

# Discussion of “A Model of Aggregate Demand, Idleness, and Unemployment”

PASCAL MICHAILLAT & EMMANUEL SAEZ

Franck Portier

10th *Journée* of the Fondation Banque de France  
June 4, 2014, Paris



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- ▶ Addresses the core questions in Macroeconomics:
  - × Is unemployment caused by high wages, low demand or frictions?
  - × What does move employment? demand shocks, supply shocks?
- ▶ My discussion
  - × The main mechanism in a nutshell
  - × because *"repetition is the mother of pedagogy"*
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# In a nutshell

## Supply

- ▶ Measure 1 of workers that produce on demand and consume (but not their own good)
- ▶ Each is endowed with one unit of time that can be allocated to
  - × production:  $z$  units of time  $\rightsquigarrow z$  units of good sold at price  $p$
  - × idleness
- ▶ Search: consumers make visits  $v$  at cost  $\rho v$  units of goods  $\rightsquigarrow$  number  $f(v)$  of matches (= probability)
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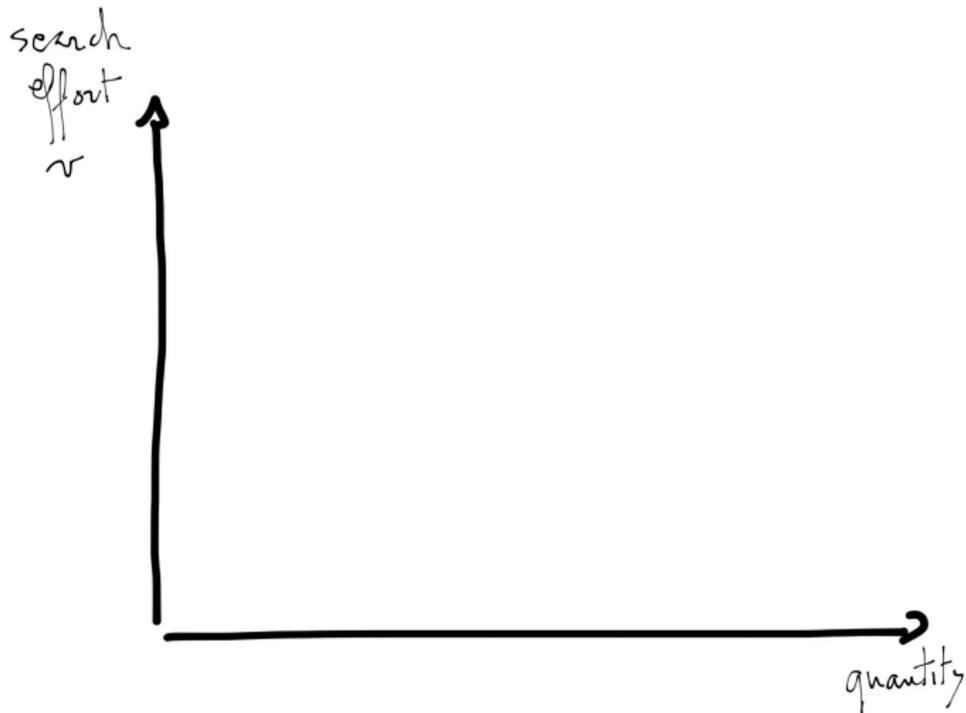
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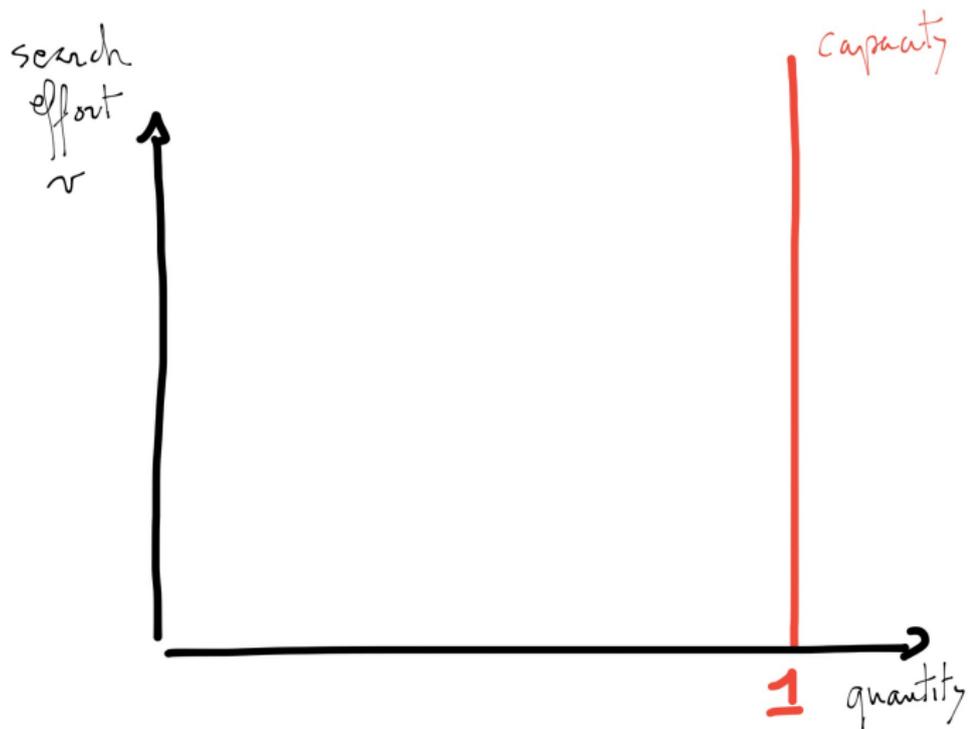
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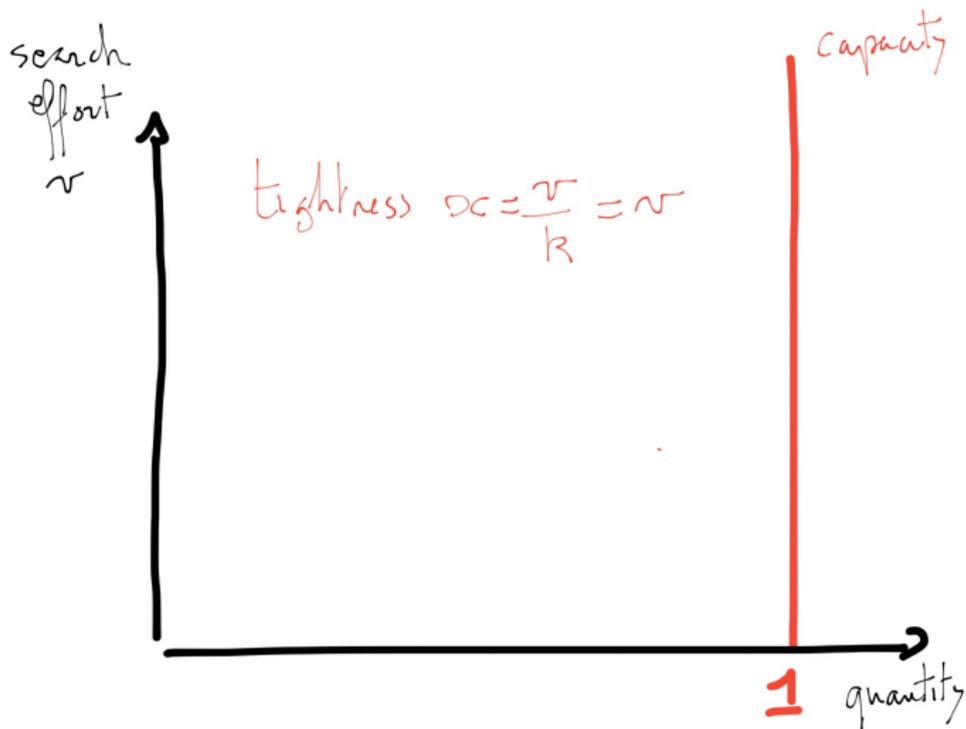
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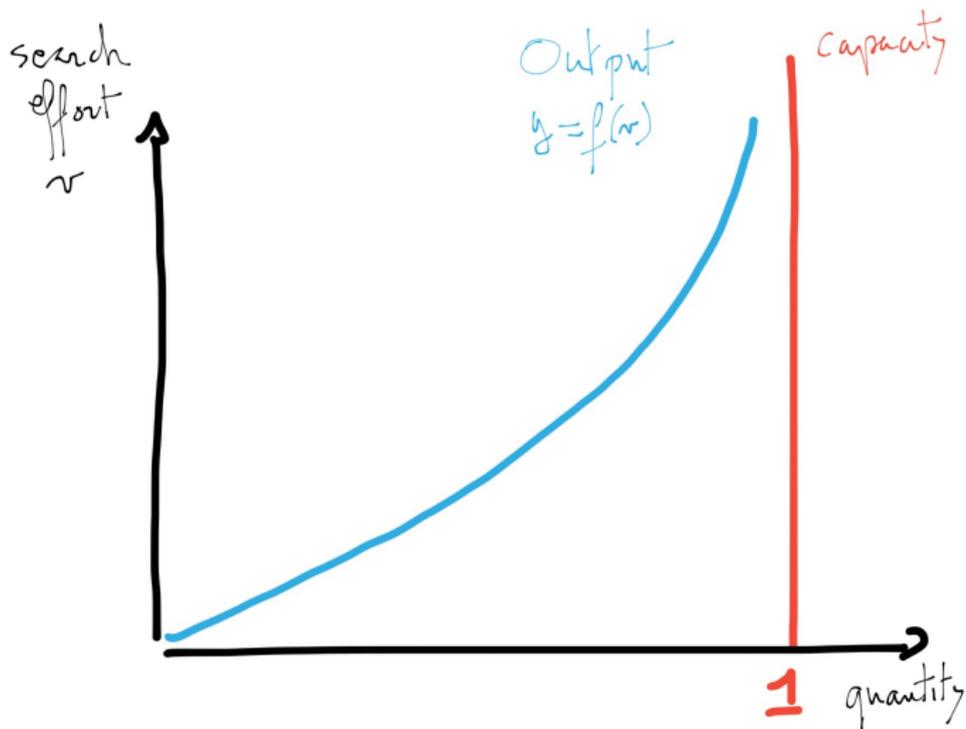
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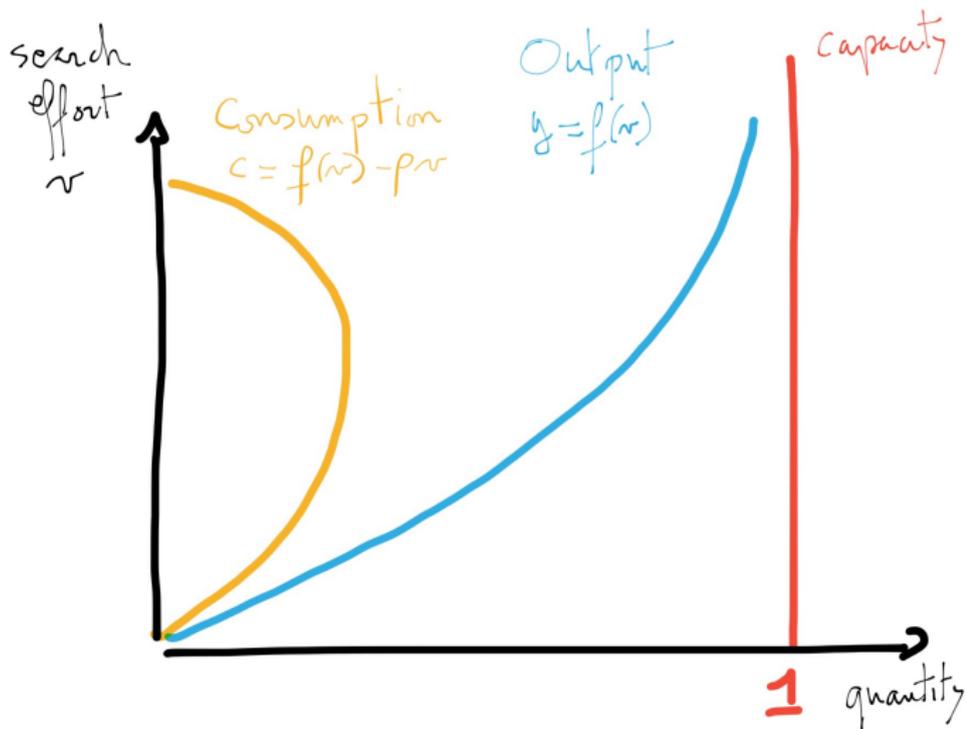
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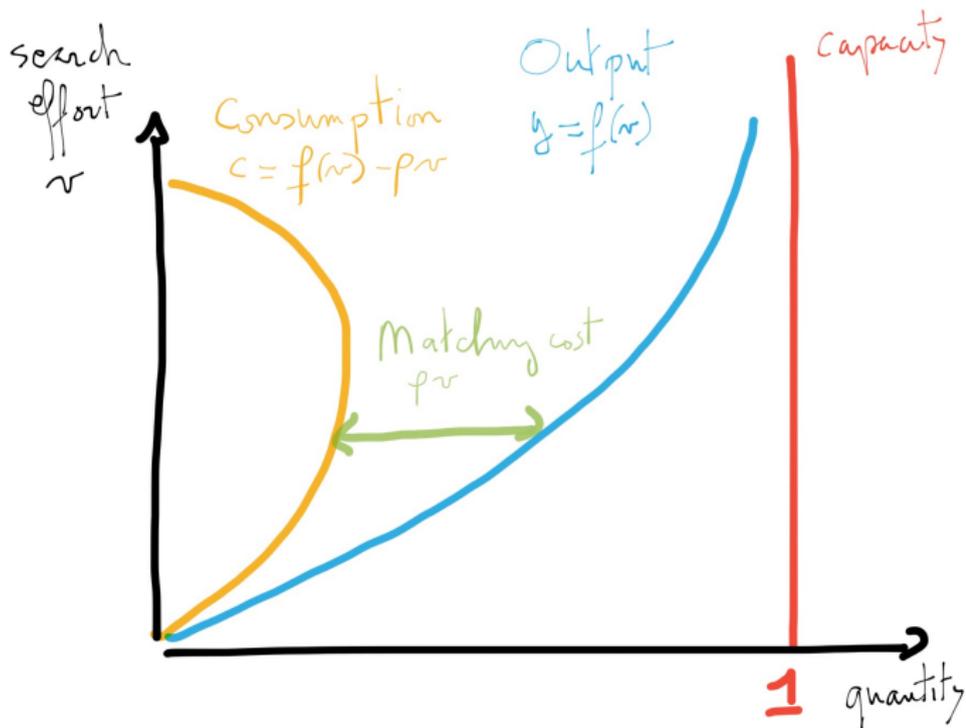
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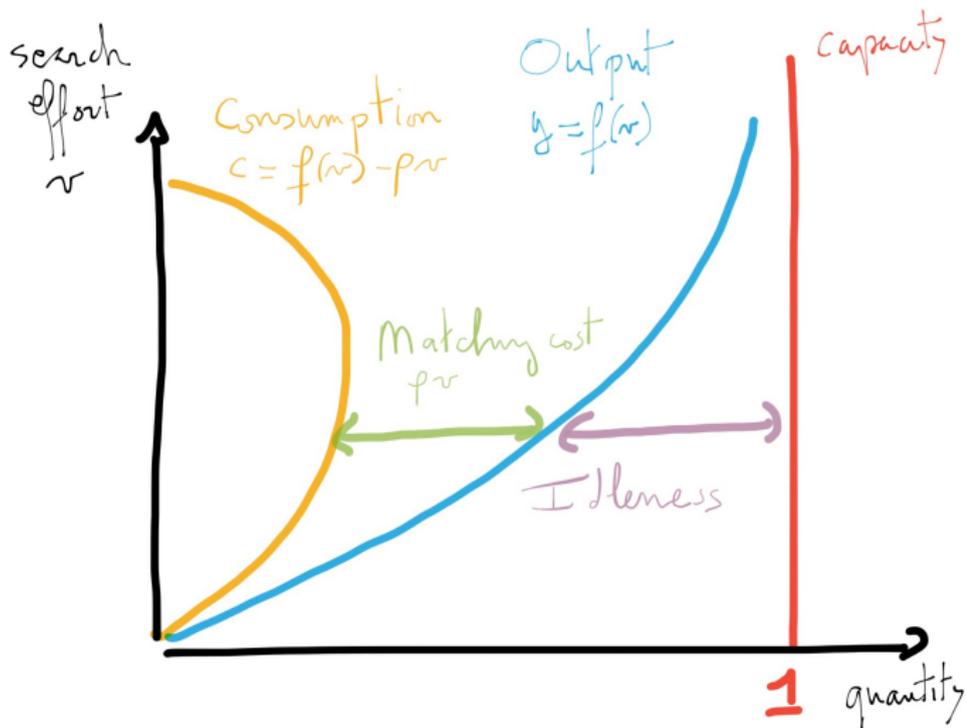
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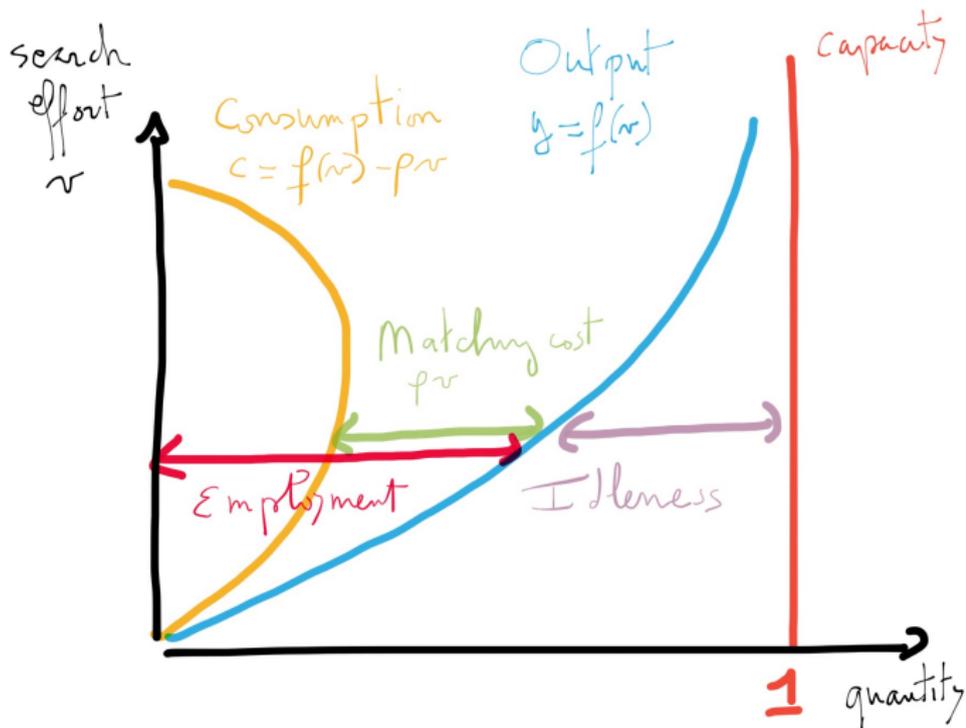
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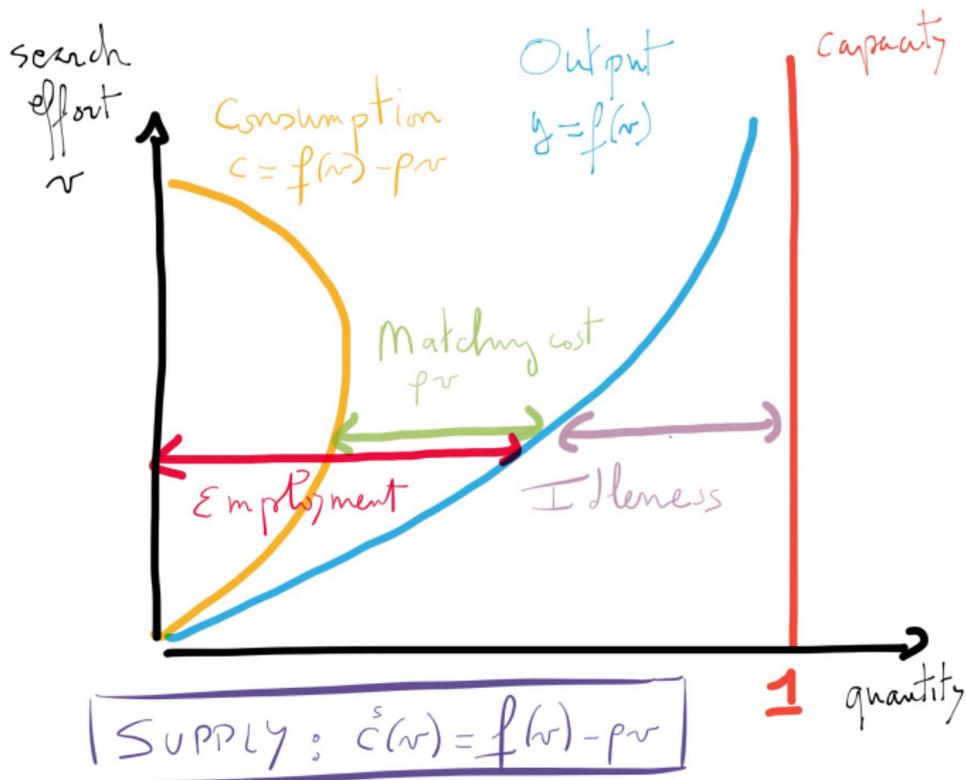
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## Demand

- ▶ Max  $u(c, m)$
- ▶  $m$  is an outside good (money?)
- ▶ BC:  $m + p \times c + p \times \frac{1}{f(v)} p \leq \mu + pf(v)$
- ▶ Solution:  $c^d(v, p)$ , decreasing in  $v$  and  $p$

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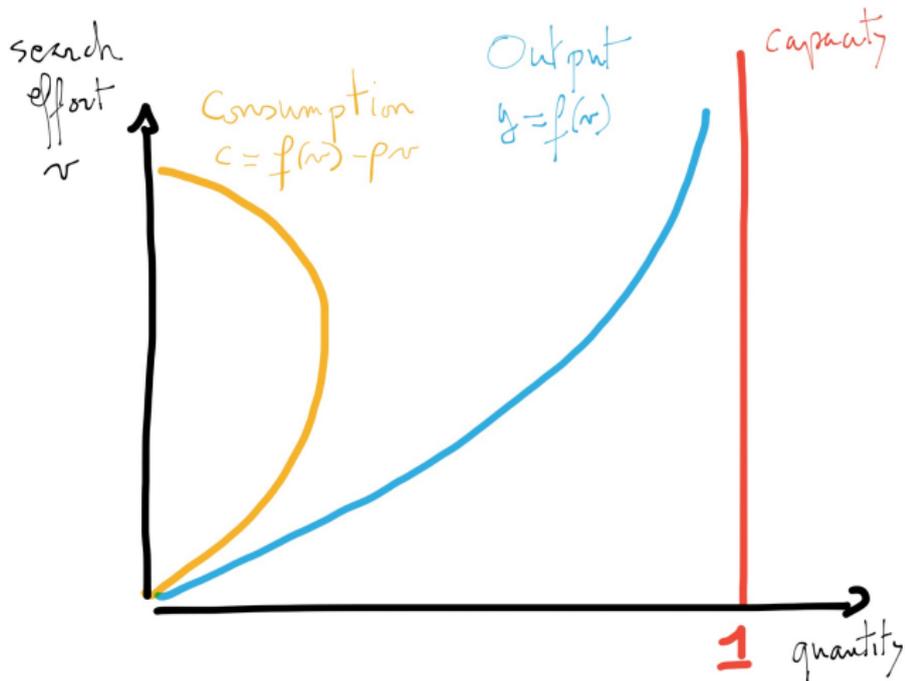
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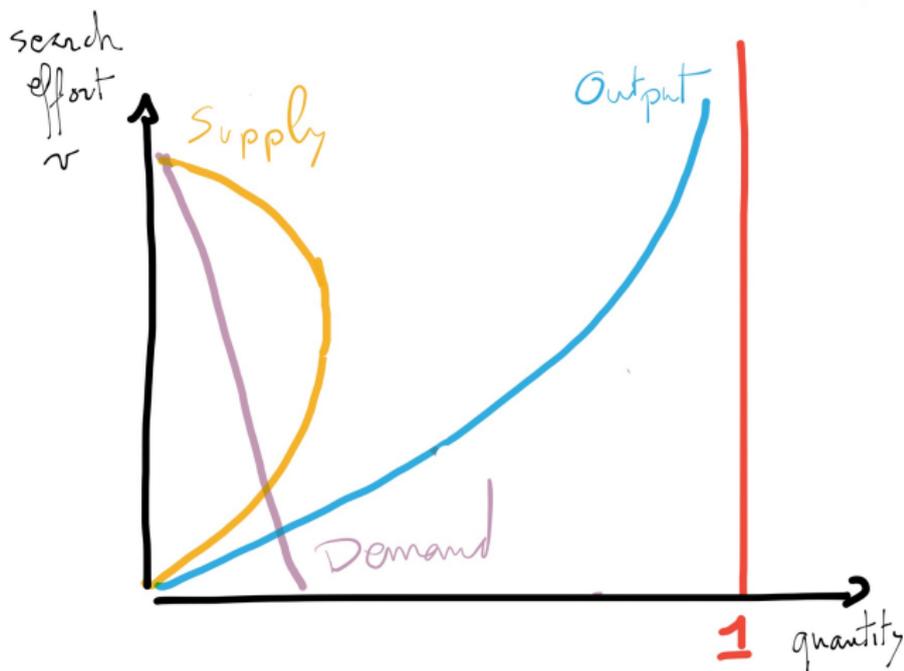
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## Equilibrium



- Note that the slope of demand depends on  $p$ .

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## Equilibrium

- ▶ equilibrium is a triplet  $(c, v, p)$  s.t.
  - ×  $c^e = c^s(v)$
  - ×  $c^e = c^d(v, p)$
- ▶ 2 equations for 3 unknowns  $\rightsquigarrow$  pick up the price theory you want
  - × classic result in search models:  $p$  does not clear any market, but decides of the exposit sharing of the match surplus
  - × Note that this does not mean that fix price is one out of many possible choice for price setting
  - × Fix price means that a different mechanism is chosen every time the environment changes

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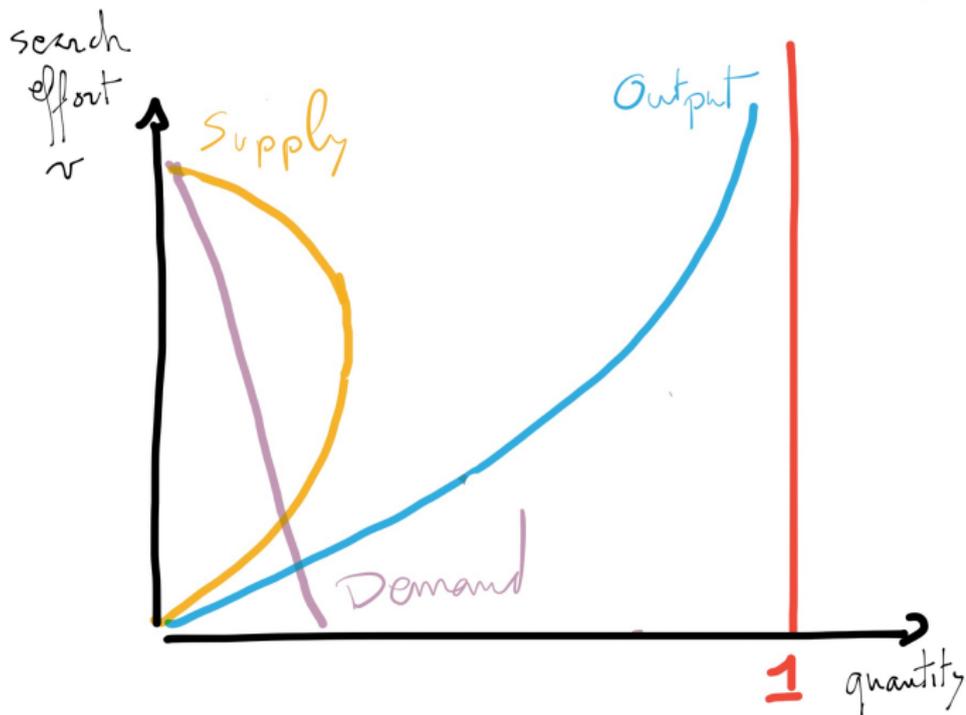
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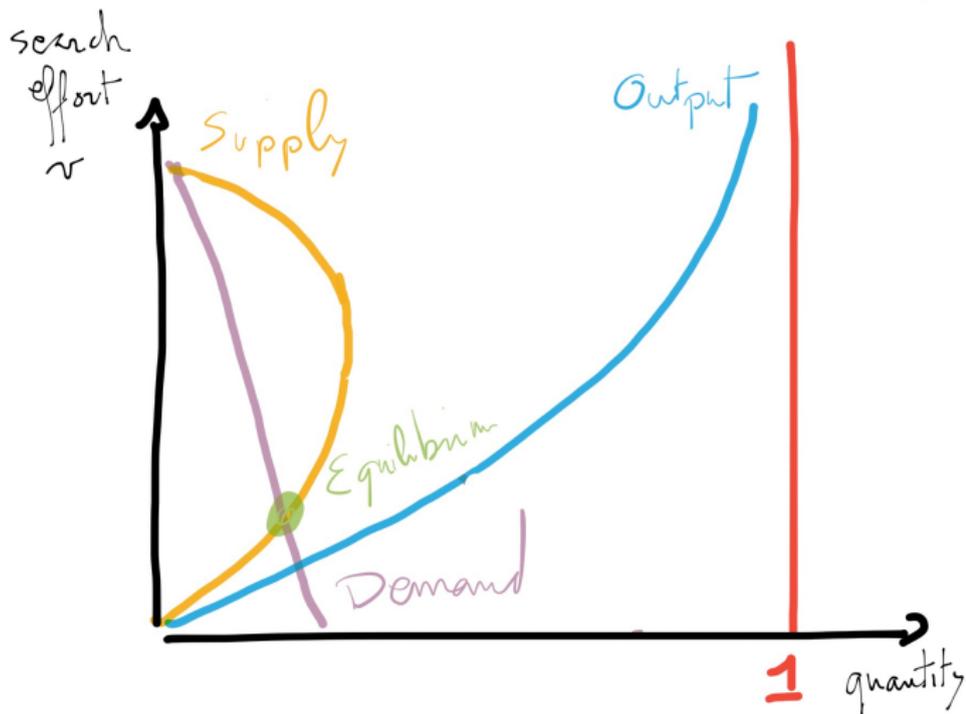
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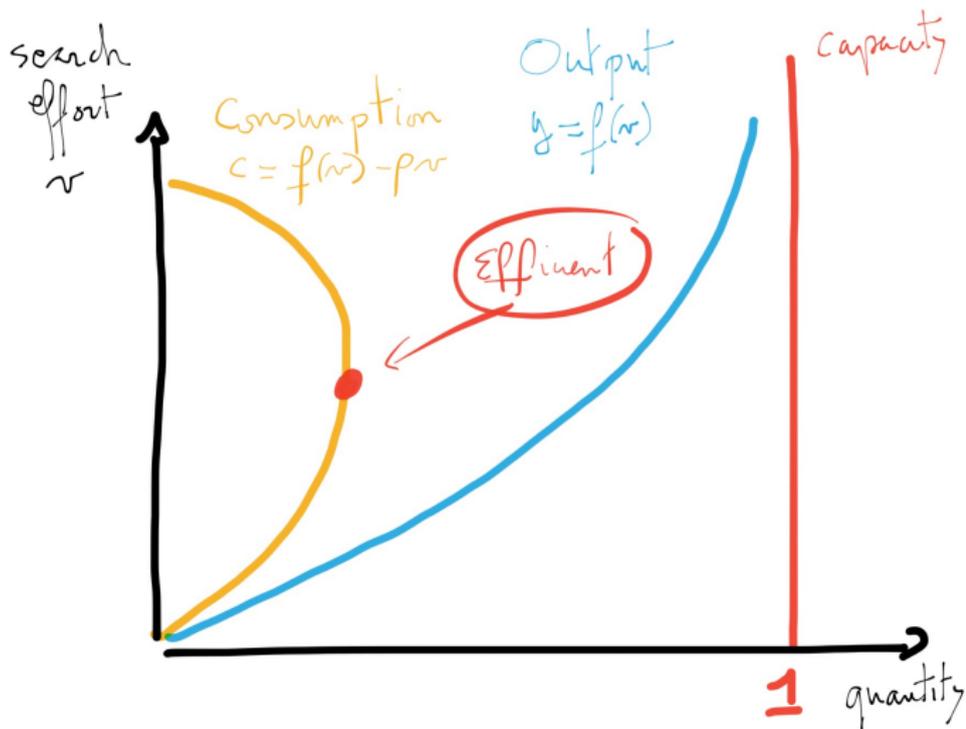
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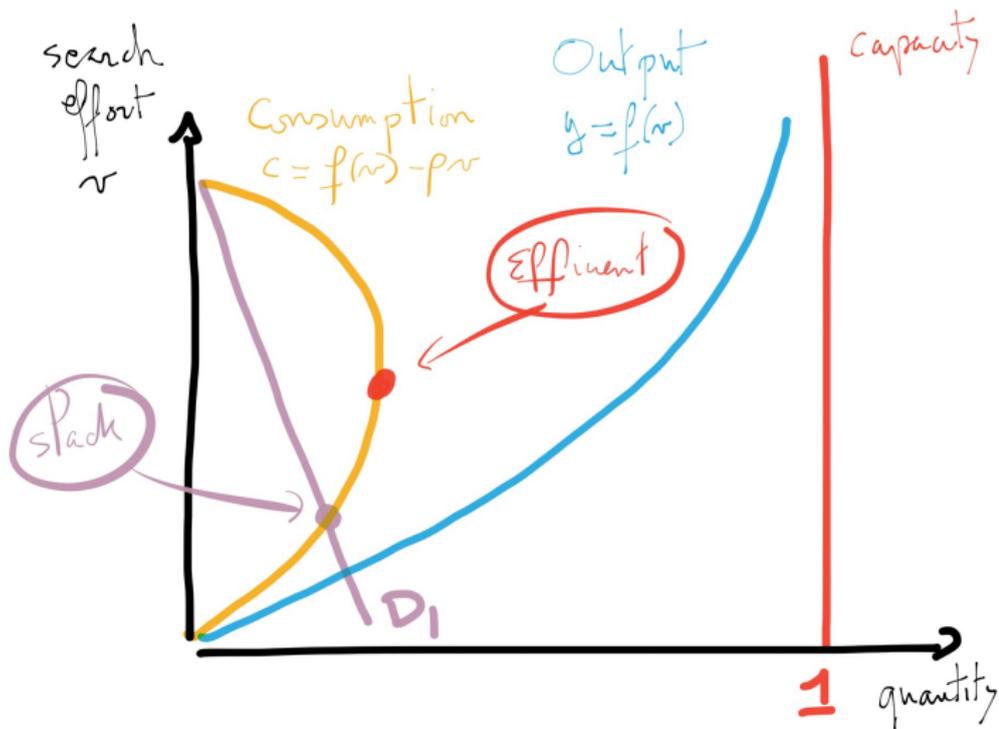
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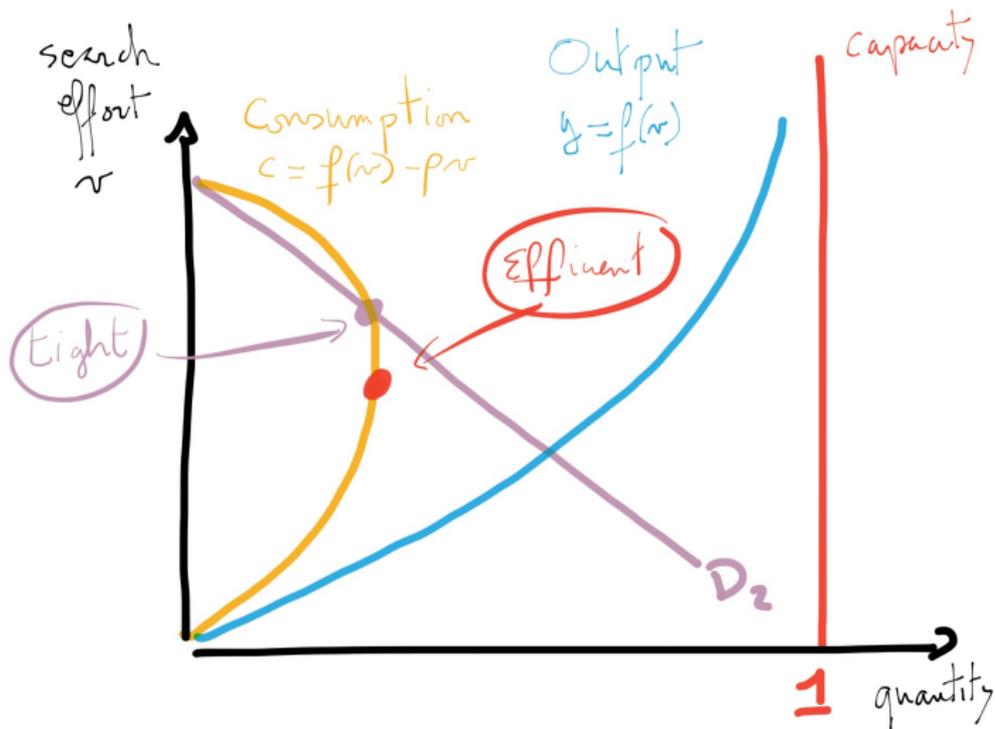
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# In a nutshell

## Comparative statics

| Increase in:     | Effect on:                  |                  |                             |   |
|------------------|-----------------------------|------------------|-----------------------------|---|
|                  | Output<br>$y$               | Tightness<br>$x$ | Labor utilization<br>$f(x)$ | Consumption<br>$c$                      |
|                  | <i>A. Efficient pricing</i> |                  |                             |   |
| Aggregate demand | 0                           | 0                | 0                           | 0                                       |
| Aggregate supply | +                           | 0                | 0                           | +                                       |
|                  | <i>C. Rigid pricing</i>     |                  |                             |   |
| Aggregate demand | +                           | +                | +                           | + (slack)<br>0 (efficient)<br>- (tight) |
| Aggregate supply | +                           | -                | -                           | +                                       |

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## Comparative statics

- ▶ From that comparative statics and from data on labor utilization, search effort (recruiting sector), output,
- ▶ one can measure
  - × price rigidity
  - × the size of demand shocks
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- ▶ This is done in an extended version of that model with frictions on both goods and labor market

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Aggregate demand shocks: monetary shocks?

- ▶ If  $p$  is fixed, the model can be interpreted as a model with MIUF
- ▶ Then  $p \times \mu$  is money supply
- ▶ The model looks pretty much like the good old fix price model
- ▶ In particular, there is an obvious monetary policy that can reach constrained efficient allocations at any time.

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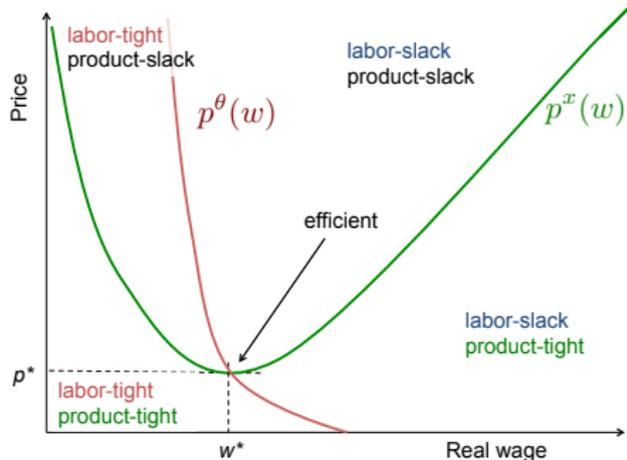
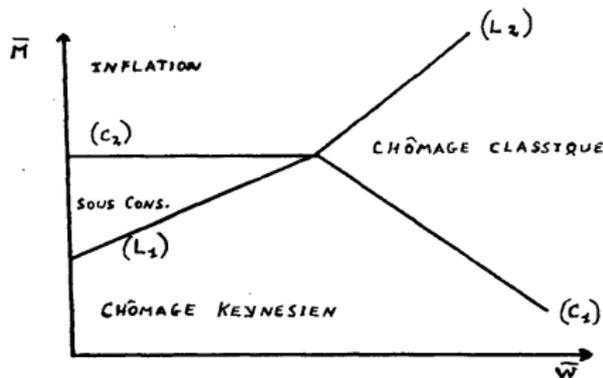
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Graphique 9. Typologie des équilibres avec rationnement dans le plan Monnaie - Seuil salarial

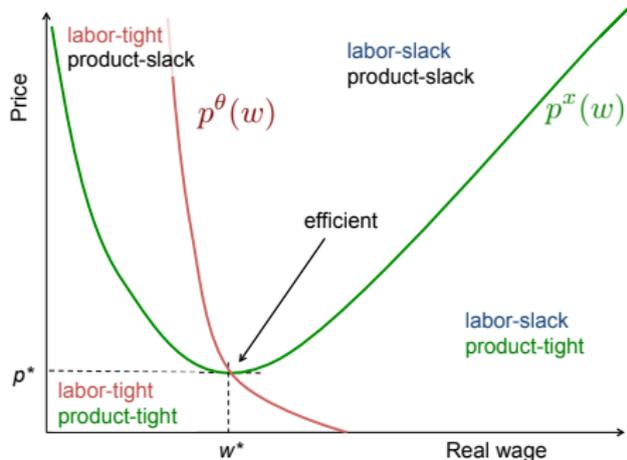
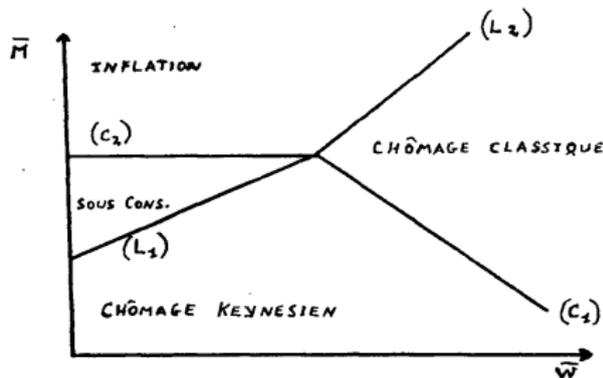


- ▶ Different stories and microfoundations
- ▶ Is that such a different story?: not so much for business cycle analysis if  $p$  is fixed.
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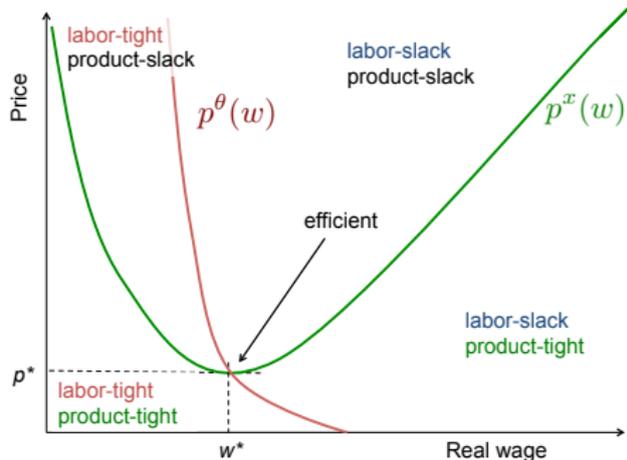
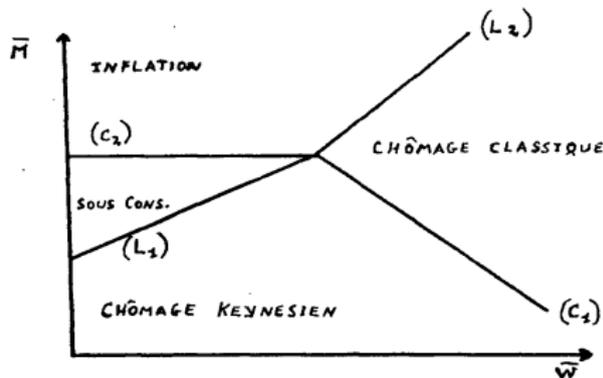


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  - × but even with determinacy, multipliers exist:
  - × which means that fluctuations are suboptimal
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- ▶ I have not found a clear way to see this in the model when prices are not sticky
- ▶ (Something we are trying to do with Beaudry and Galizia in "*Reconciling Hayek's and Keynes' views of recessions*")

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- ▶ Diamond (1982) coconut model is (to me) capturing the (Keynesian) essence of search models
- ▶ trade depends on actions that depend on trade expectations
  - × multiple equilibria are possible
  - × but even with determinacy, multipliers exist:
  - × which means that fluctuations are suboptimal
  - × and not a “constant wedge ” model
- ▶ I have not found a clear way to see this in the model when prices are not sticky
- ▶ (Something we are trying to do with Beaudry and Galizia in *“Reconciling Hayek’s and Keynes’ views of recessions”*)

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Talking about me

- ▶ We are all sometimes invited to dinners with non economists,
- ▶ (unfortunately)
- ▶ In France, it almost always means that I am the more pro-market person at the table
- ▶ My example for why the *invisible hand* has some bite is the French bread market
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  - × would be a nightmare to plan
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