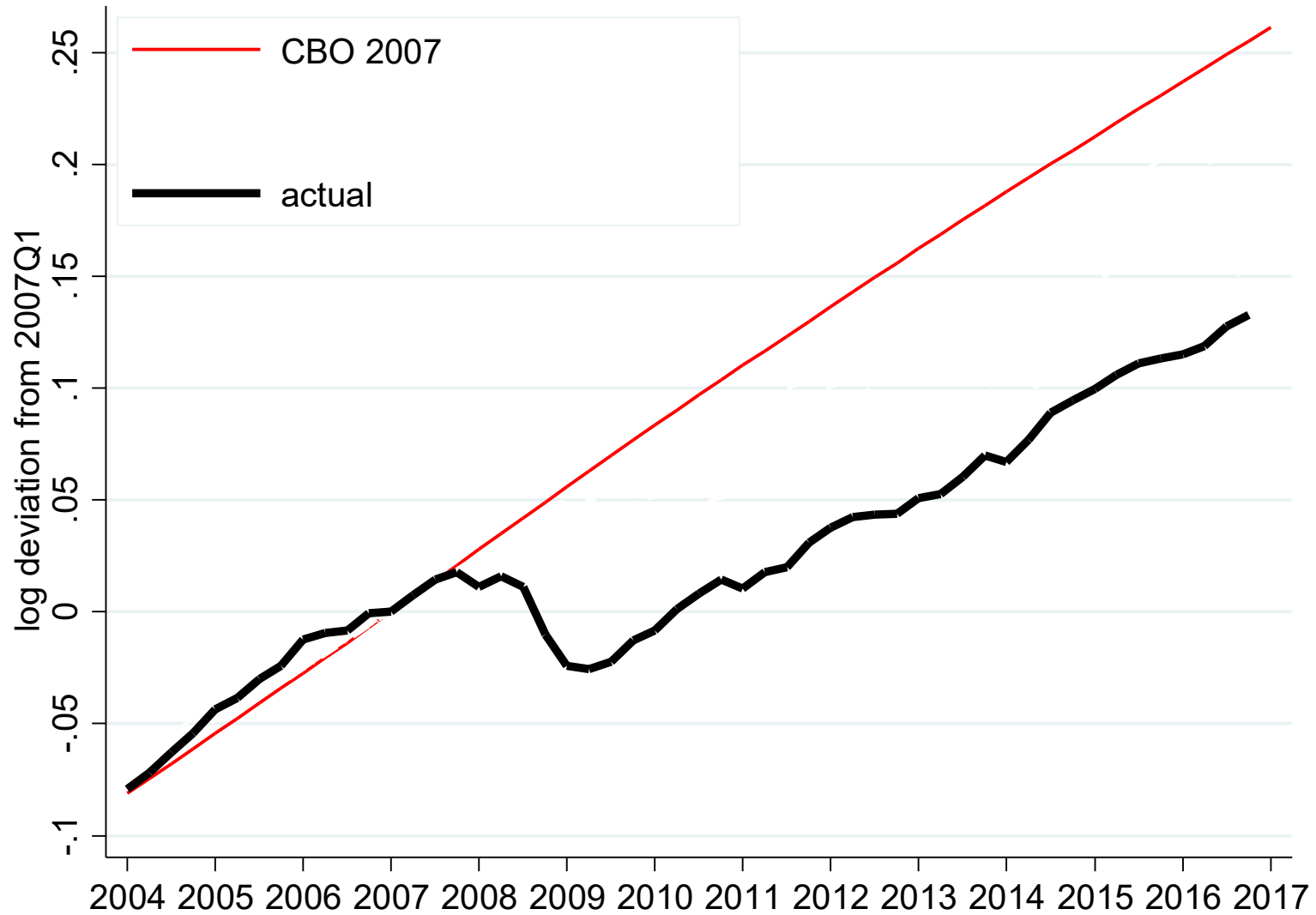


# **INSIDER-OUTSIDER LABOR MARKETS, HYSTERESIS AND MONETARY POLICY**

Jordi Gali (CREI)

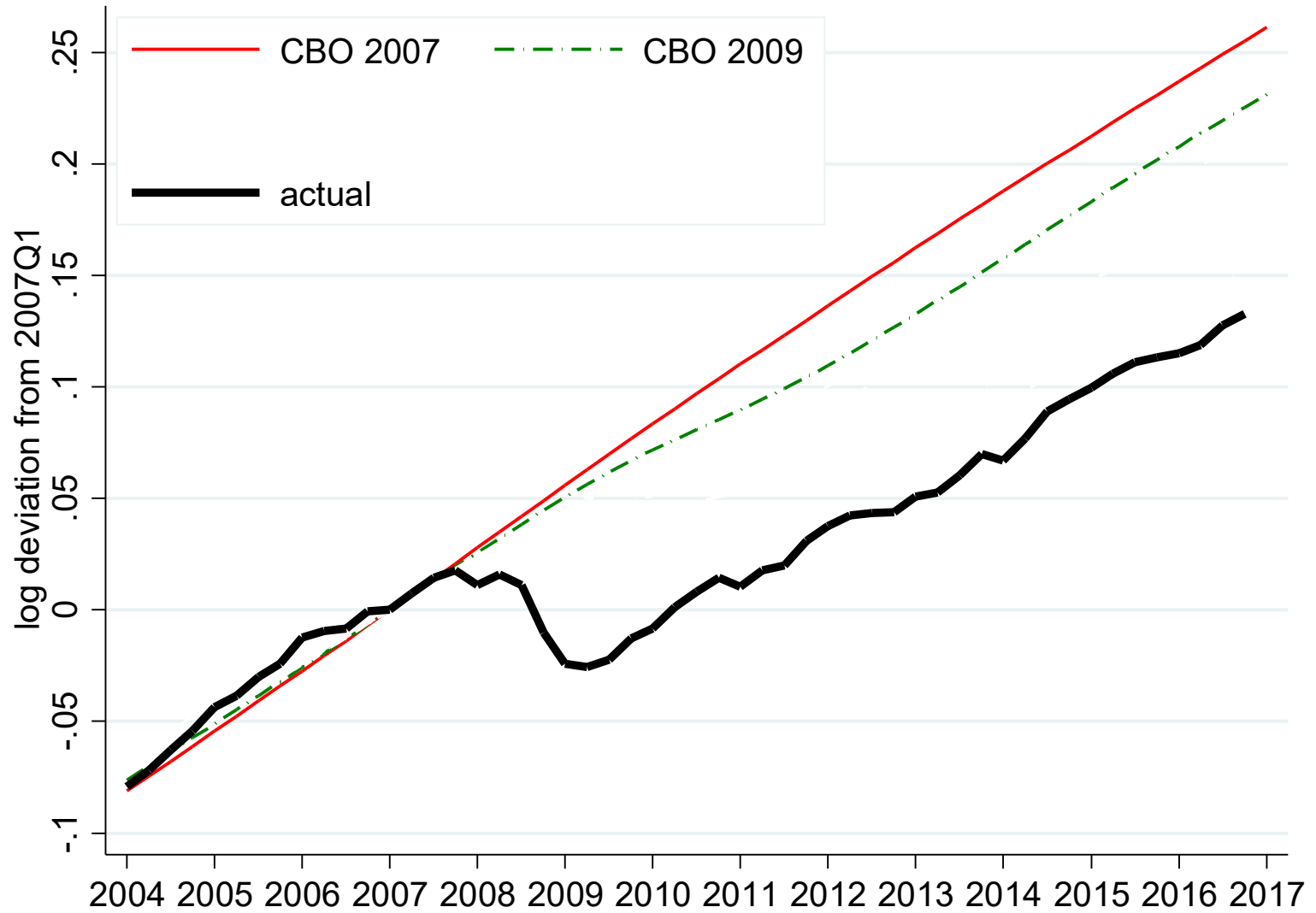
Discussion by Yuriy Gorodnichenko (UC Berkeley)

# WHY IS THIS IMPORTANT?

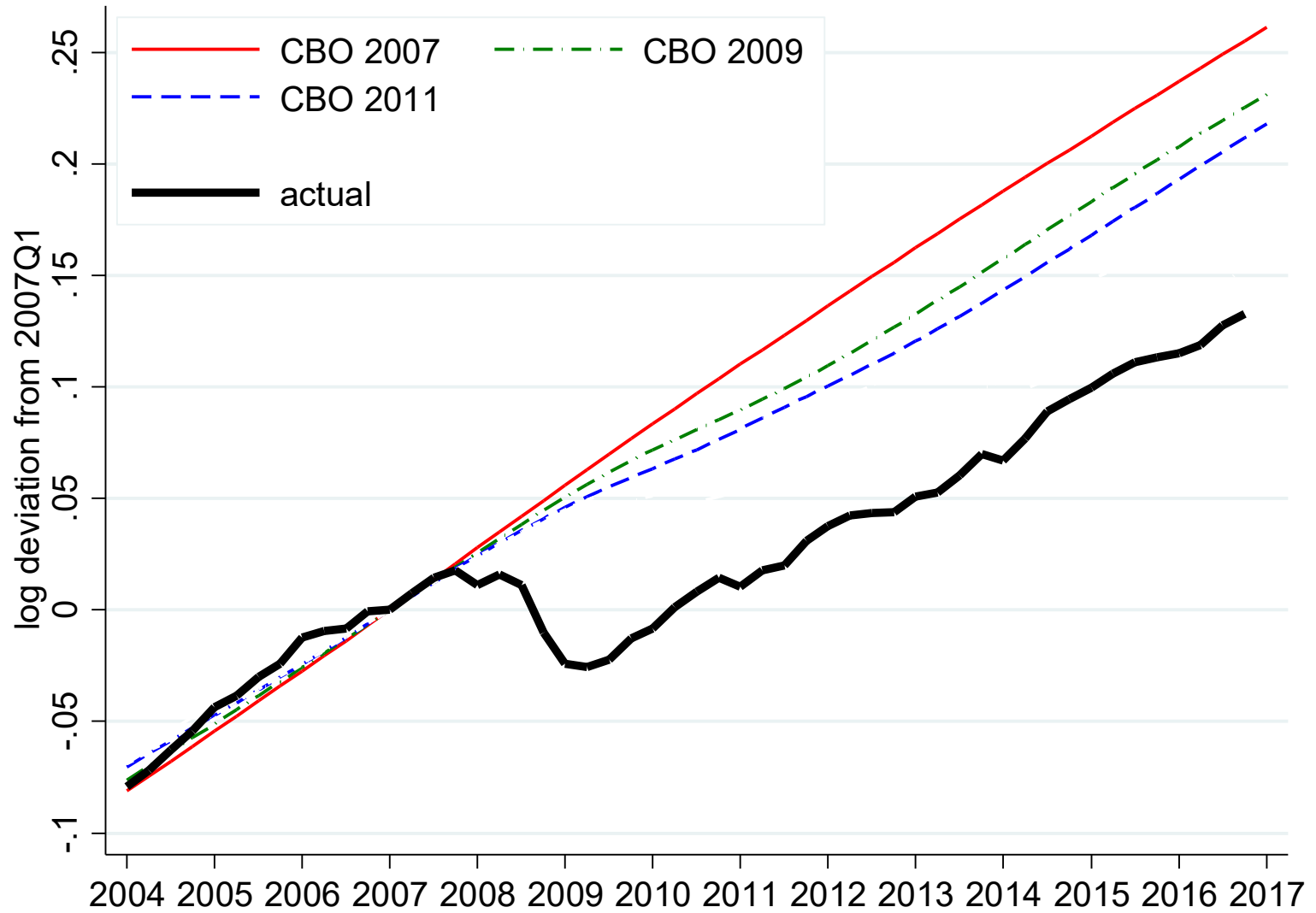


The U.S. economy is producing far less than what was expected before the Great Recession.

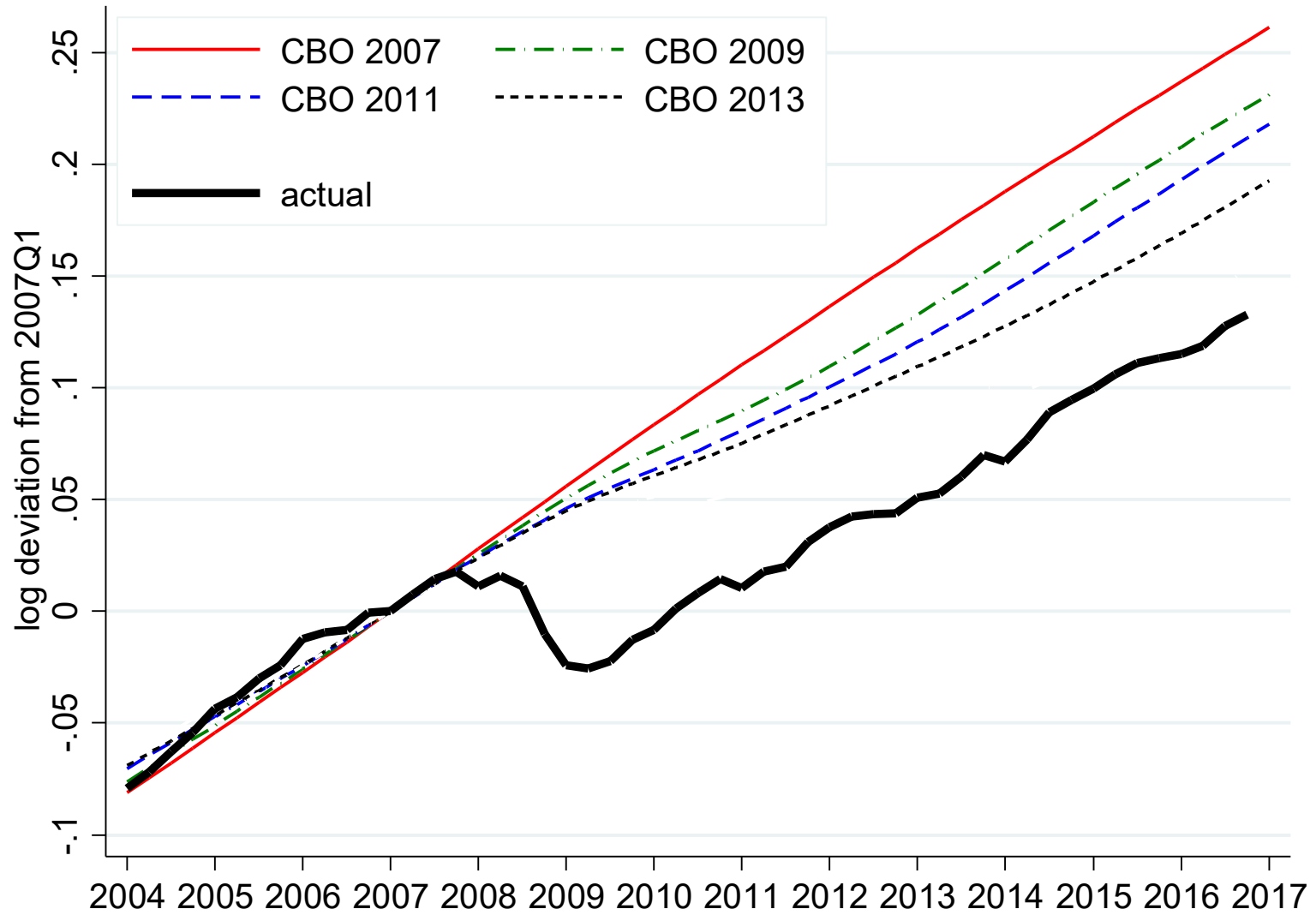
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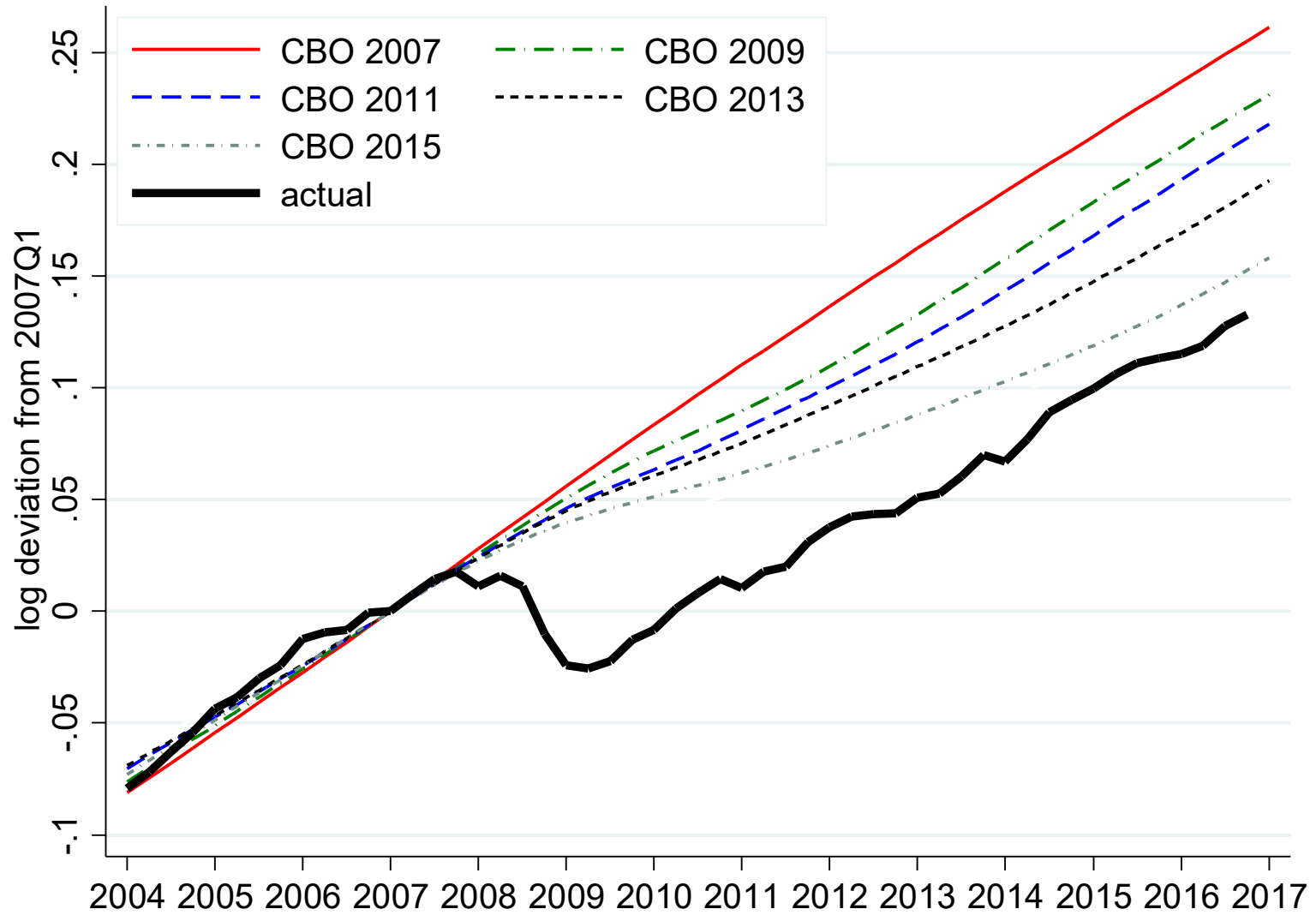
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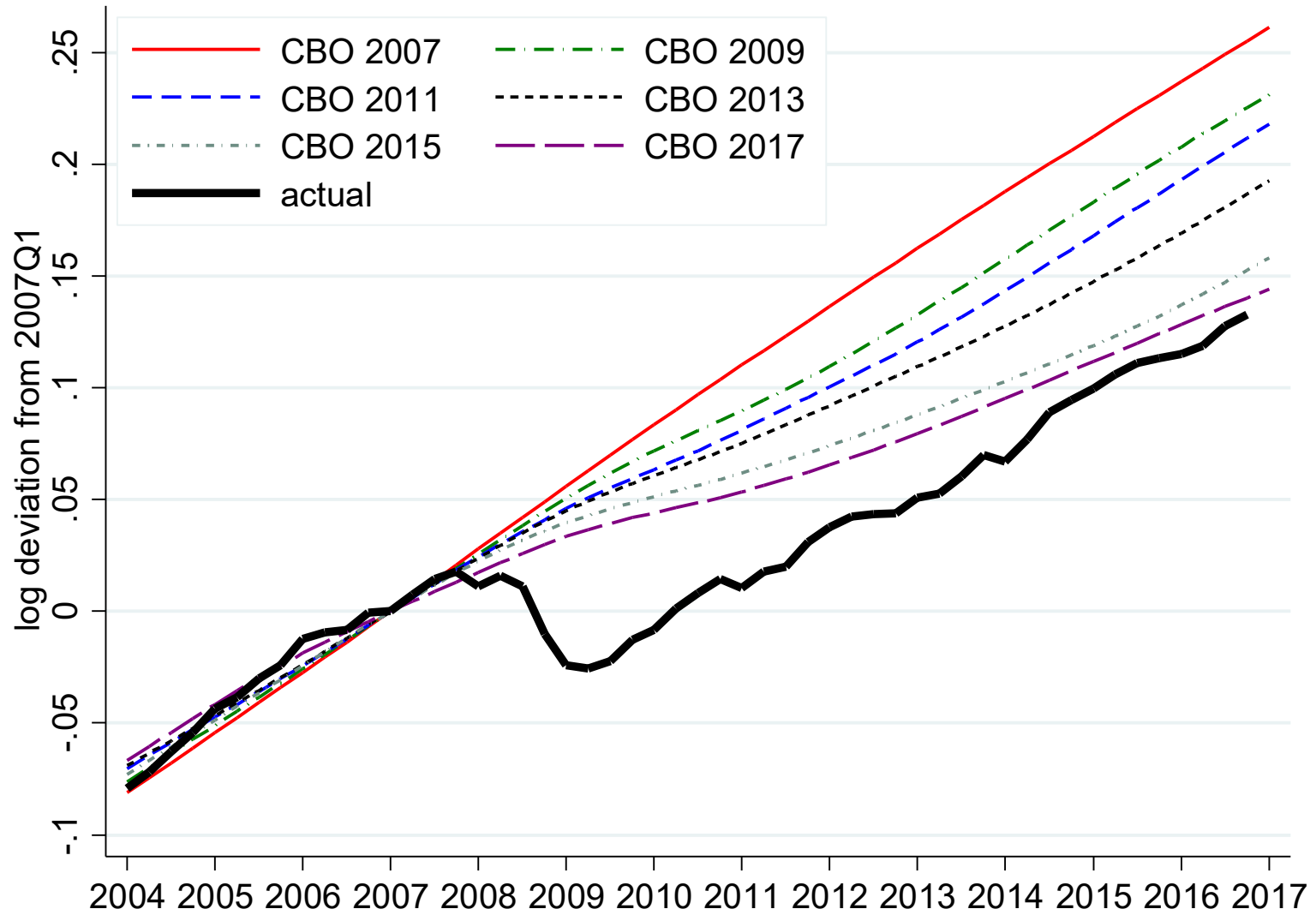
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# EXPLANATIONS?

- Measurement (Coibion, Gorodnichenko, Ulate, 2018)

*Estimates* of potential are too low and there remains a large output gap. So we need large positive policy (monetary and fiscal) shocks to push output back up.



# EXPLANATIONS?

- Measurement (Coibion, Gorodnichenko, Ulate, 2018)
- Hysteresis
  - Supply side

“...real GDP growth has been disappointingly slow during this expansion relative to earlier decades. One key reason for this slowdown has been the retirement of the older members of the baby-boom generation and hence the *slower growth of the labor force*. Another key reason has been the *unusually sluggish pace of productivity growth* in recent years. To generate a sustained boost in economic growth without causing inflation that is too high, we will need to address these underlying causes. *In this regard, the Congress might consider policies that encourage business investment and capital formation, improve the nation's infrastructure, raise the quality of our educational system, and support innovation and the adoption of new technologies...*”

Janet Yellen, Nov. 29<sup>th</sup>, 2017

# EXPLANATIONS?

- Measurement (Coibion, Gorodnichenko, Ulate, 2018)
- Hysteresis
  - Supply side (“permanent” effects on labor supply, productivity)
  - Demand side (lack of demand)

Demand-determined level of output. So we need large positive policy (monetary and fiscal) shocks to push output (and potential) back up.

# HOW TO MODEL HYSTERESIS?

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- Recession negatively affect labor supply (labor force)
- ...
- Recession affect the bargaining power of incumbent workers
  - The insider-outsider insight integrated into the state-of-the-art New Keynesian model!
  - Key policy implication: put a lot more weight on employment.

# COMMENT #1: BROADEN THE MOTIVATION



U.S. took 9 (!) years to recover from the Great Recession

## **COMMENT #2: STUDY THE DYNAMICS OF WAGES**

Option #1: unions set wages, firms choose employment

Option #2: unions set employment, firms choose wages



# COMMENT #2: STUDY THE DYNAMICS OF WAGES



Real wages barely moved during the Recession and recovery. Incumbents set wages?

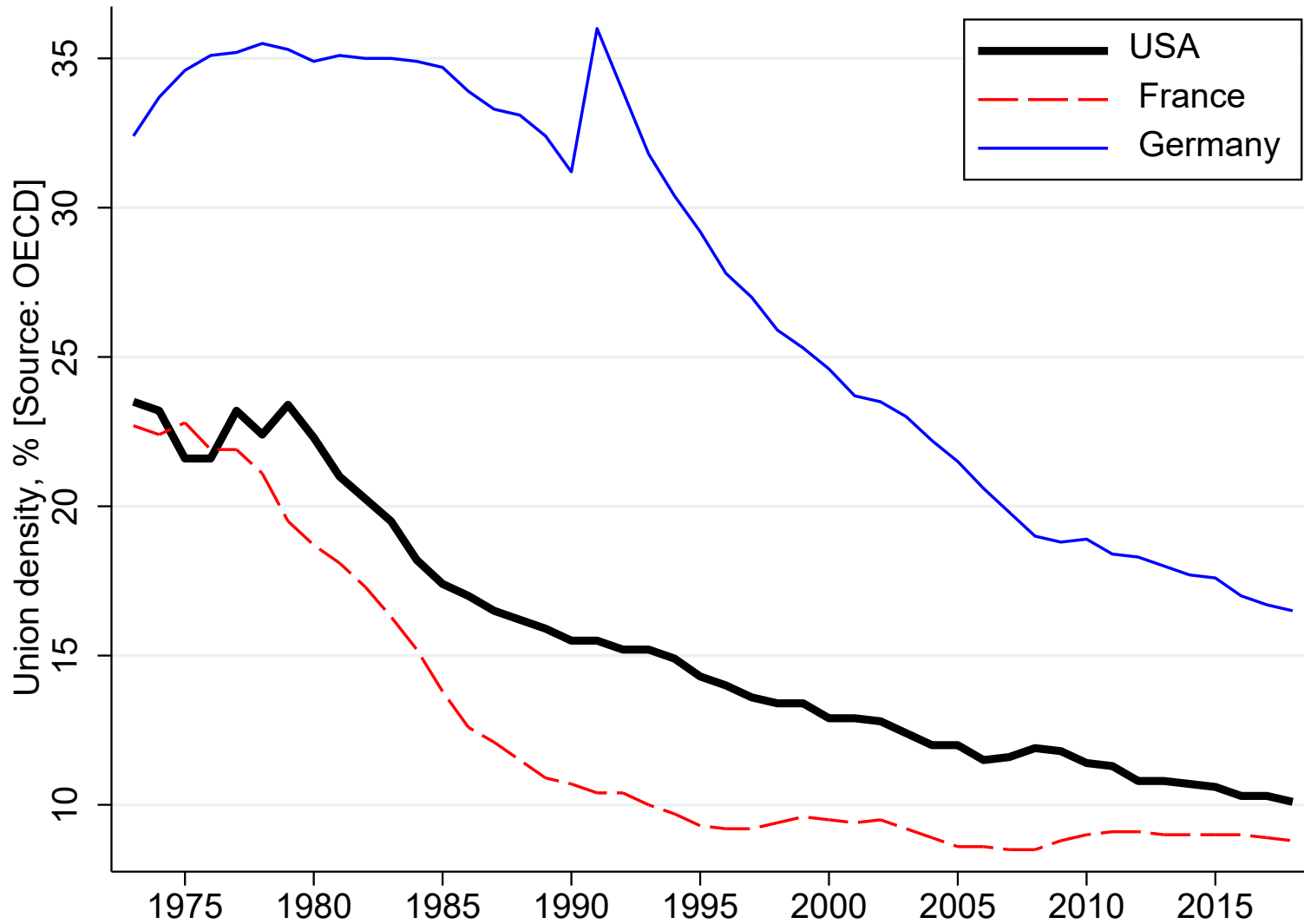
## COMMENT #3: WHO ARE THE INSIDERS?

Traditional story: trade unions are the insiders

Paper:

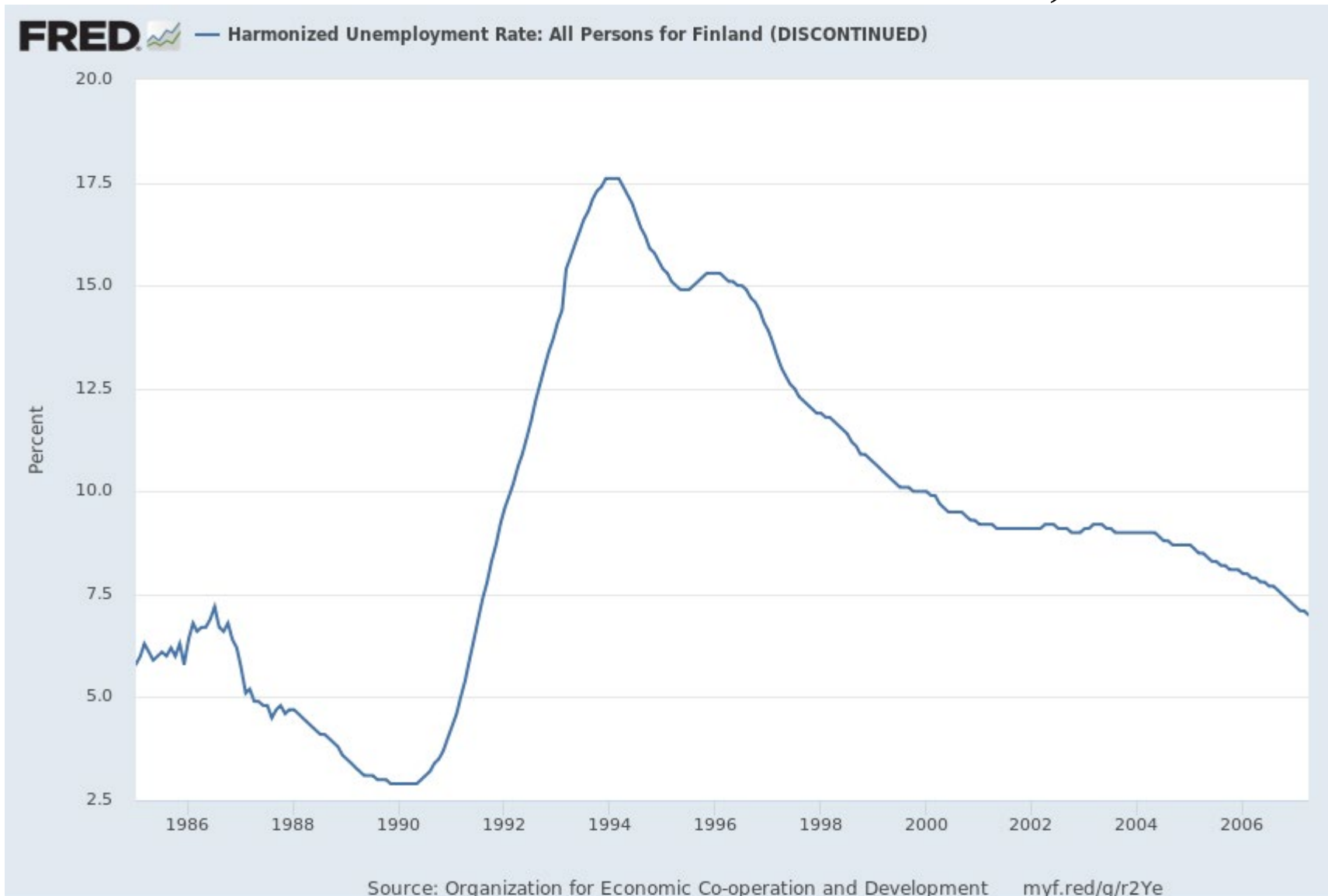
“... employed workers are given a disproportionate weight in the bargaining of wages. This may be the case for a variety of reasons: they are more likely to participate or remain close to the bargaining process, they are the ones with the ability to strike and hence are an important source of the union’s bargaining power, they are more likely to pay their union fees, etc. On the other hand, those who are unemployed are, to some extent, disenfranchised from the wage setting process.”

## COMMENT #3: WHO ARE THE INSIDERS?



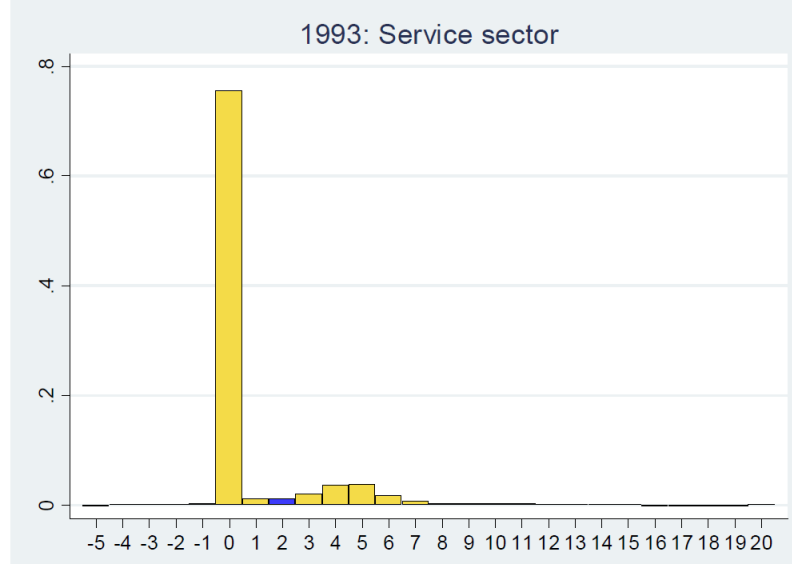
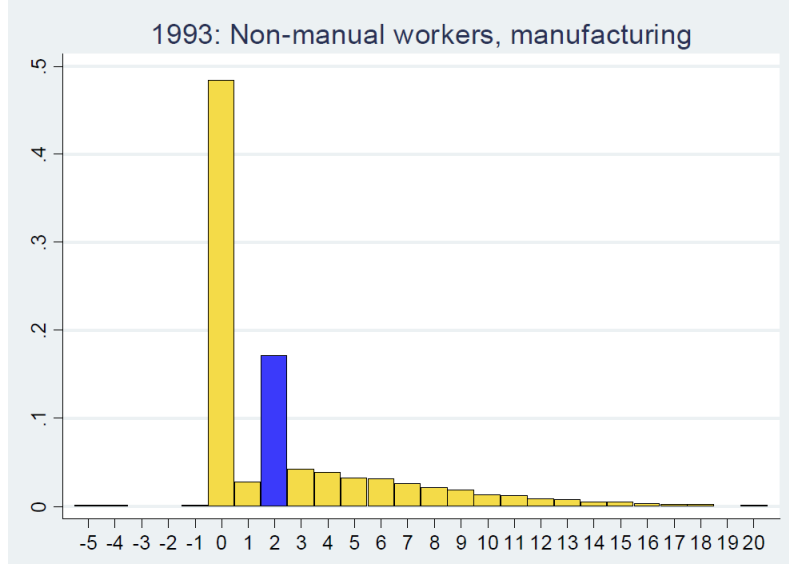
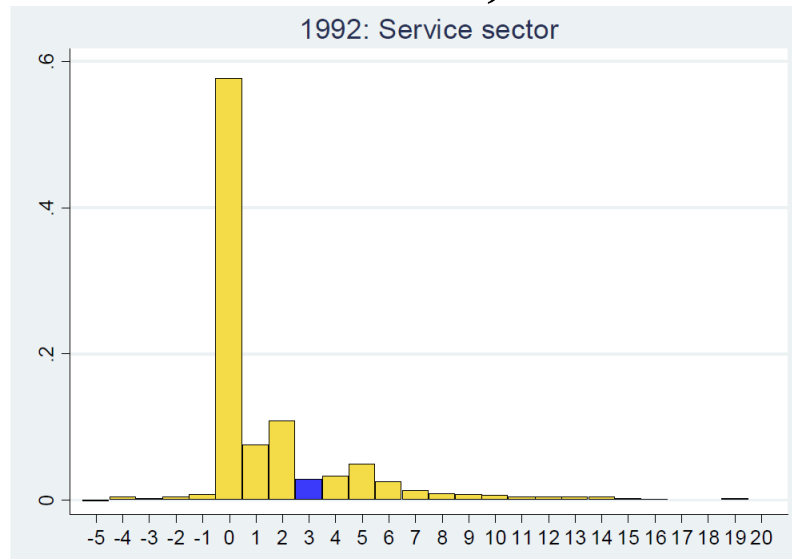
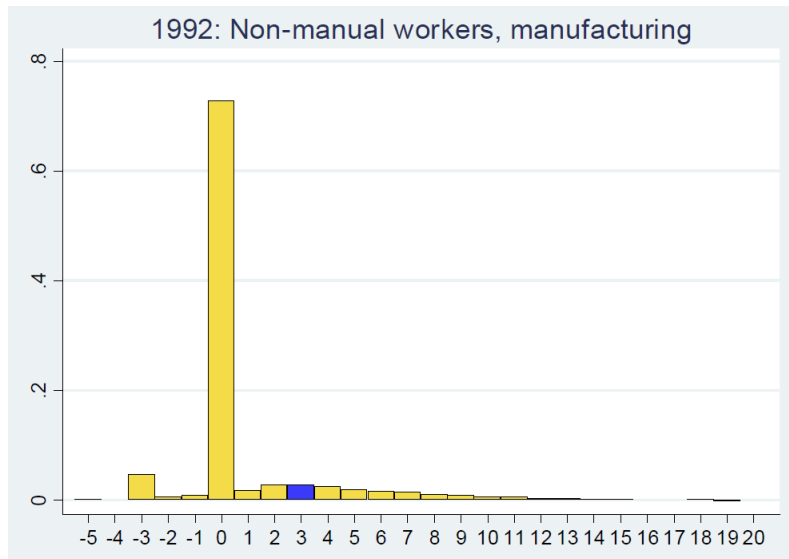
Unionization has been declining... Need a concrete story about insiders

# COMMENT #3: EMPLOYMENT VS. WAGES, FINLAND



Great Depression in Finland after the collapse of the Soviet Union  
(Gorodnichenko, Mendoza and Tesar 2014)

# COMMENT #3: EMPLOYMENT VS. WAGES, FINLAND



Finnish unions (cover >80% of workers) refused to take pay cuts

## **COMMENT #4: NO ENTRY?**

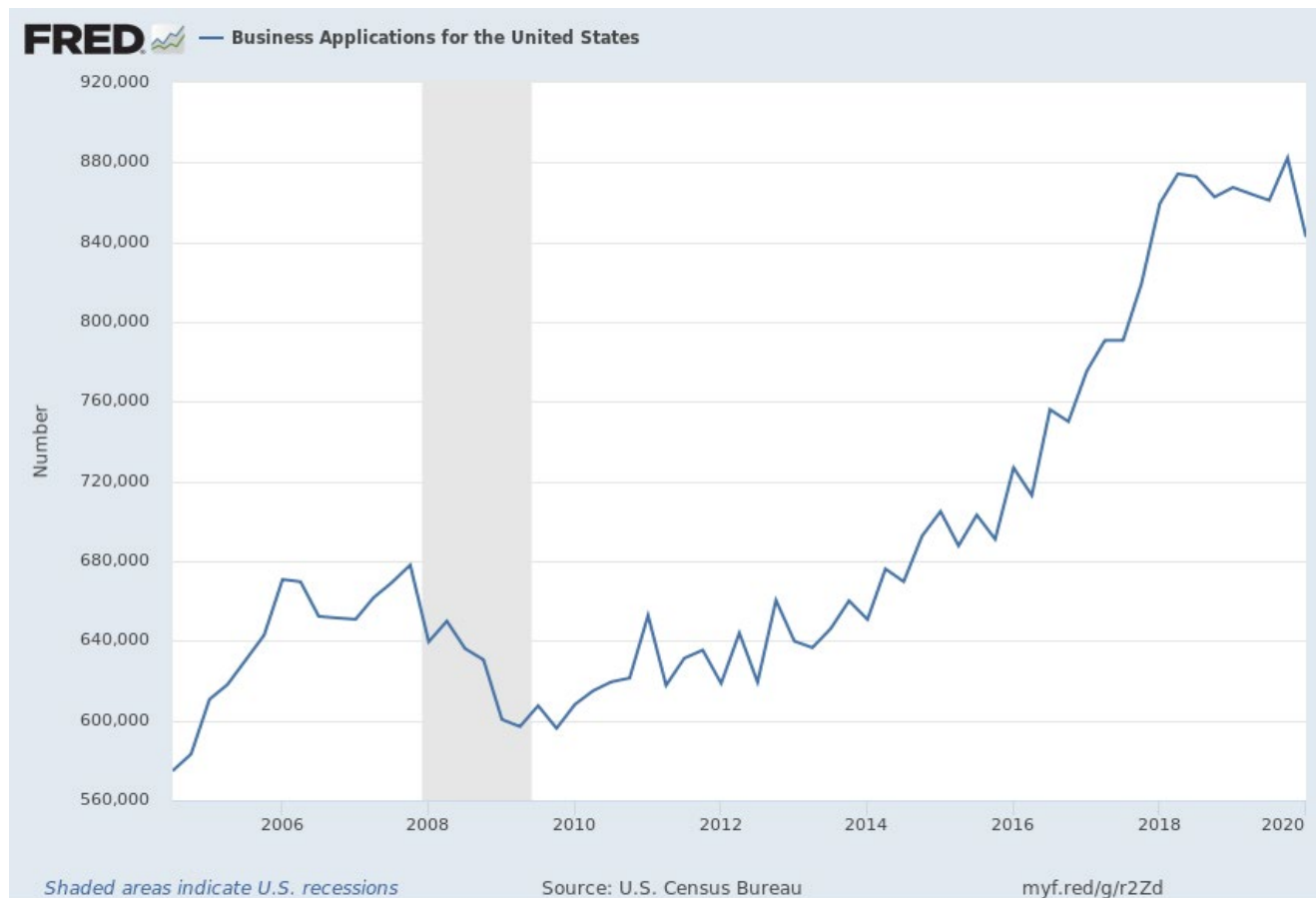
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## COMMENT #5: EMPIRICAL SUPPORT

- Model predicts:  $\pi_t^w = b_0 E_t \pi_{t+1}^w + b_1 \text{Empl. Gap}_t + b_2 \text{Dlog}(\text{Empl}_t)$

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	(1)	(2)	(3)
$E_t \pi_{t+1}^w$	0.54*** (0.15)	0.49*** (0.18)	0.48*** (0.16)
$\text{Empl. Gap}_t$ (HP)	-0.31*** (0.11)	-0.00 (0.12)	
$\text{Dlog}(\text{Empl}_t)$	0.45*** (0.06)		0.38*** (0.06)
Observations	142	142	142
R-squared	0.36	0.05	0.32

# CONCLUDING REMARKS

- Most timely paper and a great read!
- Future work:
  - Study the joint dynamics of wages and employment
  - Who is the insider in the modern economy?
  - Allow firm entry
  - Have a direct test of the mechanism