Discussion of Cacciatore and Ghironi

Trade Unemployment and Monetary Policy

Giancarlo Corsetti
Cambridge and CEPR

July 22-23 2013, Banca Nazionale Svizzera

Macro with trade model we more or less believe or 'policy advice by the seat of our pants'

- Recurrent quotation of Krugman: Integration of trade and macro at the heart of international economics
- Early 'success' in the 1990s:
  - terms of trade externality (optimal tariff argument in macro).
- Work in progress:
  - competitiveness and comparative advantages
  - firm dynamics
- Much remains to be done.

Question today

- How does more trade integration affect optimal monetary stabilization.
  - do we need more cross-border cooperation?
  - do policy makers need to pay more attention to foreign developments, on top and beyond the way they affect output gap and inflation?
- Trade integration meaningful modelled: lower trade costs translating into reallocation of production and rising trade flows.
- The (preliminary?) answer is (disappointingly?): no, not really.

Outline

1. What does the paper do?
2. The contribution of the paper
3. Comments and suggestions

The paper

Two country model with novel production structure

- Upstream competitive firms produce homogenous input
  - labor market frictions: real (search), nominal (wage adjustment costs), and interacted (bargaining over nominal, not real wage).
- Downstream monopolistic firms produce bundles of differentiated goods, using plants with heterogeneous productivity
  - goods market frictions: monopoly power, creation of varieties, and nominal rigidities

Nice way of including many relevant distortions in a tractable way.

- But also nice way to run an open economy with tradables and nontradables.

Main results: trend inflation

- With bargaining over nominal wage and wage adjustment costs, a (small) trend inflation is beneficial:
  - it raises the share of real surplus accruing to firm, raising the value of posting a vacancy by a firm
  - it addresses inefficiency wedge in job creation.
- This prescription is true independently of openness, but:
- With trade integration, optimal trend inflation is a function of trade integration, a la Melitz:
  - more trade, higher productivity, more value of posting a vacancy by a firm, need for less inflation.

Main results: stabilization

- Strict price stability not optimal (many trade-offs, no divine coincidence)
- Optimal policy can be approximated by means of rules responding only to domestic variables (many internal trade-offs)
    - inward looking policy (different from price stability)
- Benefits from cooperation small

The above is unaffected by trade integration. However:

- Large gains over 'historical behavior' (which is arbitrarily inappropriate in the model).
- These gains are larger if the economy is more open

Understanding international dimensions of monetary policy

- In the model, trade-offs related to openness are marginal relative to the many domestic distortions.
  - endogenous response of the economy to trade integration is significant, but does impinge on policy trade-offs.
- Even in the workhorse model (two country, two good with specialization), international dimension is meaningful only under specific parameterizations:
  - Local currency pricing
  - Incomplete markets and large income effects of shocks, e.g.
    - low elasticity of substitution
    - persistent shocks

Labor frictions and entry

- Potential advantages:
  - macro dynamics (see Pontus Rendahl 2012)
  - friction in adjustment (intersectoral reallocation)
- Models with firm dynamics:
  - tend to account for international correlation of business cycle (see Cavallari 2012).

Minor comments

- Cooperation may be achieved through 'inward-looking' optimal (cooperative) policy
  - still different from opportunistic policy
- Small gains from cooperation due to small spillovers
  - unrelated to endogenous synchronization of business cycle
- Law of one price versus law of one bundle price

Conclusion

Step in the right direction: much wanted integration of trade and macro
Great ideas in this model, potential not fully exploited.
Looking forward to reading more by C&G!