Discussion: “The Propagation of Technology Shocks” by Nicolas Petrosky-Nadeau and Etienne Wasmer

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The Propagation of Technology Shocks
Do Good, Labor and Credit Market Imperfections Matter and How Much?

- Develop a model with 3 market frictions
  - Labor market frictions
  - Credit market frictions
  - Goods market frictions

- Assess the contribution of each friction for:
  - Amplification $\Rightarrow$ volatility of unemployment
  - Propagation $\Rightarrow$ persistence of unemployment

- Results:
  1. Credit market frictions amplify fluctuations
  2. Goods market frictions propagate fluctuations
Table 3: Second moments - data and model

<table>
<thead>
<tr>
<th></th>
<th>US data</th>
<th>Credit, labor and goods frictions</th>
<th>Credit &amp; Labor</th>
<th>Labor &amp; Goods</th>
<th>Labor only</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>a</td>
<td>b</td>
<td>a</td>
<td>b</td>
<td>a</td>
</tr>
<tr>
<td>Vacancies</td>
<td>8.88</td>
<td>0.89</td>
<td>6.88</td>
<td>0.91</td>
<td>2.47</td>
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<tr>
<td>Unemployment</td>
<td>7.98</td>
<td>-0.84</td>
<td>4.62</td>
<td>-0.74</td>
<td>1.60</td>
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<tr>
<td>Labor tightness</td>
<td>16.34</td>
<td>0.90</td>
<td>9.93</td>
<td>0.97</td>
<td>3.35</td>
</tr>
<tr>
<td>Wage</td>
<td>0.69</td>
<td>0.55</td>
<td>0.44</td>
<td>0.95</td>
<td>0.45</td>
</tr>
<tr>
<td>Consumption</td>
<td>0.80</td>
<td>0.85</td>
<td>0.71</td>
<td>0.81</td>
<td>0.83</td>
</tr>
<tr>
<td>σ(GDP)</td>
<td>1.56</td>
<td></td>
<td>1.06</td>
<td></td>
<td>1.05</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Persistence:</th>
<th>GDP</th>
<th>θ</th>
<th>GDP</th>
<th>θ</th>
<th>GDP</th>
<th>θ</th>
<th>GDP</th>
<th>θ</th>
<th>GDP</th>
<th>θ</th>
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</thead>
<tbody>
<tr>
<td>corr(Δν_t, Δν_{t-1})</td>
<td>0.44</td>
<td>0.72</td>
<td>0.12</td>
<td>0.30</td>
<td>0.15</td>
<td>-0.01</td>
<td>0.03</td>
<td>0.14</td>
<td>0.13</td>
<td>-0.01</td>
</tr>
<tr>
<td>corr(Δν_t, Δν_{t-2})</td>
<td>0.32</td>
<td>0.36</td>
<td>0.23</td>
<td>0.28</td>
<td>-0.03</td>
<td>0</td>
<td>0.25</td>
<td>0.08</td>
<td>-0.03</td>
<td>0</td>
</tr>
<tr>
<td>corr(Δν_t, Δν_{t-3})</td>
<td>0.18</td>
<td>0.09</td>
<td>0.08</td>
<td>0.27</td>
<td>-0.01</td>
<td>0</td>
<td>0.05</td>
<td>0.08</td>
<td>-0.01</td>
<td>0</td>
</tr>
</tbody>
</table>
The Propagation of Technology Shocks
Do Good, Labor and Credit Market Imperfections Matter and How Much?
Model

- Labor market frictions
  - Costly matching of firms and workers
  - Bargain over the wage

- Credit market frictions
  - Costly matching of entrepreneurs and banks
  - Bargain over the credit agreement

- Goods market frictions
  - Costly matching of firms and customers
  - Bargain over the price
Good things

- Topic is important, approach is novel
- Focus on volatility as well as persistence
- Framework is very elegant

Bad things (some cheap shots)

- What is a ‘friction’?
- Does the standard model (with rigid wages) lack amplification?
- Why focus (only) on technology shocks?
- Unclear link to standard models (Bernanke-Gertler, price rigidity)
- Compromises on the elegance (symmetry) of the model

More important concerns

- What is the intuition for the results?
- Does this model capture important features of the real world?
Credit market frictions and amplification

- Job creation in the standard model
  \[
  \frac{\gamma}{q(\theta_t)} = \frac{1}{1 + r} E_t S_{t+1}
  \]

- Job creation with credit frictions
  \[
  K(\phi_t) + \frac{\gamma}{q(\theta_t)} = \frac{1}{1 + r} E_t S_{t+1}
  \]

- Costs of financing \( K(\phi_t) \)
  - ENPV of flow costs of entrepreneurs and bank while searching
  - depends on credit market tightness \( \phi_t \)

- Credit market frictions = fixed cost vacancy creation
  \[
  \hat{\theta}_t = \frac{1}{\eta L} \frac{S}{S - K(\phi)} E_t \hat{S}_{t+1}
  \]

- Amplification because of small surplus
- No propagation because \( \phi_t = \phi^* \) by free entry (and no shocks to CM)
Goods market frictions and propagation

- Job creation in the standard model

\[
\frac{\gamma}{q(\theta_t)} = \frac{1}{1 + r} E_t S_{t+1}
\]

\[
S_t = y_t - w_t + \frac{1 - s}{1 + r} E_t S_{t+1} \Rightarrow S_t = \text{ENPV (profits)}
\]

- Job creation with goods market frictions

\[
\frac{\gamma}{q(\theta_t)} = \frac{1}{1 + r} E_t S_{g,t+1}
\]

\[
S_{g,t} = -w_t + \frac{1 - s}{1 + r} E_t [\lambda_t S_{\pi,t+1} + (1 - \lambda_t) S_{g,t+1}]
\]

\[
S_{\pi,t} = \text{ENPV (profits)} \Rightarrow S_{g,t} \simeq \lambda_t \cdot \text{ENPV (profits)} - \text{costs}
\]

- Goods market frictions matter for job creation

  - \(\lambda_t\) = probability firm finds a customer
  - Goods market tightness (and thus \(\lambda_t\)) responds to technology shocks
Goods market frictions and propagation (cont’d)

- Direct effect technology shock on job creation

\[ y_t \uparrow \Rightarrow \text{profits} \uparrow \Rightarrow S_{g,t} \uparrow \Rightarrow \theta_t \uparrow \]

  - Strongest effect on impact
  - LR: LM gets congested, and shock dies out

- Effect technology shock on probability to find a customer \( \lambda_t \)

\[ y_t \uparrow \Rightarrow w_t \uparrow \Rightarrow \text{disp inc} \uparrow \Rightarrow \text{demand} \uparrow \Rightarrow \lambda_t \uparrow \]

  - Strongest effect on impact, LR: firms meet increased demand
  - Net effect on job creation is strongest on impact

- Effect technology shock on \( \lambda_t \) (endogenous search effort)

\[ y_t \uparrow \Rightarrow w_t \uparrow \Rightarrow \text{disp inc} \uparrow \Rightarrow \text{MU cons} \downarrow \Rightarrow e_t \downarrow \Rightarrow \lambda_t \downarrow \]

  - Strongest effect on impact, LR: firms offer more and cheaper products
  - Net effect on job creation is hump-shaped

- Increased disposable income makes it harder for firms to sell their product?
Concluding

- Very interesting paper
  - Important topic
  - Beautiful framework

- But, in the end: What do we learn?
  - Amplification from credit market frictions like any fixed cost
  - Lack of propagation from credit market seems model-dependent
  - Propagation from goods market frictions seems counterintuitive

- Questions
  - What can we do with this framework that we cannot do with standard ones?
  - Do we need all frictions in one model? What do we get from the interaction?