Comments on the paper:

"Search, Flows, Job Creations and Destructions"

by Pierre Cahuc presented at the EALE 25th Memorial Sessions.

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The article by Pierre Cahuc discusses the development of search and matching in the last decades, which is the new approach to model labor markets characterized by frictions in the form of delays due to information gathering and transaction costs. The main message is that, in contrast to a static model of perfect competition, search theory has provided a framework for understanding job and worker flows, wage dispersion, and generated important new insights into the effects of labor market policy. The perspective given in the article is that search theory has been a successful area of research providing both theoretical and empirical progress. This progress has generated new insights into policy issues related to the design of labor market institutions, such as unemployment insurance and employment protection legislation. This view of the developments in the literature has emerged as a consensus among most economists. It is also evident from the popularity of the search approach in other areas of economics beyond labor markets.

Despite these developments, Pierre Cahuc notes that there are important theoretical and empirical questions that need to be addressed in future research. From a theoretical perspective, the canonical search and matching model has difficulties in matching business cycle facts, such as the volatility of unemployment and vacancies. The main reason for the failure to fit the data is that in the model wages respond flexibly to productivity shocks that hit the economy, so fluctuations in labor productivity have little impact on aggregate measures. In recent years, various solutions have been

proposed in the literature that attempt to overcome this limitation. Looking forward, we may expect to see the formulation of a more comprehensive model which will be able to match the data.

From an empirical perspective, despite a large number of studies using new data such as large employer-employee data sets, and new statistical methods, Pierre Cahuc is making a call for more and better data at higher frequency, which will permit a more detailed analysis of labor market flows and outcomes. Access to better data which track individual choices at higher frequencies (even at daily level) is certainly important. Currently, it is possible to observe transitions across labor market states with a high precision using administrative data, which are available from various countries. However, we have limited information about other important aspects that are related to predictions coming out from the basic job search model. For example, we do not have good information about how search effort and the reservation wage vary over the duration of the unemployment spell. While the existing theory offers very clear predictions, there is very limited empirical evidence because most surveys are yearly, or at best quarterly.

Better data may also enhance our understanding of the spike in the job finding rate around benefit exhaustion. While theory predicts a positive shift in the exit rate close to benefit exhaustion, many studies from various countries have documented the existence of a spike. In addition, better data can provide answers to whether the positive correlation between generosity of benefits and unemployment duration have to do with adverse effects on search behavior, or with lifting liquidity constraints so that unemployed workers can find better jobs. To disentangle these two sources of prolonged unemployment duration requires a better understanding of the way unemployed search and how this changes over time.

While the empirical research has devoted most of its attention to the elasticity of unemployment duration with respect to benefit generosity, we still do not know a lot about the impact of

unemployment insurance on total unemployment. The elasticity of unemployment duration with respect to benefit levels or benefit duration does not provide a direct answer because of search externalities which matter differently over the business cycle. Having a worker searching less or be more choosy may not necessarily reduce efficiency because lower search effort affects others' chances of finding employment. This is expected to be more important during recessions when jobs opportunities are limited. In addition, benefits may allow to search for better jobs, which may offset the effect on unemployment going through longer spells of unemployment. Additional evidence from various countries on the effect of unemployment insurance on total unemployment is necessary in order to provide evidence based policy recommendations on an issue that emerges in the policy debate during every recession when governments extend their safety-nets.

Related to the last point is how workers' search behavior changes over the business cycle. In the canonical model of search and matching aggregate fluctuations are driven by the number of vacancies posted by firms. Extensions of the model allow for worker's search effort to determine the fluctuations of employment and unemployment. Examining the cyclical behavior of individual search effort can provide valuable information on the source of volatility in the labor market and shed light on the overall impact of benefit extensions during recessions.

Finally, a lot can be learned about the optimal design of labor market policies, such as unemployment insurance and active labor market policies, by using ideas developed in recent decades in the field of behavioral economics. For example, the way individuals discount the future, understand the rules of the game, and are influenced by the behavior of others are likely to explain observed behavior and provide insights for policy changes that will increase welfare without reducing efficiency.