Comment on
“Global factors, Unemployment Adjustment and the Natural Rate” by Ron Smith and Gylfi Zoega

The present paper studies the expected returns of employment on the of OECD unemployment using principal component analysis. The authors try to measure the effect of labour market institutions on the unemployment adjustment through four macroeconomic variables. The empirical framework show that institutional variables have no effect on the equilibrium level of unemployment, that the increased coordination reduces the speed of adjustment; that increased employment protection, reduces the short run effect of changes in the global factor but increases the long run effect; and that a higher replacement ratio increases the short run effect of changes in the global factor.

The results seem interesting with reference to their policy implications especially for Mediterranean countries where the unemployment rates are relatively high. The role of institutional factor in the adjustment of unemployment should be considered using several variables such as employment protection and the degree of coordination. However some findings are still unclear and even imprecise.

First of all, the principal component analysis needs to be clearly presented and detailed. The authors should describe the technique and justify the use of OECD unemployment as a common component. In addition the variable “shocks” should integrate both national and international shocks for the studied countries.

For the model presented in the first section, the parameters need to be defined and interpreted. Estimation results are presented without interpretation and thus the authors should give more explanations about the R-squared and the sign of each coefficient, with reference to previous literature.

Furthermore, it would be interesting to illustrate using an example of institution which could influence the adjustment of unemployment. For example, French case as well as other Mediterranean countries shows particular specificities regarding labour market features such as low flexibility, high levels of coordination and of unemployment.

Some other econometrical issues need to be reviewed:

- The selectivity regarding the missing data especially for the fixed effect models.
- Differences in R-squared for each countries:
- The Swamy RCM ?
- The Heckman procedure to deal with selectivity

Finally, I suggest the alternative use of the Oaxaca-Blinder decomposition technique in order to explain the differences between countries regarding unemployment rates and regarding the effect of institutional variables. The authors could also use the decomposition technique for binary or ordinal variable using Yun (2004) procedure.

References:

- Oaxaca, R. &. Ramson, M.R., (1994): “On Discrimination and the Decomposition of Wage Differentials”. *Journal of Econometrics,* 61 (1), 5-21.
- Yun, M S., (2004). Decomposing differences in the first moment, *Economics Letters*, 82, 275-280.