

Discussion: Political Distribution Risk and Aggregate Fluctuations

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Claudio Michelacci, 1st BdE Annual Research

Motivation

- Politics affects the **distribution** of income
- There are shocks to **politics**
- So we have **political distribution risk**
- This paper: **distribution risk** is an important **driver of aggregate fluctuations** in the US (and other countries)

Political distribution shocks matter, I

- 1) **Cross-country evidence** to show that politics affects capital share
 - ① Case studies
 - ② Cross country panel regressions where labour legislation is instrumented with changes in political system
 - ③ US states panel regressions exploiting time variation in the introduction of Right-to-work legislation
- 2) **A Bayesian proxy VAR** a la Mertens and Ravn (2013) on US data where the minimum wage is used to identify **all the effects** of redistribution shocks

Political distribution shocks matter, II

3) A DSGE model with labour market search frictions **to quantify the importance** of distribution shocks

- ① The model is calibrated and solved non linearly
- ② The bargaining shock is estimated using a clever **partial filter** and it maps into some suggestive narrative
- ③ Bargaining shock matters **substantially for welfare** (reply to Lucas 1985)
- ④ The model performs better than RBC model with shock to TFP and labour share (Ríos-Rull, Santeulàlia-Llopis 2010)

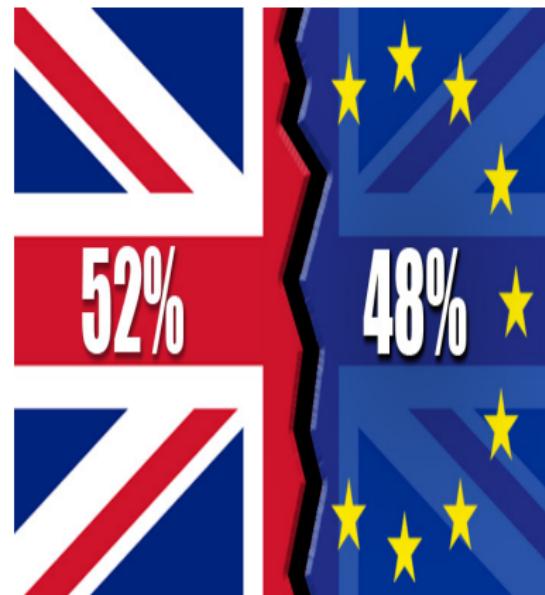
Evaluation

- A tour de force: more than **100 pages of great economics** with a **record**
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No doubts that **politics** can be **shocking!!!!**



(a) Shock 1, 23 June 2016



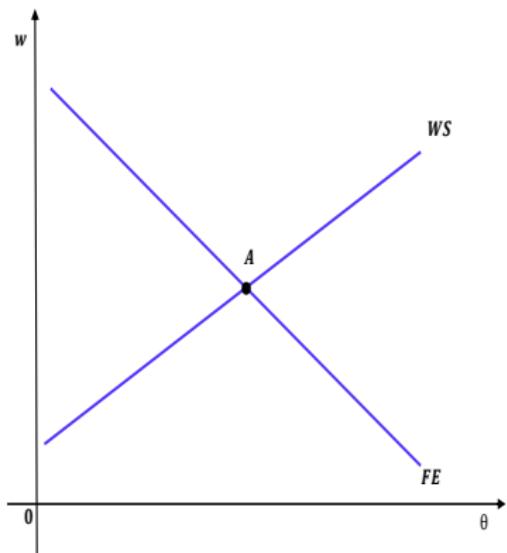
(b) Shock 2, 8 November 2016

And we know that **politics** is about **redistribution**

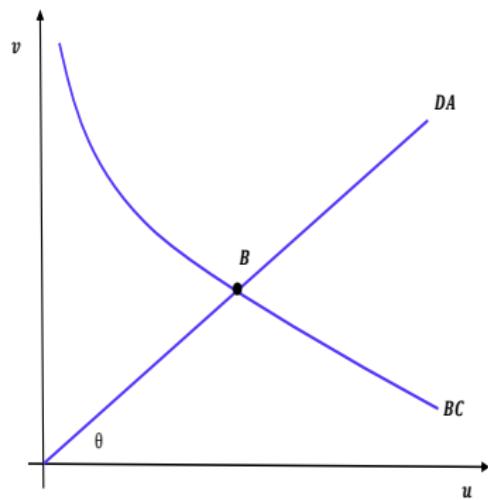
This discussion

- Review of the **mechanics of a bargaining power shock**
- Discuss **identification** of shocks
- Discuss **welfare implications** of the analysis
- Discuss relation **bargaining power** and **trade unions**

Labor market equilibrium

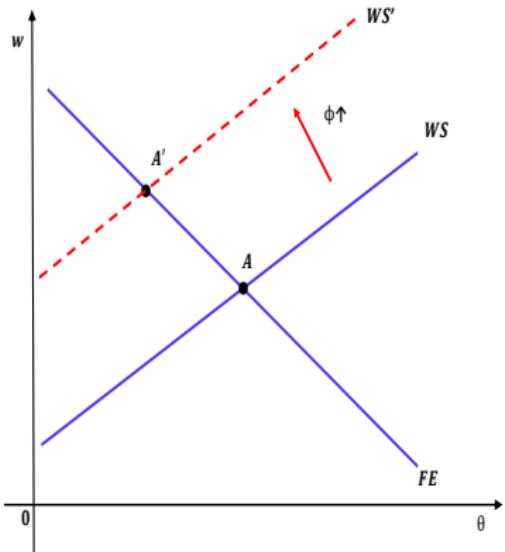


(a) Wage Setting and Free Entry

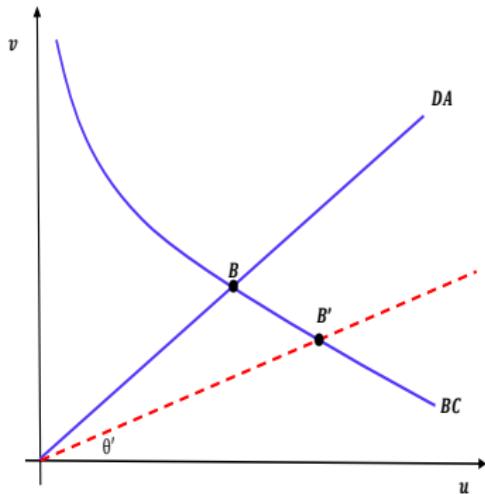


(b) Beveridge Curve

Increase in bargaining power, ϕ



(a) Wage Setting and Free Entry



(b) Beveridge Curve

w up, θ go down, u up, v down, and GDP down

Used for **identification of ϕ -shock**

Also the identification of ϕ_t comes from wage data

Wage equation:

$$w_t = \phi_t y_t + (1 - \phi_t) r U_t$$

It is the basis of the algorithm used to recover ϕ_t

Structural assumptions (some irrelevant for allocation):

- ① Wages are continuously renegotiated
- ② No wage differences between **new** and **pre-existing** jobs
- ③ No **on-the-job search**

but could **revert** the conclusion that wages increase in response to ϕ -shocks: lower θ leads to less job-to-job movements and thereby to smaller wage increases

Lucas (1977)

“any attempt to assign systematic real wage movements a central role in an explanation of business cycles is doomed to failure”

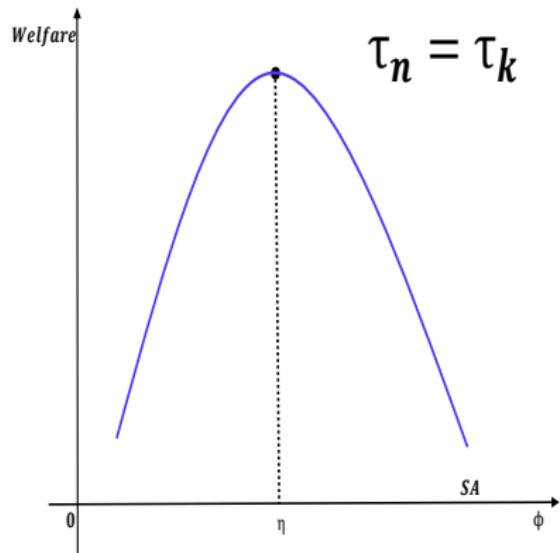
- The transmission mechanism and identification works through wage push shocks
- **Other margins of identification:**
 - ① Apply methodology to **wages of newly hired** workers (from unemployment)
 - ② An **inefficient increase** in worker bargaining power leads to a **fall in job separation** rates

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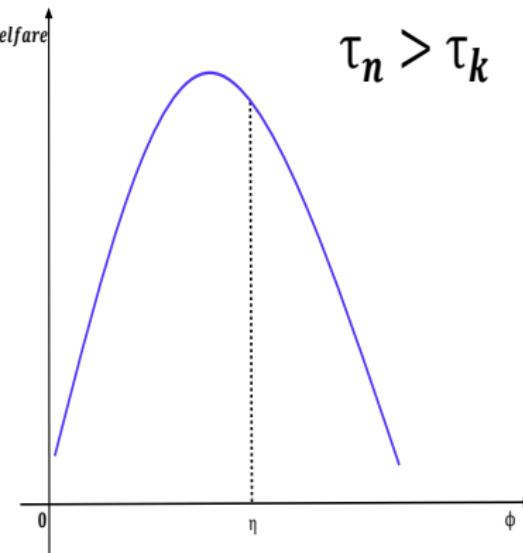
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Welfare and Hosios' condition



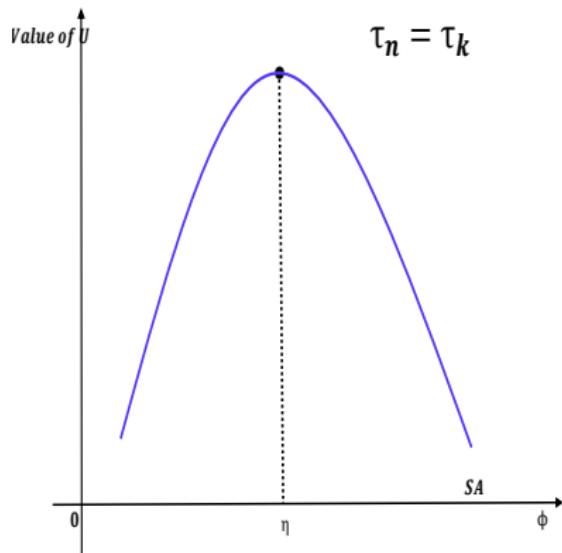
(a) Aggregate welfare $\tau_n = \tau_k$



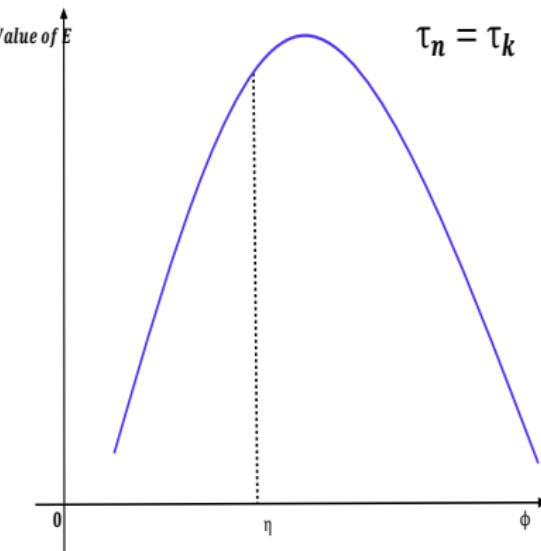
(b) Aggregate welfare $\tau_n > \tau_k$

Given the assumed calibration, any **increase in ϕ reduces welfare**, so welfare gains of reducing volatility in ϕ are large. But why should $\phi = \eta$?

Insiders and Outsiders and bargaining power



(a) Value of unemployment



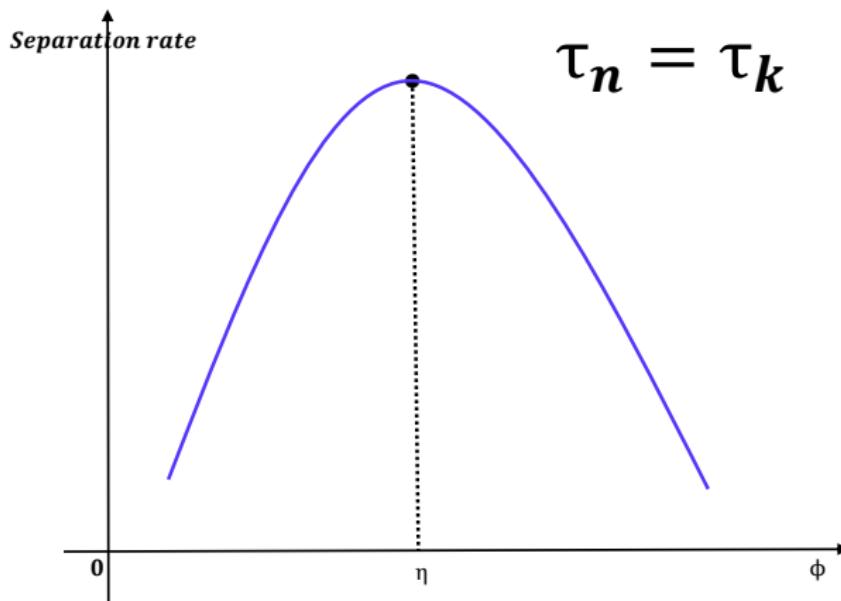
(b) Value of employment

This would suggest $\phi \geq \eta$. This should be investigated further. It matters for results.

Further identification: Endogenous separation rate

Under Nash bargaining, jobs destroyed if $S \simeq y - rU < 0$

Lower U (search inefficiencies) leads to **less destruction**



(a) Separation rate

Bargaining power, search inefficiencies and unions

- In the narrative approach changes in worker bargaining powers are often equated to changes in the power of **trade unions**.
- But **large, national** trade unions may **also internalize** the effects of wage changes on employment.
- Some (left-wing?) economists have even argued that **trade-unions can restore efficiency** in the canonical random search model.
- **Additional evidence** on search inefficiencies would help

The time series for Worker Bargaining Power

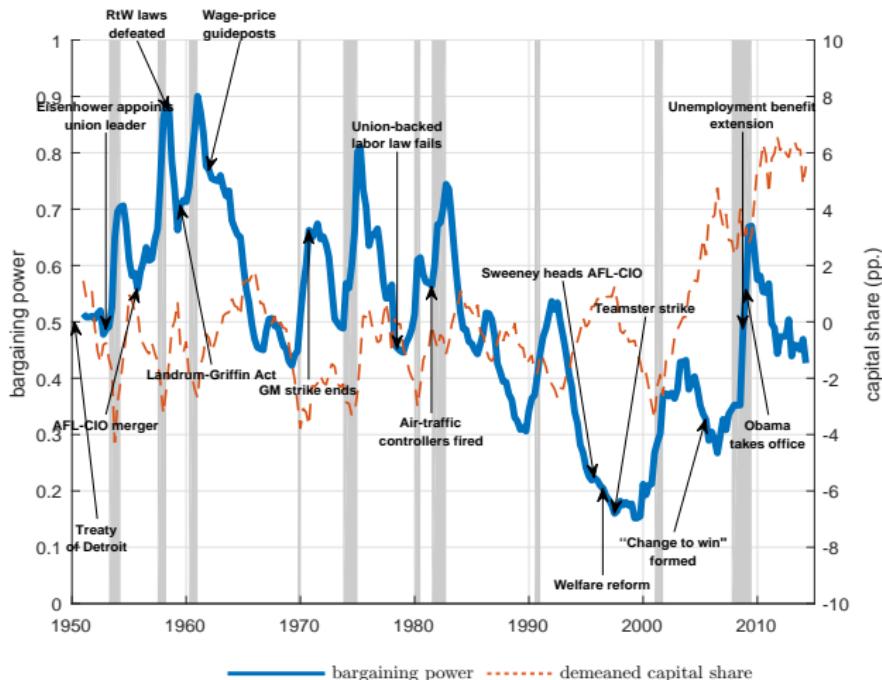


Figure 11: Bargaining power process implied by the baseline calibration

Some observations

- Worker bargaining power **spikes** in recessions: no creation of **new** jobs and rigid wages in **pre-existing?**
But this would have nothing to do with fluctuations in bargaining power.....
- Why not performing **historical decomposition** to show the contribution of ϕ -shocks to variables?
- In the recent recession bargaining power spikes some quarters after the end of the recession: can this contribute to explaining **job less recoveries?**

Conclusions

Great work!