Discussion of "The Dark Corners of the Labor Market" by Vincent Sterk

Kurt Mitman

Institute for International Economic Studies, Stockholm University

International Conference on Labor Markets in/after Crises
May 15, 2015

THE DARK CORNERS

- ▶ Standard (DMP) labor market models generally feature one steady state

  - ▶ Generally driven by mean reverting shocks
  - ▶ ⇒ We can't get stuck in a "dark corner"

- ▶ What if we live in a world with multiple steady states?

  - ▶ Even if shocks are mean reverting...
  - ▶ ...a big enough shock may send us to a new steady state

THE DARK CORNERS

- ▶ Standard (DMP) labor market models generally feature one steady state

  - ▶ Generally driven by mean reverting shocks
  - ▶ ⇒ We can't get stuck in a "dark corner"

- ▶ What if we live in a world with multiple steady states?

  - ▶ Even if shocks are mean reverting...
  - ▶ ...a big enough shock may send us to a new steady state

- ▶ Looks for empirical evidence of the existent of multiple steady states

- ▶ Shows quantitatively, a model with multiple states states driven by job separation shocks fits the data well

BIG PICTURE THOUGHTS

- The labor market in the US exhibits significant volatility and persistence

- Typical shocks we feed in (e.g. productivity, separations) much less volatile and persistent

- After Shimer (2005) lots of focus on *amplification*: generating high volatility from small shocks, but can't generate phenomena like jobless recoveries

- Vincent shows the data favors explanations that generate not only amplification, but *endogenous propagation*

EMPIRICAL INVESTIGATION

▶ Estimates a reduced form model of the labor market based on the law of motion for unemployment:

$$u_t = (1 - \rho_{f,t})u_{t-1} + \rho_{x,t}(1 - \rho_{f,t})(1 - u_{t-1})$$

- ▶ u_t unemployment rate
- ▶ $\rho_{f,t}$ job-finding rate
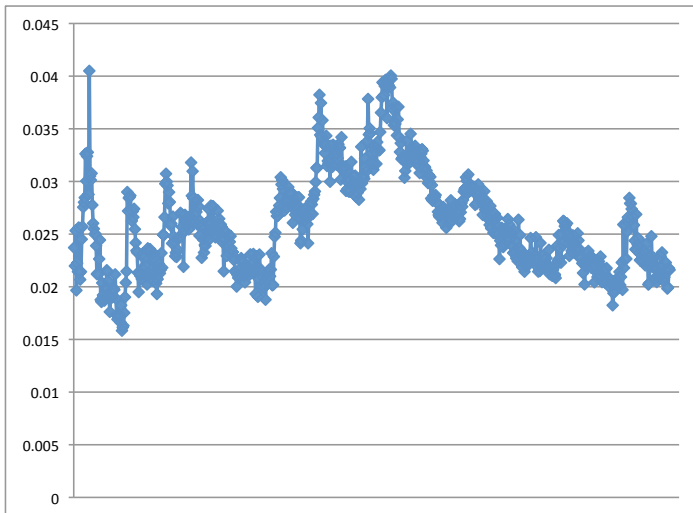- ▶ $\rho_{x,t}$ separation rate

▶ Steady states given by:

$$u^* = \frac{\rho_x^*(1 - \rho_f^*)}{\rho_x^*(1 - \rho_f^*) - (1 - \rho_f^*)}$$

▶ Idea is to estimate k-period ahead forecasts for ρ_f and ρ_x
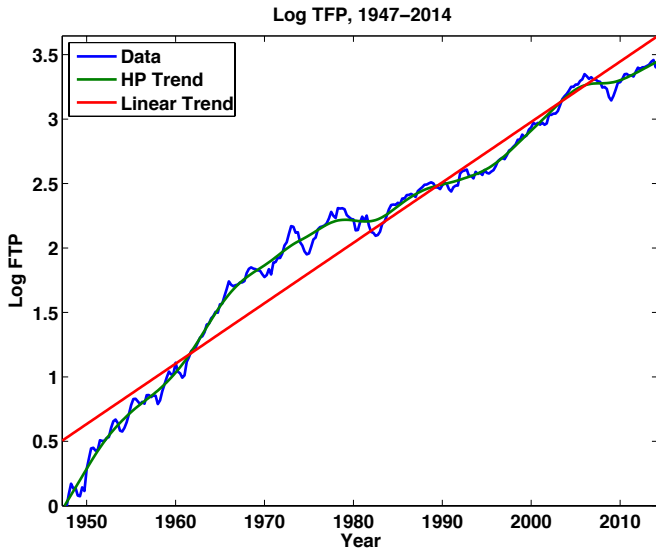
Comments on Empirics

- More evidence on why your preferred model specification is the right one

- Would be useful to show that this specification can recover "true" DGP via Monte Carlo study

  - Generate time series data from different models with single/multiple steady states

  - See if your model can properly identify the steady states

- Why focus on only 1990-2014?

SEPARATION RATES 1948-2014

Calculated using Shimer (2005) method from CPS

PERMANENT OR MEAN-REVERTING SHOCK?

Log TFP, 1947–2014

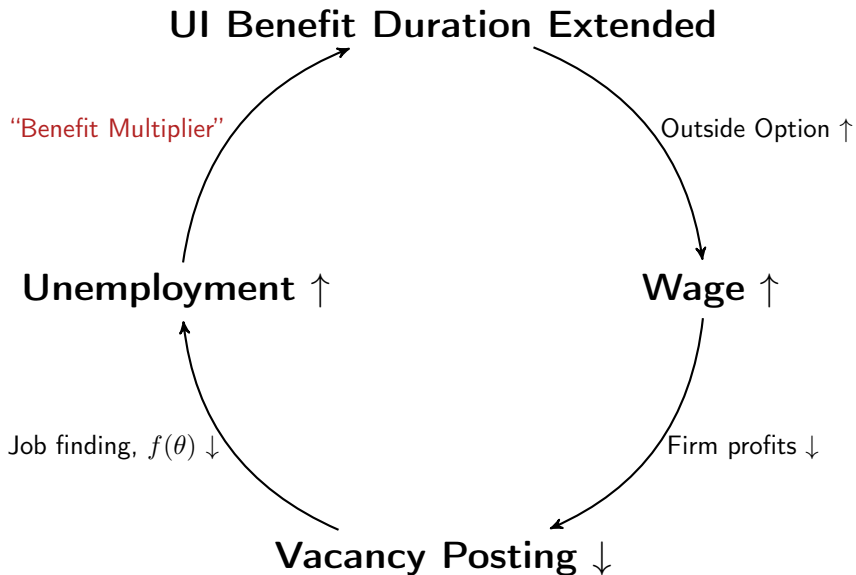# QUANTITATIVE EXERCISE

- Pissarides (1992) style model:
    - If unemployed for more than one period, lose skills
    - Firms have to pay to retrain workers
    - Vacancy posting depends on share of workers that have lost skills

- If there is a big increase in separations, shift to higher share with lost skills, leads to lower firm profits, lower vacancies, feeds back in to more lost skills

- Model generates *endogenous propagation* of separation shocks (and also other shocks!)

COMMENTS ON QUANTITATIVE EXERCISE

- DMP a bit of a straw-man here:
    - Shimer (2012) shows separations generate $1/4$ of fluctuations in u, rest comes from job-finding
    - With only separation shocks, tightness roughly constant we know it won't match the data

- Should you really use deviations from trend in separations? Level not just deviation seem like it's important in this model.

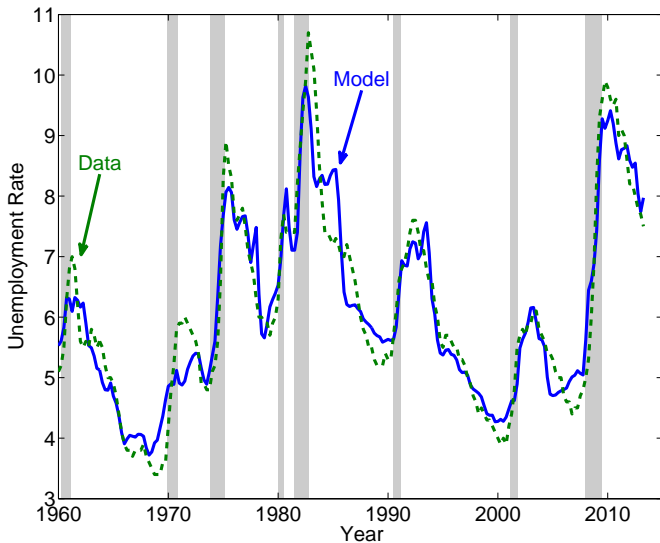# BENEFITS THAT DEPEND ON UNEMPLOYMENT

Extended benefits program:

- ▶ 13 extra weeks of benefits when $U > 6.5\%$

- ▶ 20 extra weeks of benefits when $U > 8\%$

In addition, discretionary extensions in recessions

Model with $b(u)$, $b'(u) > 0$ admits multiple steady states!

BENEFITS AS A PROPAGATION MECHANISM

Mitman & Rabinovich (2014)

Combining both elements

- ▸ Recent research has shown long-term unemployed face significant barriers in getting re-employed

- ▸ Pissarides (1992) style channel potentially important, but maybe refocused on long-term unemployed

- ▸ Loss of skills and benefits would provide additional amplification

- ▸ Both effects could be quite small, but if feedback is significant...