Mark Gertler opened the discussion by suggesting that the type of fixed costs used to justify changes in labor supply along the extensive margin can be important for explaining the low sensitivity of labor supply to temporary wage or tax changes. Large “setup” fixed costs associated with entering the labor market might reduce the incentive of workers to exit the market in response to temporary wage or tax changes. Raj Chetty agreed that these types of frictions are important, and drew a connection to the question raised by Orazio Attanasio and Robert Shimer as to whether the quasi-experiments the authors consider identify the Frisch elasticity, or some combination of this elasticity and structural frictions, such as fixed costs. Chetty argued that macro elasticity estimates should take all these different effects into account, and explained that it is possible to interpret the paper’s estimates as combinations of preference-based and frictional components, rather than simply as pure preference parameters.

A number of participants touched upon the challenges that heterogeneity in the labor market poses for mapping micro elasticity estimates to the macro level. Jonathan Parker explained that ideally, macro models should feature a rich labor supply sector that realistically captures all the heterogeneity in the market, and that is carefully calibrated to match the microdata. But in practice, especially when labor supply considerations are not of central importance, it can be useful to rely on more simplistic models of the labor market. He therefore suggested that a useful extension would be to more formally characterize the conditions under which it can be appropriate to use micro estimates, which reflect many dimensions of labor market heterogeneity, to calibrate the parameters in these more simplistic macro models.
James Poterba made a related point about the difference in measurement between tax rates used in micro studies and macro studies. He explained that micro studies often exploit nonlinearity in agents’ budget sets to accurately pin down the relevant tax wedge that they face. For example, research by Gruber and Wise (1999) takes disability insurance and other social transfers into account when calculating the marginal return to remaining in the labor force. These micro measures, moreover, can be very different from those based only on average tax rates, such as the ones often used in cross-country macro comparisons.

Following up on these two ideas, George-Marios Angeletos expressed skepticism about whether it is even necessary to discipline models built to answer macro questions with the microdata. In particular, he explained that it is possible to redefine the parameters controlling the elasticity of labor supply in macro models so that they simply represent the response of equilibrium aggregate employment to aggregate wage fluctuations. Tautologically then, the model’s calibration would only depend on aggregate data.

In response to the issues raised concerning agent heterogeneity and mapping micro estimates to macro models, Raj Chetty made three points. First, he acknowledged that the type of practical guidance suggested by Jonathan Parker certainly deserves greater attention. Second, in response to James Poterba, he clarified that the authors do include in their analysis studies focusing on retirement behavior, such as the research led by Gruber and Wise (1999), and use the measures developed by this literature to compute the micro elasticities reported in the paper. He acknowledged that computing tax rates net of transfers is more of a challenge for cross-country comparisons such as Prescott (2004), but explained that the authors’ preferred macro estimates actually come from Davis and Henrekson (2005), who make an effort to correct for these difficulties. Third, in response to George-Marios Angeletos, he clarified that they do not advocate calibrating the basic macro labor supply model to the microdata. Rather, the main thrust of the paper is to demonstrate that this basic model is simply inconsistent with the microdata along certain dimensions.

Mark Bils and Robert Hall both commented on aspects they would like to see receive more attention. Bils argued that greater emphasis should be placed on how wealth effects to labor supply can drive movements along the extensive margin, as opposed to which value of the Frisch elasticity parameter is “best.” In his view, focusing on the relationship between consumption and productivity for agents at the
margin between entering and exiting the labor force is more promising than simply focusing on consumption and productivity at the aggregate level. He cited Chang and Kim (2006) as one paper that moves in this direction by allowing for compositional effects in aggregate productivity and consumption. Hall also made a general call for the development of more careful structural models of the labor market, in particular models that imply predictions about the cyclical behavior of aggregate unemployment. In response, Raj Chetty suggested the possibility of using the elasticity estimates reported in the paper to help calibrate these newer structural models, and to help quantify the fraction of the labor response that comes from labor supply relative to other frictions, such as search and matching.

Finally, Greg Mankiw requested that the authors clarify why they claimed that the macro elasticity implied by the cross-country evidence are roughly consistent with those from micro studies, while Robert Shimer argued in his comments that this is not the case. Raj Chetty explained that the difference depends on the distinction between a Frisch (intertemporal substitution) elasticity and a Hicksian (steady-state) elasticity. Figure 2 of the paper plots the difference in tax rates across countries against hours of work. Since the source of variation is the permanent difference in tax rates across countries, this data directly identifies a Hicksian elasticity, not a Frisch elasticity. The Hicksian elasticity, moreover, is what the authors argue is consistent with micro estimates. Work by Browning (2005) shows that under time-separable utility, the wedge between the Hicksian and Frisch elasticities is increasing in the size of the income effect. Chetty explained that Prescott (2004) finds a large Hicksian elasticity as a result of his parametric utility specification, which produces large income effects inconsistent with microeconomic evidence. A more detailed discussion of this issue is included in section III of the paper.

References

