I have a couple of technical remarks and suggestions.

- The specification of optimal employment in Eq. (2) is an exact one, i.e. it does not include any idiosyncratic component. What if the channel through which labour market institution affect the adjustment process is the idiosyncratic component entering Eq. (2), rather than the parameters of the cost function in Eq. (3)

- To allow for higher order dynamics in Eq. (12) it is possibly to include directly in Eq. (3) a third term capturing the cost of adjusting the speed with which changes in employment are put into effect (second-order adjustment costs), see Pesaran (1991). Using this approach the dynamic specification in Eq. (12), which now seems quite "ad hoc", might be justified in terms of firms’ optimizing behaviour.

- The equation following Eq. (20) should not include the expectation term (in light of Eq. (20)). I guess that equation (19) should better include a term like $E_t(\Delta p_{it+1})$ (rather than $E_{t-1}(\Delta p_{it})$); the choice made by the authors facilitates estimation and testing, as in practise one can disregard the process generating the $x_{it}$ variables (as it happens with limited information methods), but the recent literature points out that such an approach may flaw inference.

References