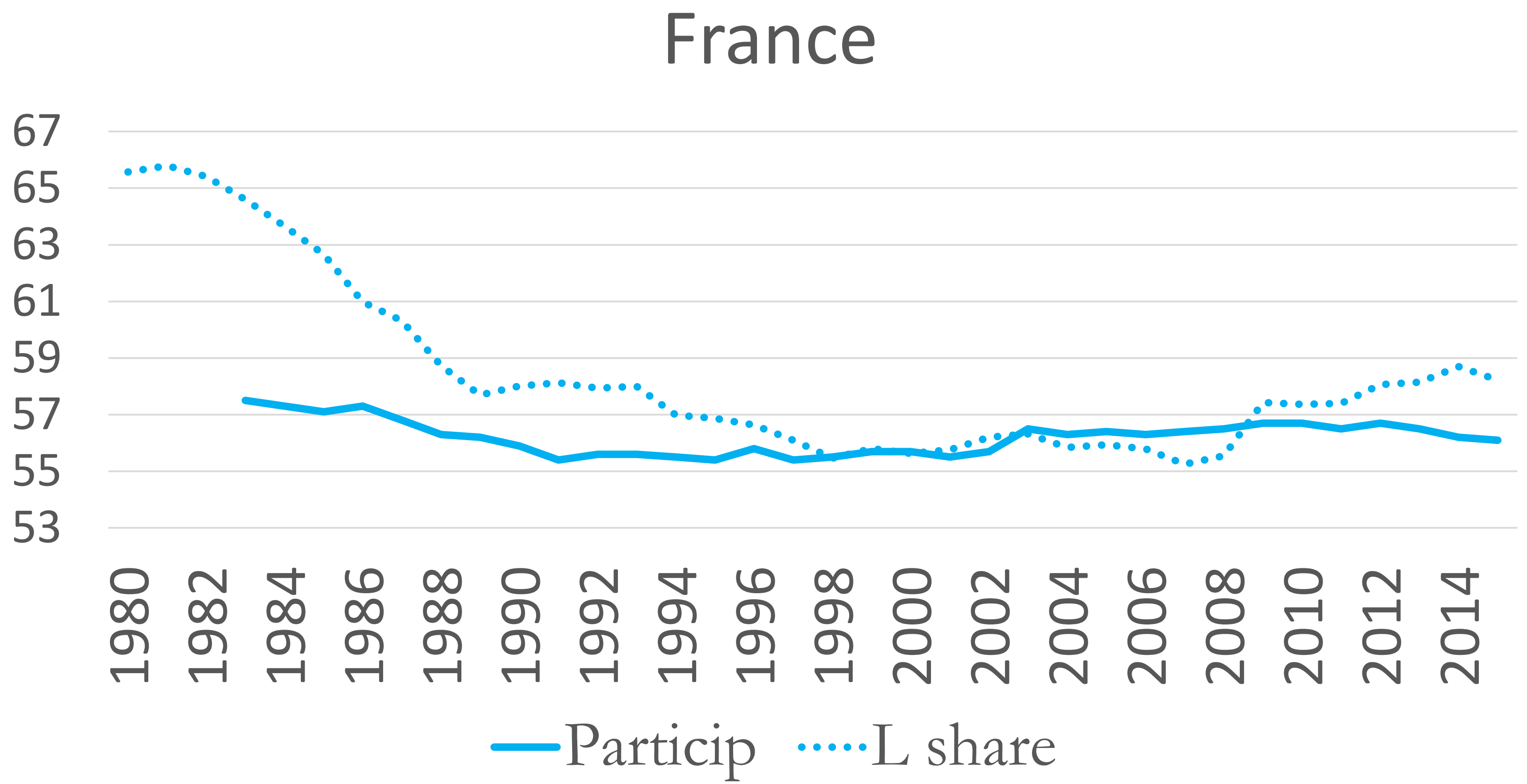
participation an labor share



participation an labor share



participation an labor share



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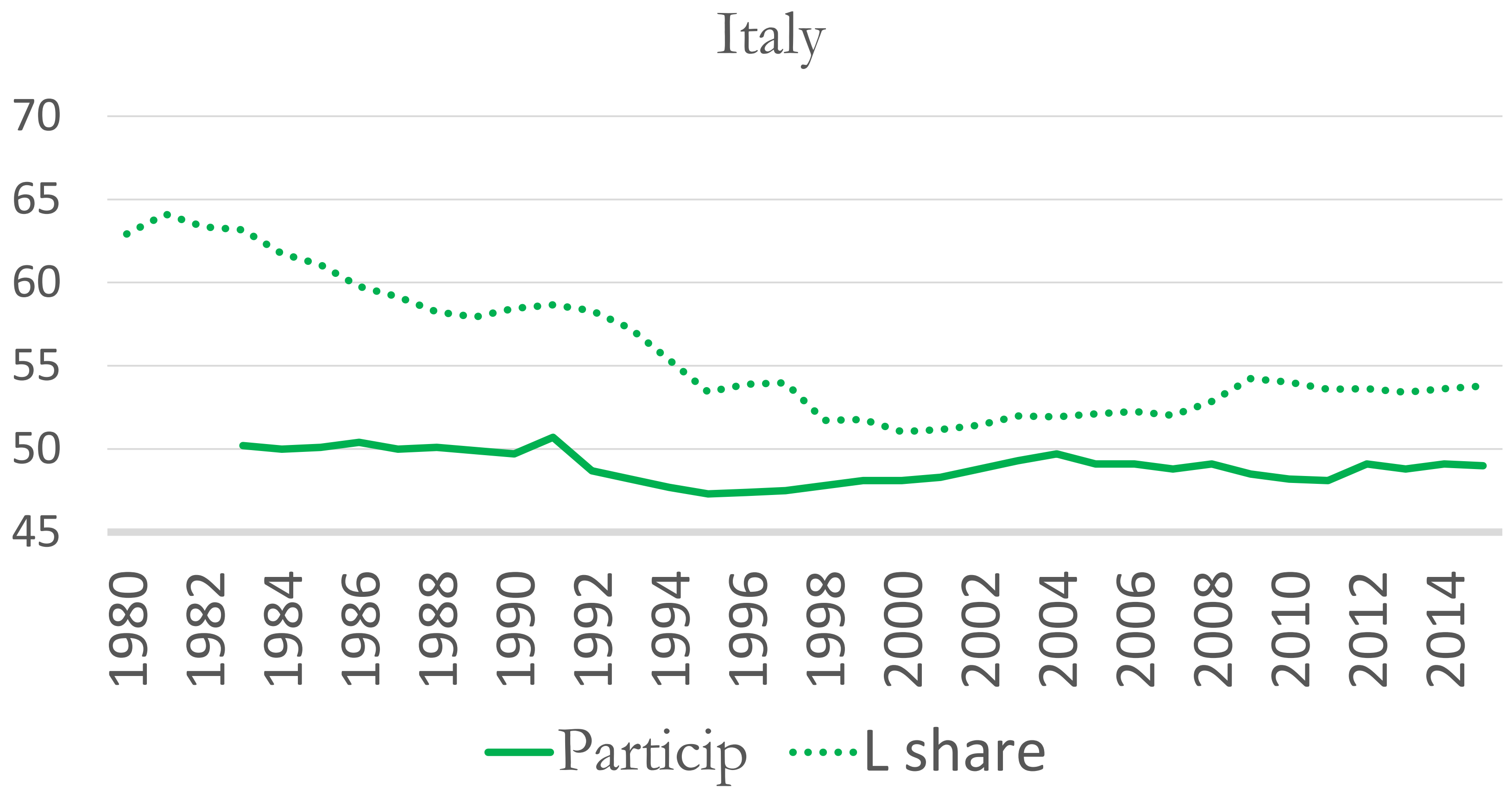

to end on a lighter note

- ✓ if inflation reduces real wages
- ✓ and nominal wages are rigid upward
- ✓ we can have upward sloping Philips' curves
- ✓ deflationary policies can be expansionary
- ✓ the FOMC will increase rates in responses of labor market weaknesses (thank you for the tip!)
- ✓ and Europe will start growing when a German will be at the helm of the ECB…

THANK YOU!