Comments on
“Insider-Outsider Labor Markets, Hysteresis and Monetary Policy”
by Jordi Galí

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General Comments

- Highly relevant topic
- Elegant and lucid analysis
- Significant implications for the design of central bank mandates and policy strategies
The Job of the Discussant

- Praise the author’s seminal work
- Quibble with some technical details
- Put empirical results in international context
- Shameless promotion of discussant’s own work
Stylized NK Model

Labor Demand Curve: \( \omega^d_t = \alpha_t - \alpha n^d_t \)

Price Markup Gap: \( \mu^p_t = \alpha_t - \alpha n_t - \omega_t \)

\( \rightarrow \) Aggregate price inflation responds to price markup gap

Labor Supply Curve: \( \omega^s_t = c_t + \varphi n^s_t \)

Wage Markup Gap: \( \mu^w_t = \alpha_t + (1 - \alpha + \varphi)n_t - \omega_t \)

\( \rightarrow \) Aggregate wage inflation responds to wage markup gap
Alternative Forms of Labor Market Inertia

- Real wage rigidity (Blanchard & Gali 2007)

\[ \omega_t(j) = \gamma \omega_{t-1}(j) + (1 - \gamma) \omega_i^s \]

- Employment targets (this paper)

\[ n_t^*(j) = \gamma n_{t-1}(j) + (1 - \gamma) n_i^s \]
Elements of Myopia in Wage Setting

• Time-Consistent Targeting

\[ (1 - \beta \theta_\omega) \sum_{k=0}^{\infty} (\beta \theta_\omega)^k E_t \{ n_{t+k}(j) - n_{t+k}^*(j) \} = 0 \]

• Time-Inconsistent Targeting

\[ (1 - \beta \theta_\omega) \sum_{k=0}^{\infty} (\beta \theta_\omega)^k E_t \{ n_{t+k}(j) \} = n_t^*(j) \]
The Monetary Policy Reaction Function

● Respond to Output Growth

\[ i_t = \phi_i i_{t-1} + \phi_\pi \pi_t + \phi_y \Delta y_t \]

● Respond to Unemployment Gap

\[ i_t = \phi_i i_{t-1} + \phi_\pi \pi_t + \phi_u u_t \]
German Unemployment, 1975-2015

Percent

- 1975
- 1980
- 1985
- 1990
- 1995
- 2000
- 2005
- 2010
- 2015

Reunification

Hartz IV
The Evolution of the U.S. Employment Gap

Source: Levin (JEDC 2014)
The employment gap is the sum of the participation gap and the unemployment gap:

$$\bar{n} = \bar{l}_f + \bar{u}_r.$$

The participation gap adjusts slowly to the unemployment rate:

$$\bar{l}_{ft} = 0.97 \bar{l}_{ft-1} + 0.06 \bar{u}_{rt}$$

The unemployment gap and the participation gap have distinct effects on inflation:

$$\pi_t = \beta\pi_{t+1} + \kappa_p(\psi_e \bar{u}_r + \psi_l \bar{l}_f)$$
Figure 10: Optimal Policy under Commitment
Evidence from U.S. Panel Data, 1990-2012

Contemporaneous Explanatory Variables

\[ \omega_{ij,t} = 0.66 \omega_{ij,t-1} - 0.006 \text{unemp}_{ij,t} - 0.091 \text{nonpart}_{ij,t} - 0.021 \text{underemp}_{ij,t} \]

(320.4) (10.3) (40.8) (50.9)

Lagged Explanatory Variables

\[ \omega_{ij,t} = 0.62 \omega_{ij,t-1} - 0.018 \text{unemp}_{ij,t} - 0.093 \text{nonpart}_{ij,t} - 0.020 \text{underemp}_{ij,t} \]

(290.9) (30.6) (41.0) (50.6)

Note: Each regression uses 1,173 observations. All variables are given in natural logarithms. Each equation includes state dummies, time dummies, and 19 demographic controls. The t-statistics are shown in parentheses.

Source: Blanchflower & Levin (NBER WP, 2015)
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