Discussion of "The Cyclicality of the Opportunity Cost of Employment" by Chodorow-Reich and Karabarbounis

Kurt Mitman

Institute for International Economic Studies, Stockholm University

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The Opportunity Cost of Employment

The goal is to accurately measure:

$$\underbrace{z_t}_{\text{Flow utility of U}} = \underbrace{\xi_t}_{\text{Leisure component}} + \underbrace{b_t}_{\text{Transfers tied to U}}$$

- ξ_t:
  - Use large household model
  - Estimate C_u/C_e using micro evidence from CEX/PSID
- b_t:
  - Programs: UI, SNAP, TANF, Medicaid
  - Micro evidence to disentangle component tied to U
  - Aggregate data on dollars spent

Finding: ξ_t, strongly pro-cyclical, b_t counter-cyclical but $b_t << \xi_t$, so z_t is pro-cyclical, elasticity wrt productivity ≈ 1

Why z_t? And why cyclicality?

- Ultimately, interested in understanding dynamics of the labor market
- z_t in the context of DMP:
  - Surplus from employment $p_t - z_t$
  - Surplus split by bargaining, worker bargaining power determines w_t
  - Firm profits $\pi_t = p_t - w_t$
  - To generate dynamics need volatile π_t, can be achieved by depending on level and cyclicality of w_t
  - If elasticity of z_t wrt p_t is less than that of w_t, can adjust level and bargaining power to generate volatility

The Large Household

$$\xi_t = \frac{\overbrace{[U^u(C_t^u, 0) - \lambda_t C_t^u]}^{\text{Leisure of Unemployed}} - \overbrace{[U^e(C_t^e, 0) - \lambda_t C_t^e]}^{\text{Leisure of Employed}}}{\underbrace{\lambda_t}_{\text{Marginal utility wrt C}}}$$

What happens when p increases?

- Wages of employed increase $\Rightarrow$ household is wealthier
- Consumption of employed goes up $\Rightarrow \lambda \downarrow$
- Perfect risk sharing between E & U $\Rightarrow$ consumption of unemployed goes up
- High wages of E subsized U
- Pro-cyclical $w \Rightarrow$ pro-cyclical ξ_t

Consumption vs Expenditure

- Aguiar & Hurst (2005):
  - Expenditure $\neq$ consumption
  - Drop in C associated with expenditures associated with work (e.g. meals away from home)
- Kaplan & Menzio (2013): Unemployed pay less for same goods
- Use CEX for shares, but NIPA for aggregate?
  - Aggregated CEX under measures consumption
  - Less volatile and less pro-cyclical than NIPA
- What about service flows from durables?

Incomplete Markets/Heterogeneity

Why not calibrate model a la Krusell, Mukoyama & Sahin with benefit eligibility/take up?

BUT, Chang & Kim (*AER* 2007,2014):

- Incomplete markets, endogenous extensive labor supply, heterogeneity in productivity
- No benefits, $b_t = 0$, only ξ_t component
- Opportunity cost is pro-cyclical, but $\hat{\epsilon}(\xi, p) << 1$ (Consistent with Koenig, Manning & Petrolongo 2014)
- Individual reservation wages don't move much, but distribution of reservation wages.
- Volatility comes via marginal worker changing

Value of Benefits

Authors find $b = 0.041$ marginal product of employment:

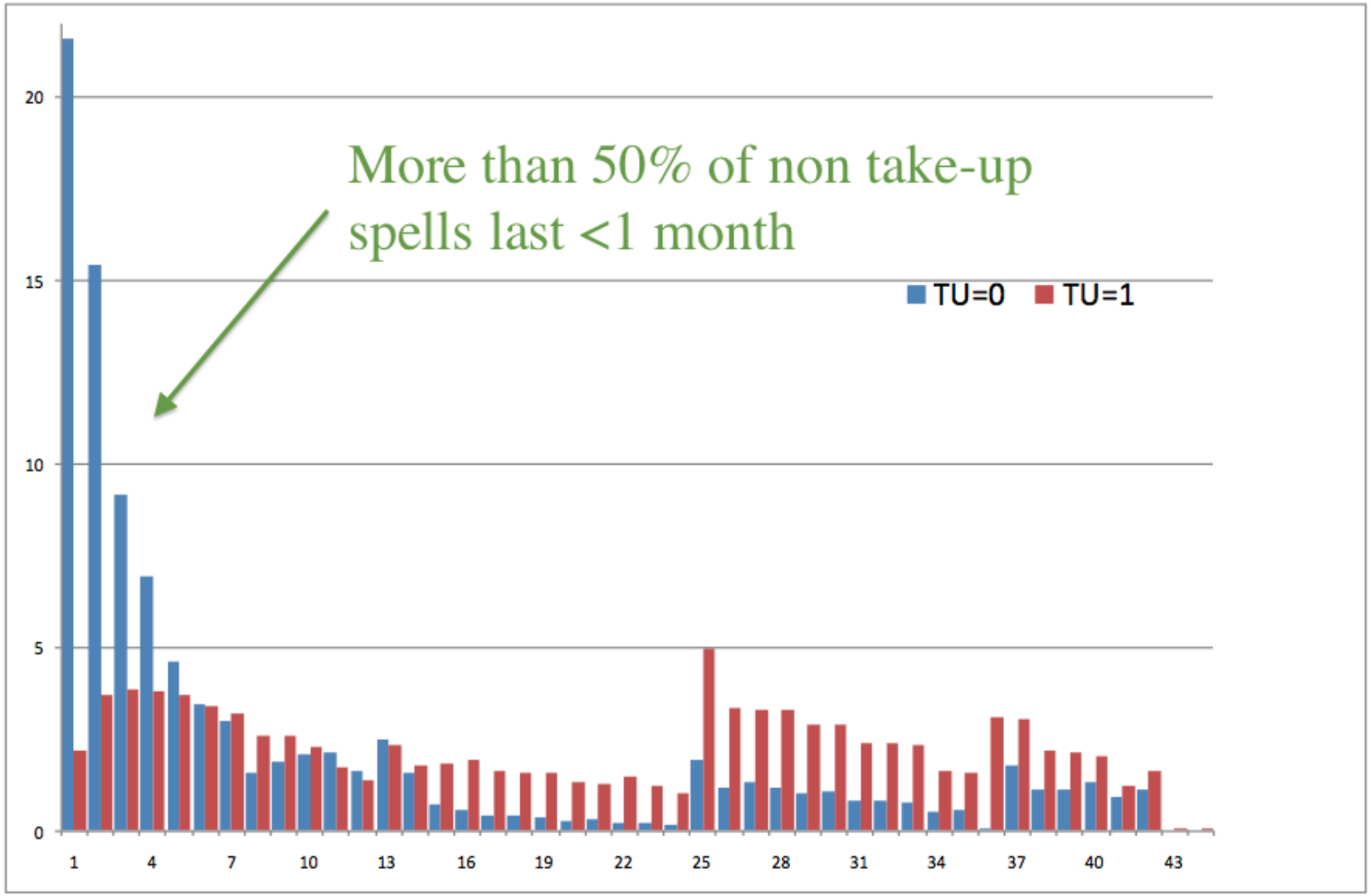
- $b_t \approx$ aggregate dollars spent on UI divided by number of unemployed divided by GDP per capita, net disutility of take-up

At micro level (Auray, Fuller & Lkhagvasure 2014):

- Fraction eligible $\approx 60\%$, Take up $\approx 75\%$
- Receive 45% of previous earnings $\Rightarrow$
  $0.66 \times 0.75 \times 0.45 = 0.223$
- b relative to individual productivity the relevant margin

Why convex cost of take-up? Stigma goes up in recessions?

Take-up Rates



Distribution of U duration by take-up, Blasco & Fontaine (2012)

Reconcile b with the Lit

- Huge literature looking at the effects of UI on unemployment (e.g. Meyer, Katz & Meyer, Card & Levine+ many more)
- Chetty (2013) Consensus: 10 week benefit extension leads to 1 week increase in unemployment duration
- Rothstein (2011) and Farber & Valletta (2013) conclusively showed not because of search effort
- Hagedorn, Karahan, Manovskii & Mitman (2013): 10 week extension leads to 1.1 week increase in duration

Philosophy of the Exercise

Want to identify z_t

- Use model A to identify z_t
- Given z_t from model A, say model B is bad

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Why not the opposite?

- Use HM to identify z_t
- Given z_t from HM, say CRK is bad