

Abstract

In very recent years, there has been a huge debate in macroeconomics about what fiscal policies should be used in times of recession, but despite the fact that the main component of government consumption is compensation to public employees, the effect of public employment and wages policies for the cyclical behavior of the economy is not a very common topic in macroeconomic research. The paper is aimed to study the effects of public employment and public wages policies in a two-sectors model augmented with search and matching frictions along the lines of Mortensen and Pissarides (1995), in which job seekers direct their search between the two sectors (public and private sector). In order to do this, I extend the model of Michailat (2012) and Michailat (2014) and allow public sector jobs to differ from private sector jobs. With this characterization, job seekers direct their search toward a specific sector and this, as I will show, can substantially improve our understanding of the role of public employment policies in this model. The results can be summarized as follows. By comparing the multipliers in models with random and directed search, I show that in the latter is strongly negative in the short run, while the first is always positive; in the long run, however, their difference is quite small. Viceversa, when I assume constant marginal returns to labor, the multiplier significantly changes only in the long run. I then simulate the baseline model under both a positive and a negative technology shock, in order to study the cyclical properties of the multiplier. I find that, unlike Michailat (2014), the multiplier is only mildly countercyclical. I then study the effects of fiscal shocks in the form of public wages. In my model, the latter have only a small negative effect on employment. This result is partly driven by the fact that rigid private sector wages only respond to technology shocks. While keeping the assumption of rigid wages, I study how the public employment multiplier varies if I allow private wages to respond markedly to conditions on public sector jobs. When this happens, the multiplier is significantly lower both in the short and in the longer run.