

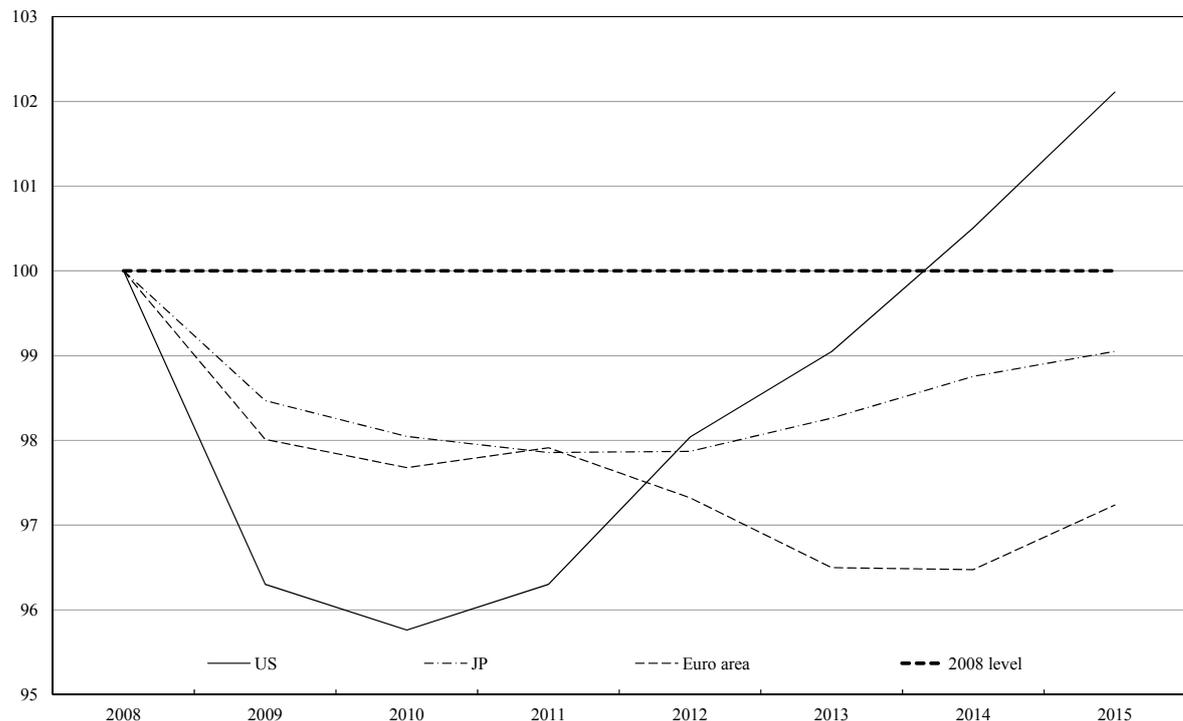
**COMMENT TO
 “A FISCAL JOB? AN ANALYSIS OF FISCAL POLICY AND THE LABOR MARKET”
 BY ELVA BOVA, CHRISTINA KOLERUS AND JULES S. TAPSOBA**

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The paper is very rich and offers two complementary focuses. The first one regards the analysis of the cyclical pattern of employment and unemployment, in particular of its asymmetry. This analysis echoes the “jobless recovery” literature and is particularly topical in this time of nascent and moderate recovery (see Figure 1). The second focus is on the impact of public finances on the business cycle and the identification of fiscal variables apt to boost a recovery. This perspective is relevant in the current context of fiscal constraints in many countries, highlighting the importance of quality of public finances. This discussion sets out the main findings of the paper and continues with general remarks. Then, it presents some caveats or room for improvement.

Figure 1

Employment Level
(2008=100)



Source: AMECO (Autumn 2013).

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 The views expressed therein are those of the author only and do not necessary reflect those of the European Commission.

Table 1

Impact of Fiscal Variables

<i>Increasing discretionary current spending</i>
Spending on goods and services (++) Public sector wages (+) Unemployment benefits (-) Early retirement benefits (-) Active labor market policies (?)
<i>Cutting tax rates</i>
Labour taxation (social contributions on employment) (++) Consumption taxes (VAT) (+) Therefore: fiscal devaluation (+) Personal income tax (+) Corporate income tax (+) Fiscal policy can help close the employment gap
<i>Effect unchanged in recessions and recoveries w.r.t. normal times</i>
Spending on goods and services (++) Public sector wages (+) Unemployment benefits (-) Early retirement benefits (-) Social contributions on employment) (++) Corporate income tax (+)
<i>Different in recession and recoveries w.r.t. normal times</i>
Consumption taxes (VAT) (+) Personal income tax (+) Active labor market policies (?)

1 Main findings

The paper confirms the validity of the Okun's law, by finding a stable relationship between unemployment/employment gaps and output gaps across different specifications. It also shows its asymmetric pattern. Recessions cause a widening of unemployment gaps during a time horizon of up to two years, while the cumulated impact of recoveries is not stable.

The paper also shows that fiscal policy can help close the employment gap. Table 1 summarises the main findings related to the impact of fiscal variables.

2 General remarks

The topics covered by the paper are very relevant. Its findings are in line with the literature. The paper is well drafted, albeit too concise sometimes. It highlights key policy messages, based on sound intuitions rather than econometric sophistication.

The approach of the paper rests on macroeconometric panel analysis, covering many relevant fiscal variables (see Table 1 above) in a holistic view. The empirical framework is fairly simple but uses a relatively large numbers of empirical observations (although not for all variables), covering 25 years over 32 OECD countries.

The two specifications used are:

- Okun's law (U, E) + fiscal variables + interacted terms

$$U_t - U_t^* = \beta_0 + \beta_1(Y_t - Y_t^*) + \beta_2 f(X_t) + \beta_3(Y_t - Y_t^*) f(X_t)$$
- Dummy variables (with lags) of recessions and recoveries + fiscal variables + interacted terms

$$U_t - U_t^* = \beta_0 + \beta_1(Rec) + \beta_2 f(X_t) + \beta_3 f(X_t) (Rec) + \beta_4 f(X_t) (Recov)$$

3 Caveats and room for improvement

Following are four main points that may deserve specific discussions or further work.

3.1 Running robustness checks on the indicators of business cycle

The definition of the cycle is convenient but rough, namely the use of the HP filters, while heated debates in some countries arose about the true magnitude of the business cycle (e.g., for Spain). There is a need to cross-check the results using NAWRU and potential output (based on a production function approach instead of a purely statistical filtering. The use of annual data is not fully adequate to a recession/recovery analysis, where quarterly data preferable when it comes to computing the output gap. Lastly, alternative definitions of discretionary measures could be used. While the paper uses a top down approach (residual from simple fiscal rules), it could be complemented by a bottom up perspective, using the sum of legislated changes in spending.

3.2 Acknowledging the microeconomic dimension and the quality of policy design, not captured by macro approaches

The macro-approach needs to be qualified. Beyond the monetary value of expenditures and revenue, the micro policy design should be taken into account. The importance of micro effects should be recalled shortly in the paper.

For revenue, the detailed policy design matters a lot:

- Targeting tax cuts on the most vulnerable groups (tax shift focused on the low-skilled/low wage earners and second earners)
- Design of tax bases (e.g., Keen, 2013, for the structure of VAT, exemption and reduced rates),

- Interaction with tax compliance (some increases in statutory rates may stimulate grey economy and blur the frontier unemployment/employment in absence of good tax governance).

For expenditures, the policy design matters a great deal as well, explaining some unclear macro results (Arpaia and Mourre, JES, 2009):

- Role of the incentives (activation mechanism and monitoring in ALMP, duration and job-search criteria for unemployment benefits),
- Targeting expenditures on the most vulnerable groups (employment support, in-work benefits),
- Administrative capacity for efficient implementation (public employment services, vocational training).

3.3 *Fleshing out the very brief discussion of fiscal devaluation*

The paper could include a short discussion on tax shift, which recalls its two main dimensions:

- supply side effects (increase incentives to work) operating mainly in the long run but also in the short term. This corresponds to the structural impact of a tax shift,
- short term competitiveness effects or “fiscal devaluation” effect. It operates through cuts in labour costs, with increase in labour demand, as claimed in the paper, but also through terms of trade effect since exports are VAT-free.

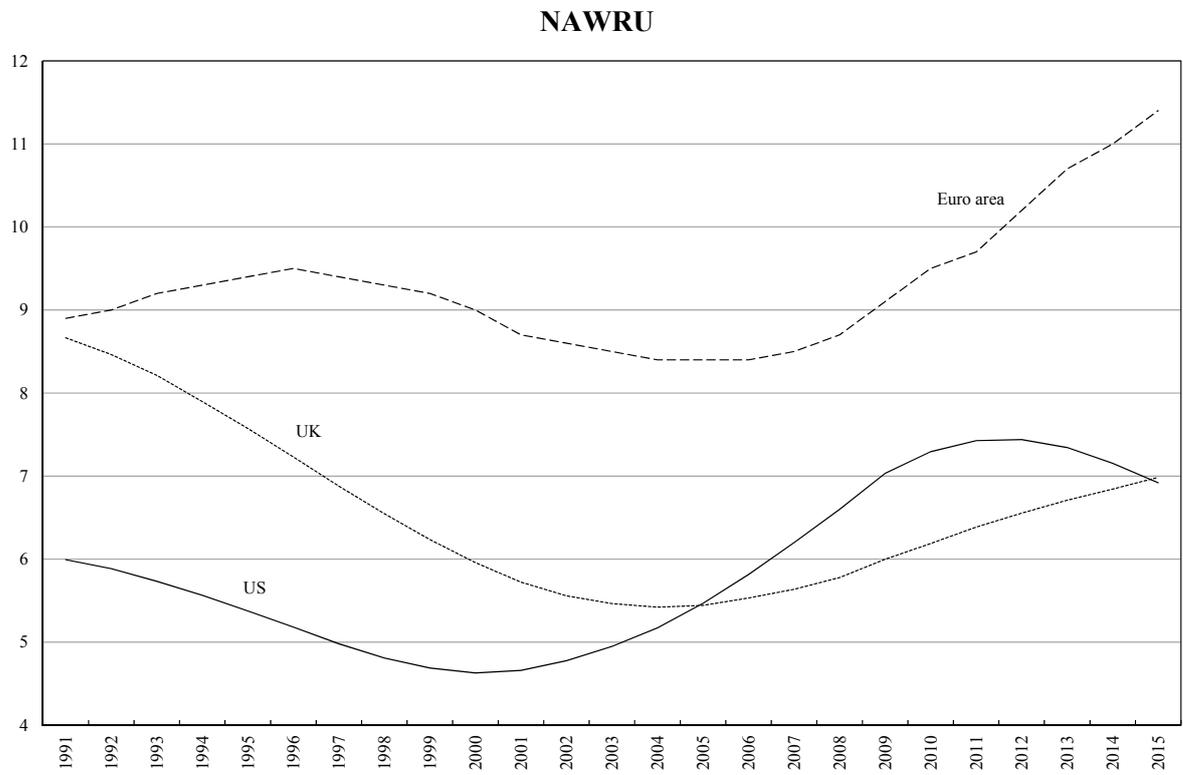
The fiscal devaluation impact is not very strong, if many countries are applying it at the same time (beggar-thy-neighbour policy). Moreover, fiscal devaluation is perhaps less suited in times of recession or low business cycle, while it is possibly better suited in case of structural loss in trend output, due to cumulated loss of competitiveness.

3.4 *The development of (un)employment gap in recovery: checking if the results hold in different country groups*

The evidence supporting an unstable effect of recovery on (un)employment gaps is a bit thin. A possible explanation (not highlighted in the paper) is the great deal of uncertainty at times of nascent recovery. The latter is also established statistically with some delay. This encourages prudent behaviour by firms regarding hiring and investment.

As a concrete suggestion, the paper may differentiate by group of countries, to see if the pooling assumption is correct. This would be economically justified by the difficulty to disentangle cycles from trends and the existence of very different trends across (groups of) countries. For instance, different results are expected for European Countries, compared with other advanced economies and emerging economies. In the euro area, the structural unemployment, captured by the NAWRU, is higher than that of the US or UK and on an upward trend, as shown in Figure 2.

Figure 2



Source: AMECO (Autumn 2013).

