DISCUSSION OF INTERNATIONAL COMPETITIVENESS AND MONETARY POLICY BY P. BERGIN AND G. CORSETTI

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Monetary policy with endogenous relocation of manufacturing firms

- Welcome addition to the monetary policy literature
- Imports 'production relocation externality' in a new Keynesian open economy model
- Parallel development as in the trade literature on optimal tariff: role of GATT and WTO analyzed through the prism of manipulation of the terms of trade. Ossa (2011) introduces 'relocation externality' (manufacturing jobs) as key.
- Similarly monetary policy seen as trading off output gap and terms of trade. This paper introduces relocation effect.

Mechanism I

- Monopolistically competitive (manufacturing) sector: fixed cost in units of labour; trading costs with the rest of the world (home market effect).

- Manufacturing set prices ahead of production: entry and pricing decisions depend on uncertainty about marginal costs (only source of uncertainty in the model is stochastic labour productivity shock)

- Uncertainty implies a 'risk premium' in a firm's price if monetary policy does not stabilize. Monetary policy can fully offset the productivity shock. Exchange rate adjust to replicate flex price equilibrium.

Mechanism II

- Corollary is that a stabilizing monetary policy will lead manufacturing firms to set a lower price ("policy induced comparative advantage". This increases demand for the home manufacturing good.

- Free entry condition means home manufacturing sector expands at the expense of foreign's.

Comments: wages

- Important assumption in the model is the traded homogeneous non-manufacturing goods sector which keeps constant the wage rate and equalizes the wage rate across countries (no trade cost) .

- The positive profits made by domestic manufacturers as a result of increased demand can be in principle competed away either through entry, leading to a production relocation effect, or through an increase in wages, leading to a terms-of-trade effect.

Comments: wages

- The relative strength of these two effects is determined by the elasticity of the labour supply curve facing the manufacturing sector as a whole.

- This model with traded homogeneous nonmanufacturing goods generate a perfectly elastic labour supply curve and therefore has only production relocation effects.

- How realistic is this assumption? (Chinese style assumption where labour can be drawn from a large pool of agricultural workers into the manufacturing sector with (until recently) not much wage increase)

Comments : Price setting

- Model assumes Producer currency pricing. What if we assume local currency pricing instead?

- May be more importantly, is it realistic to assume that depending on monetary policy and exchange rate regime the price setting choice is not endogenous (PCP versus LCP)?

- That would lead to overestimating the effects of stabilizing monetary policy.

Comments : other view

- This paper: Nice property of monetary policy having a persistent effect on the industrial structure. Comes from stabilization of exchange rate not level of real exchange rate (undervaluation).

- Other view (level) : Rodrik (2008) argues that countries with poor institutions have comparative disadvantage in products that are more institutions-intensive or more relationship-intensive (tradables). Real exchange rate undervaluation alleviate "taxation" of tradables and fosters growth. Some empirical support.

Comments: monetary policy

- Do we really believe the exact role played by monetary policy in this model? (replicates flex price equilibrium by offsetting exactly effect of a unidimensional shock on productivity)

- Probably not. Already problematic if heterogeneous shocks across industries (industry composition and stochastic structure would matter).

- Paper has perfect risk sharing (log utility), balanced trade, no capital stock…

Comments : broader

- But may be the key point would generalize well: decline in uncertainty (due to stabilization policies) plays a key role for sectors in which home market effect is important.

- But welfare gains of the model (even generalized) are driven by decrease in trading costs. Do we think it is a first order consideration?

- Do we think there is a good mapping between manufacturing sector and trading costs? If anything we know that trade negotiations have brought those costs down disproportionately for the manufacturing sector.

Comments: exploring

- It seems that fiscal policy (expanding demand for manufacturing sector) would have powerful effect on welfare in the model via the same channel

- In the same spirit, introducing demand shocks seems natural and would enrich the analysis considerably.

Empirical analysis

- Regression of share of exports in differentiated goods on fixed effects, exchange rate regime (peg dummy) and interaction peg*Diff where diff is a dummy for differentiated good sector.

- Hyp: peg means no monetary policy independence, means high risk premium

- Very hard to get rid of endogeneity concerns: structural reasons to adopt a peg (small country, commodity exporter) may be controled for by a fixed effect but more cyclical reasons that may affect more traded good sector are difficult to control for: inflation taking off, bad policies may lead to adoption of a peg.

Conclusions

- It is very nice to see some new ideas in the monetary policy literature.

- Model can be used to explore many more things before going to more normative conclusions.