Discussion of:

Variable Pay and Risk Sharing between Firms and Workers

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The paper

- Key question in economics: are wages insulated from shocks? (Macro version: are wages rigid?)
- Modern labor/finance literature at the firm (-worker) level finds evidence of only partial insurance: shocks are partially transmitted
- This paper focusses on one tool to overcome wage rigidity, and therefore share risk: variable pay
- It offers evidence that VP is an important flexibility lever for the firm
- It proposes a dynamic principle-agent model with risk aversion on both sides and limited commitment on the worker side consistent with the evidence

Results

1. VP enables risk sharing wrt aggregate shocks, firm specific performance shocks and firm specific financial shocks:
   - Aggregate local shocks: BP acyclical, VP procyclical
   - Firm performance shocks (EBITDA, productivity,....): BP does not react, VP does
   - Changes in credit rating affect both BP and VP, but more the latter
2. Wages more disperse in firms that relay more on VP
3. Firms relaying more on VP display:
   - A less volatile performance
   - A higher performance growth

Comment 1: The need of a sharper question?

- The paper touches on a variety of issues relevant for different fields (macro, finance, labor, industry dynamics):
  1. Implications for theories of wages
  2. Reliance on VP
  3. Risk sharing
  4. VP effects on firm performance (both growth and dispersion)
  5. VP effects on worker outcomes
- Hard to reconcile everything
- An obvious fix is to move the model in the beginning, and that would dictate what the key question is

Comment 2: Is it wage flexibility in general or is it specific to VP?

- Why useful to distinguish BP and VP? In the end, we care about the total risk sharing
- The authors: VP used to overcome wage rigidity. A (too) simple solution to a fundamental question?
- Important specificity: VP is bounded below at 0, so there is an asymmetry in its capacity to share shocks: it works better for positive ones
  1. Are the zeros in VP within or across workers? Ie., those that have it, have it always, but in different degrees, or do they get it some years and not in others?
  2. It would be useful to model the asymmetry econometrically: Tobit-style models
  3. Asymmetry could be tested directly. Important for macro models, where we care more about downward rigidity

Comment 3: Can moral hazard be really ruled out?

- They exclude that VP used to overcome moral hazard because of teams and use of aggregate shocks. But:
  - Moral hazard could be overcome even in teams: unions to address the n problem, coworker monitoring, moral....
  - For aggregate shocks, we know that even CEO are rewarded for luck
  - In fact, the sharp drop in reliance on VP after the great recession likely to reflect that incentive pay had gone too far and was a cause of the crisis, rather than a change in reliance on a sharing mechanism
- Is the effect of VP common across workers or is there an important worker level component, more consistent with MH?
  - The fact that dispersion increases with VP intensity signals worker level matters, but it might just be that it turns on for those that have a VP component

Comment 4: What explains the heterogeneity in the effects of VP and its use?

- Volatility lower for firms that rely more on VP, but I expected in earnings rather than sales, employment, productivity.
  - Possible cause: reversed causality, ie., VP used more in more stable environments, as the principal-agent model with MH predicts
- Why higher average growth? Not obvious
- At a deeper level, why do some firms rely more on VP? What are the differences in firm characteristics?

Other suggestions

- The key driving force in the model is the principal's risk aversion. I would try to test this, for example looking at firms with a blockholders vs. firms with dispersed shareholders
    - Evidence on aggregate shocks for private firms mixed: also BP procyclical but no difference in cyclicality of VP
- For changes in credit rating, it would be interesting to show the event study
- Following the literature, discuss what we learn by differences in response between idiosyncratic and aggregate shocks