Discussion: Employment protection legislation and financial frictions: what drags Italian GDP down? - Giacomo Rodano, Alfonso Rosolia, Filippo Scoccianti

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Research question

- What are the respective aggregate and distributional impacts of size-dependent EPL and credit frictions in Italy?
- A general equilibrium model with occupational choice and heterogeneous entrepreneurial ability (Lucas, 1978), with downward adjustment costs on labor (Hopenhayn & Rogerson, JPE 1993); the authors add :
  - Size-dependent adjustment costs: in firms larger than 15 employee threshold, the dismissed worker decides whether to convert reinstatement into payment of sum set by the judge
  - Financial frictions (capital): collateral constrain similar to Buera *et al* (2014)
- Two frictions concomitantly introduced because they may arguably interact to explain the absence of evident heaping at just below 15

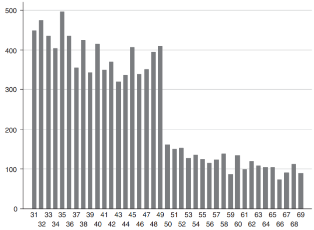
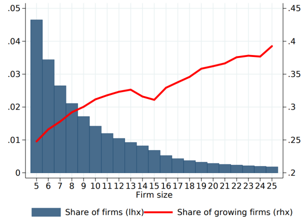


FIGURE 2. NUMBER OF FIRMS BY EMPLOYMENT SIZE IN FRANCE

Notes: This is the population of French firms with between 31 and 69 employees in manufacturing. This plots the number of firms in each exact size category (i.e., raw data, no binning) for the year 2000. There is a clear drop when regulations begin for firms with 50 or more employees.
Source: FICUS

Figure 2: Firm size distribution and firm dynamics, 2003-2007



Source: own elaborations on Inps data.

Notes : Histogram (France, Garicano et al, 2016) and density (Italy) of firms' size

Main results

- Three experiments (i.e. three calibrations) to compare steady-states:
  - Removing the size-dependent severance costs:
    - Employment above the threshold increases and employment below the threshold decreases
    - General equilibrium effect dampens the overall positive effect on employment
    - The share of entrepreneur decreases (due to wage increase) causing an increase in average TFP
    - If any, negative effect on output due to lower capital accumulation (substituted by cheaper labour)
  - Relaxing the credit constrain in presence of size-dependent EPL:
    - Significant impact on output through capital deepening and better allocation
  - Relaxing the credit constrain and removing size-dependent EPL:
    - No sharp difference regarding the effect on output: few interactions
- Bottom line: negligible effect of removing size-dependent EPL as compare to sizeable effects of relaxing financial constraints

General comments

- Legislation distorting the firm size distribution and implication in terms of productivity and welfare: topical and important subject in Italy, but in Europe in general
- Distributional and aggregate effects of removing size-dependent EPL qualitively comparable to the ones derived by Garicano *et al*, 2016: size-dependent downward adjustment costs on labor and size-dependent regulatory tax on labor have qualitatively similar effects
- Main contribution: jointly considering size-dependent EPL and credit constrain, and calibrating the model to Italian data, leads to relativize the effect of size-dependent EPL

Comments on the calibration

- (i) the parameters determining idiosyncratic shocks, (ii) δ and (iii) τ to broadly match (i) a moment of the firm size distribution (share below 15), (ii) the employment share of firms below 15, (iii) share of 10-15 firms that grow above 15, (iv) the exit rate
- Sensitivity analyses: respective roles of the free parameters to match those moments
  - τ: share of 10-15 firms crossing 15 seems also largely driven by λ
  - Firm size distribution for varying τ holding λ constant; and conversely
  - Is the equilibrium share of entrepreneur in line with the figure found in the Italian data ?
  - External validity: from high value of τ to no EPL
- Two experiments: in terms of policy recommendation,less obvious policy tools for the second one

Other comments

- Other potential factors explaining firm size distribution in Italy: small companies are family business: preferences, sectoral composition effect, tax avoidance (Bobbio, 2016)
- Type of contract: short term contract can partly mitigate the effect of dismissal cost on headcounts; maybe particularly interesting in the context of the Italian job act
- Transition between the steady states
- More details on the solution algorithm