

8-MINUTE DISCUSSION OF “SHOPPING
EXTERNALITIES AND SELF-FULFILLING
UNEMPLOYMENT FLUCTUATIONS” BY
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AEA Meetings

Leena Rudanko, Organizer

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THE HOLY GRAIL OF FLUCTUATIONS MODELING

Output and employment are highly sensitive to driving forces, or possibly indeterminate

Without

- increasing returns to scale in matching or technology (Diamond, Farmer, ...)
- or arbitrary assumptions about price or wage stickiness (Calvo, all New Keynesians, ...)

THE PAPER

is a major step forward if it holds up empirically.

If not a theory of multiple equilibria, potentially a theory of amplification of shocks.

THE BASIC NEW IDEA

Sellers have market power that depends on how hard people shop.

Households allocate more effort to shopping when a member is unemployed, a demonstrable fact.

Low market power discourages employment, the reverse of the New Keynesian model.

DEMAND CHANNEL

The model also has a demand channel—families with an unemployed member buy less, so total employment falls.

In most GE models, the interest rate absorbs a demand shock, so it has no effect on employment, barring ZLB. There's no demand externality. Would be nice to know why that is not true in this model.

The authors believe that the demand channel is not essential to the key strategic complementarity of the model.

CYCLICAL BEHAVIOR OF PROFIT MARGINS

In direct contrast to the New Keynesian model, profit margins are higher in good times, when people are too busy working to shop hard.

A new paper of mine observes that advertising should be highly sensitive to profit margins and that advertising is highly procyclical, so it supports the hypothesis that profit margins are procyclical, as in this paper, not countercyclical, as in the NK model.

LINKAGE TO THE EMPLOYER'S PAYOFF FROM A NEW HIRE

The payoff to a new hire is the marginal revenue product of labor.

In the NK model, where market power is higher in recessions, the MRPL falls on that account and the incentive to create jobs falls (Rotemberg-Woodford (1999)).

In this model, the reverse happens—lower market power reduces labor demand.

The authors should explain the difference, which is absolutely central to the model.

SHIMER PUZZLE

The model has modified Nash bargaining, with non-standard outside options.

It is otherwise in the DMP class, so one might expect the Shimer puzzle that the wage, not unemployment, responds to changes in the MRPL.

Further study of footnote 6 may reveal the answer, but the authors should give the reader more help.

STOCK MARKET

The model has the ancillary property of explaining large declines in the stock market in slumps.

In most GE models with realistic adjustment costs, the stock market is the value of the capital stock, so it's hard to explain stock-market fluctuations of any important magnitude.

No capital in this model, however.