Discussion of:

Fiscal policy in EMU with downward nominal wage rigidity

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Short Summary

They ...

- evaluate the state-dependent effectiveness of a cut in SSC (compared to government spending)
  - in a multi-country (IT-REA-ROW) estimated model with occasionally binding constraints (DNWR and ZLB).
- show that DNWR has exacerbated the crisis (2% of GDP).
- find that the multiplier of a SSC reduction is higher under DNWR.
- show that a SSC reduction generates persistent output effects $\Rightarrow$ reduces budgetary costs of reform.

Praise

- Important contribution to literature on state-dependent effects of policies.
- They explained the underlying economic mechanisms very well.
- Extremely relevant question and policy conclusions for high-debt EU countries.

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Table 12: Reasons for not hiring workers with a permanent job contract

(percentages)

	Not relevant	Of little relevance	Relevant	Very relevant	Total
Uncertainty about economic conditions	4.6	6.8	42.5	46.0	100
Insufficient availability of labour with the required skills	19.2	38.0	33.2	9.6	100
Access to finance	23.6	32.5	28.9	15.1	100
Firing costs	12.8	23.9	32.5	30.9	100
Hiring costs	18.9	39.6	27.1	14.4	100
High payroll taxes	3.8	9.1	32.9	54.2	100
High wages	11.9	47.1	30.7	10.3	100
Risks that labour laws are changed	10.6	31.2	38.1	20.2	100
Costs of other inputs complementary to labour	17.0	38.0	33.7	11.3	100

Note: weighted statistics (weights post-stratified in order to match the number of firms in the underlying population).

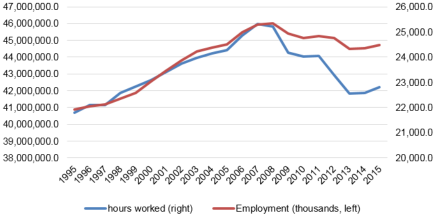
Source: D'Amuri et al. 2015, ECB-WDN Country Report Italy.

Comment 1: Motivation - Why Italy?

- In 2018, Italy had the **3rd highest labor tax wedge** among OECD countries (OECD Taxing Wages, 2019).
- Around **60% of Italian firms adjust their wages less frequently than once a year**, in other countries, most firms adjust once a year.
- Italian firms are **more likely to reduce labor input** (29 %) than to only cut/freeze wages (6%).

(Numbers are based on the ECB-WDN survey as in Branten et al. 2018 and D'Amuri et al. 2015.)

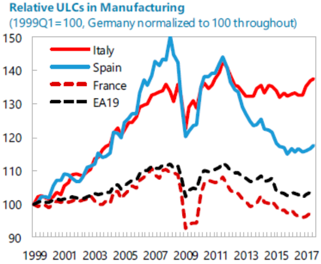
Figure: Hours worked and Employment in Italy



Data Source: Istat, 2019.

Comment 1: Motivation - Why Italy?

- In recent years, a 30 % gap in ULC between Italy and the EA has opened $\Rightarrow$ consequences on Italian competitiveness (Kangur, 2018).



Source: Kangur, 2018.

Comment 2: The Role of Bargaining

- In Italy, 99% of workers are covered by a collective pay agreement (Boeri, 2014).
  - The majority of the workforce is covered by sectoral agreements which are extended to the national level.
  - Firm-level agreements are possible, but much less common, very rare in the (poorer) south of Italy.
- **Interesting model extension:** Add a frictional labor market with a collective bargaining regime.
  - Closer to the Italian institutional setting.
  - Effects most likely depend on modelling of worker's outside option (fixed vs. wage-dependent).
- Role of intensive vs. extensive margin of labor adjustment (Attinasi et al. 2016).

Comment 3: The Fiscal Rule

- You assume that government expenditures are fixed in real terms. Government budget closes via a labor income tax.
  - Shift of the tax burden from employer to employee?
  - Overall tax wedge?
- Cut in employers' SSC vs. cut in employees labor income tax.
- My suggestion: Compare different settings.
  - Importance of the choice of fiscal instrument to compensate for public revenue losses.
  - **Fiscal devaluation**
    $\Rightarrow$ finance SSC reduction via increase in consumption tax.
    $\Rightarrow$ What if you increase the profit tax instead?
- How do these measures compare in terms of social welfare?

Further Comments

- Relevance of the share of liquidity constraint households?
  - Use survey evidence for calibration?
- Fiscal measures only if DNWR regime is binding.
  - Do agents know and anticipate that?
- **Future work:** The role of binding financial/credit constraints?
  - **Relevance for Italy:** More than 50 % of firms that reduced labor input faced financial constraints (D'Amuri et al. 2015).

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