Discussion of "The Great Recession : A Self-Fulfilling Global Panic"

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Franck Portier

Conference on Macroeconomics – Understanding low growth
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Toulouse
School
of **Economics**

Paper's contribution
Two key elements

- Very rich paper
  - Full of ideas, mechanisms, results
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1. A theory for "panic" equilibria
2. A theory for the international transmission of shocks

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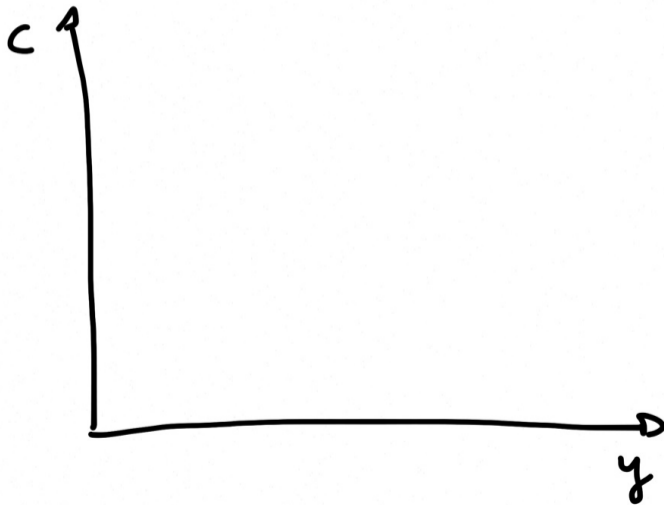
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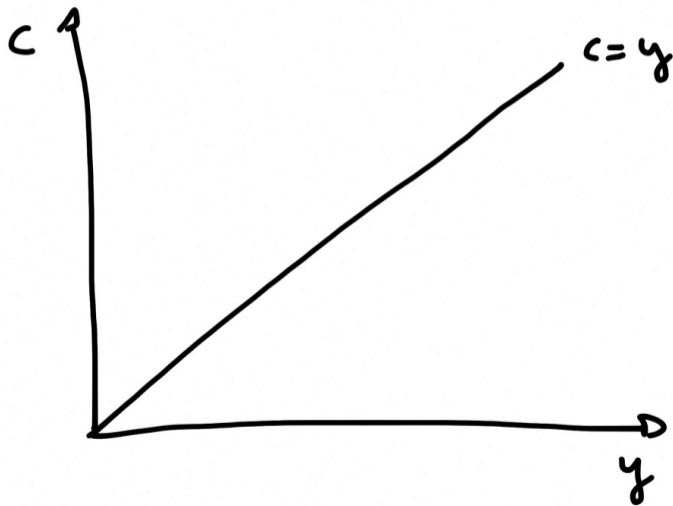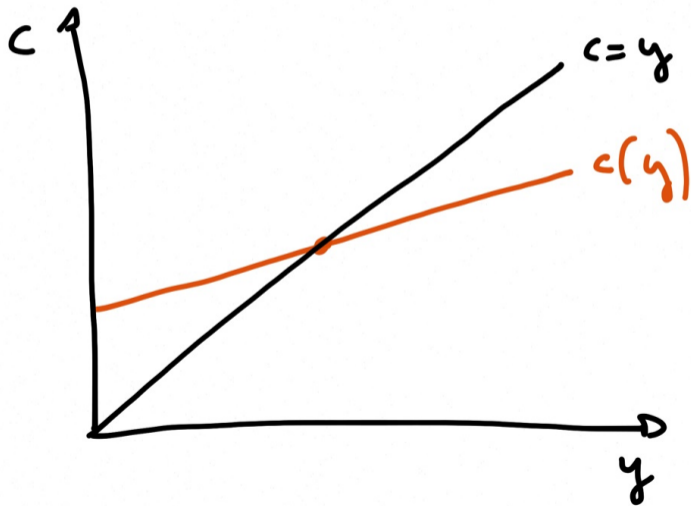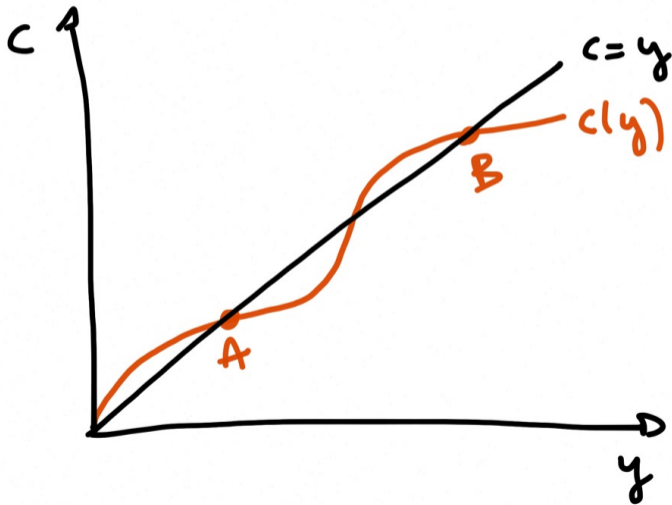▶

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Multiplicity

- ▶ Multiplicity is indeed not so difficult to obtain.
- ▶ Consider a static GE model of yeoman farmer *(the YEOMAN FARMER model)*
- ▶ N farmers with preferences

$$U(C_i) - L_i^{1+\gamma}$$

- ▶ C_i is a CES aggregator of C_{ij}
- ▶ Each farmer has monopoly power on good i
- ▶ Technology is

$$C_{i,(1)} = AL_i^\alpha$$
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- The model is solved by deriving the best response function

$$P_i = P_i^\star(P)$$

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- ▶ If farmer i expects the price of the competitors to be high, then he expects demand to be low.
- ▶ It will be not profitable to operate with technology 2 as it required high scale of production to cover the fixed cost.
- ▶ Therefore the farmer will operate with the high marginal cost technology.
- ▶ Therefore prices will be high.

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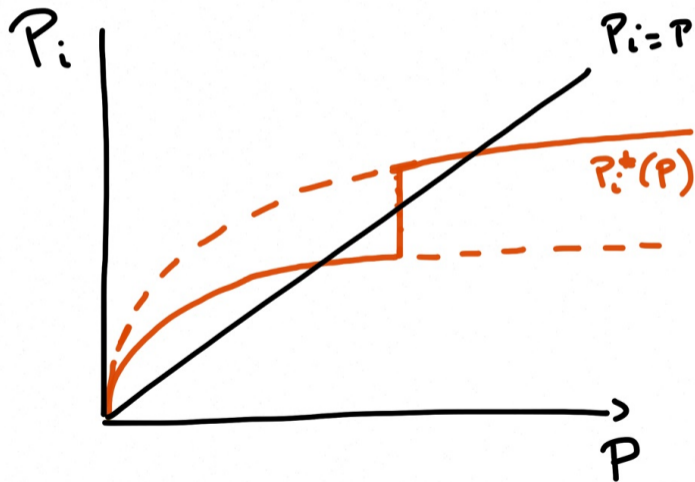- ▶ Therefore prices will be high.

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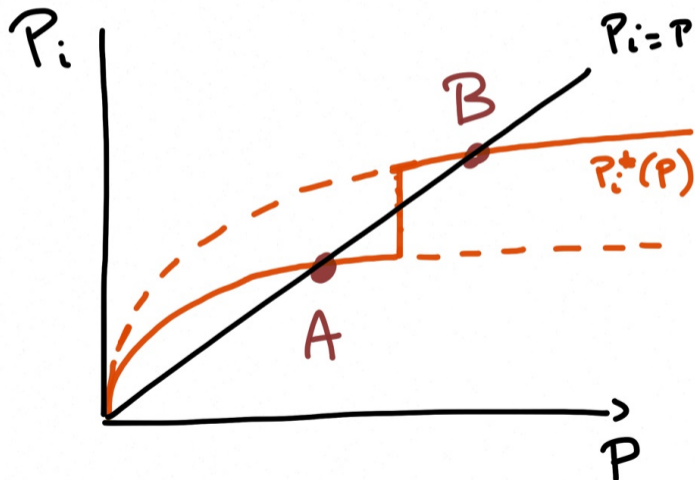- Therefore prices will be high.

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2. A theory for the international transmission of shocks
A two-country Keynesian Cross

- ▶ A fraction ψ of home consumption is in home goods
- ▶ A fraction $1 - \psi$ of home consumption is in foreign goods
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- ▶ Equilibrium is given by

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y &= \psi c(y) + (1 - \psi)c^\star(y^\star) \\
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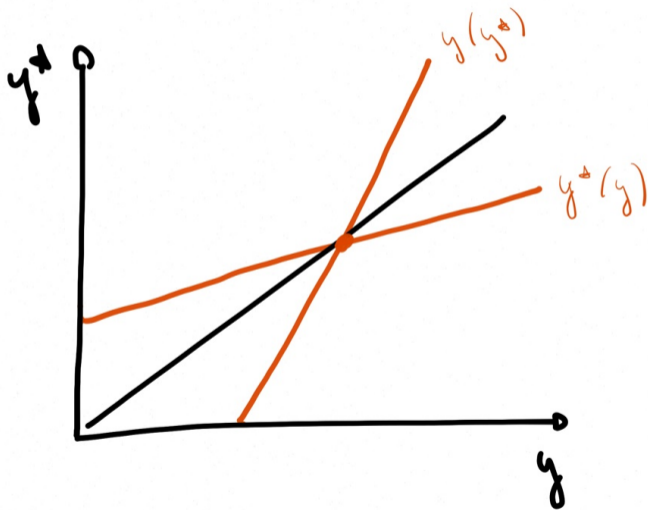A two-country Keynesian Cross

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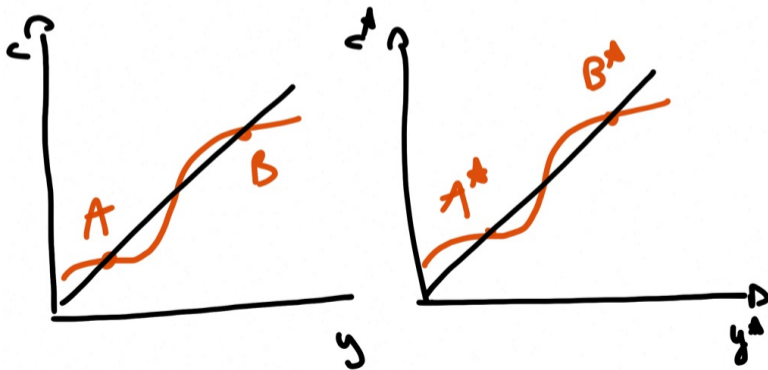$$\Psi c + (1-\Psi)c^{*}$$
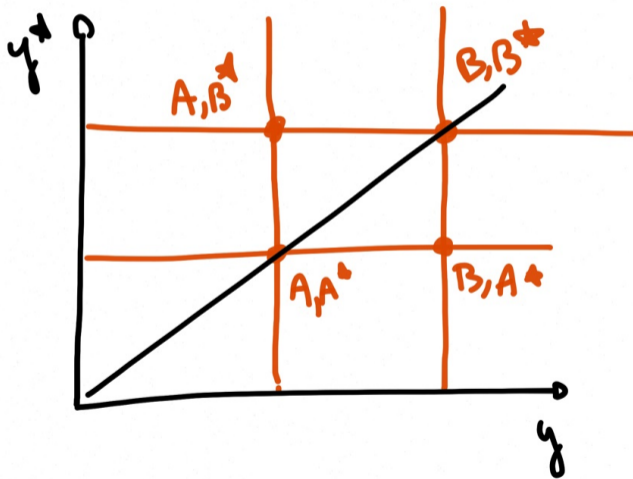
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A two-country Keynesian "Cross"

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2. A theory for the international transmission of shocks
Coordination

- ▶ One can be doubtful that sunspot create so discrete jumps in economic activities
- ▶ This requires a lot of coordination between agents
- ▶ It is even more improbable that the low equilibrium is selected *simultaneously* but the two economies
- ▶ Philippe and Eric have a nice result :
    - ✗ High integration eliminates asymmetric equilibria
    - ✗ Intuition : if integration is total, we are back to a close economy
    - ✗ the model assumes full coordination within a country
    - ✗ A more economic story : if home is pessimistic, the foreign economy will be pulled down flow external demand), and B^* will disappear.

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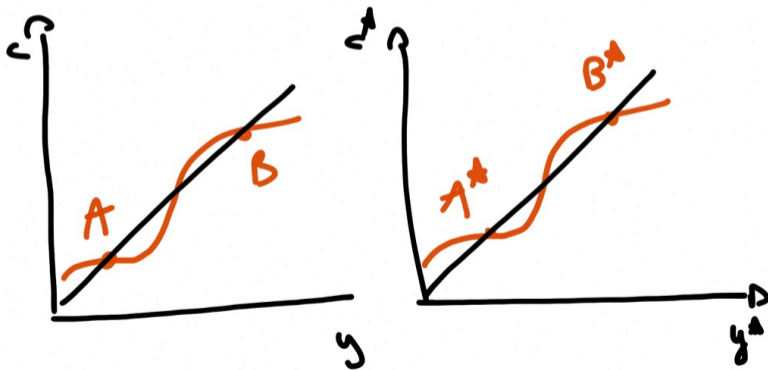
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A two-country Keynesian "Cross", high integration

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2. A theory for the international transmission of shocks

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Coordination

- ▶ Demand linkages eliminate the non-symmetric equilibria
- ▶ Demand linkages related to change in expectations create comovements
- ▶ With Paul Beaudry and Martial Dupaigne, we have found evidence of expectations coordinating economies
- ▶ We have identified US *news* about future TFP
- ▶ We have shown that it creates a boom in the US as well as in Canada
- ▶ Same result with Germany and Austria
- ▶ If the news is global (in all agents information sets, then expectations are coordinated.

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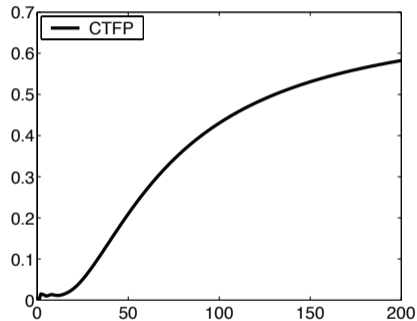
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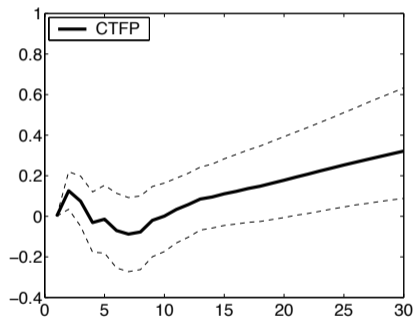
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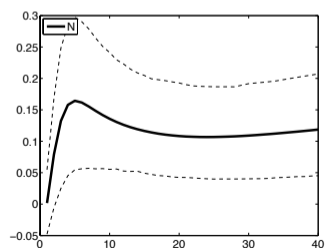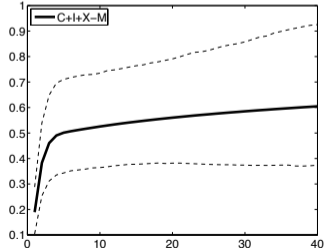
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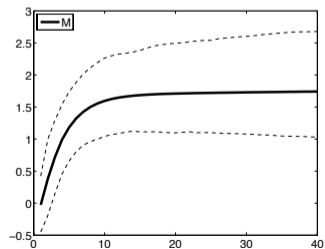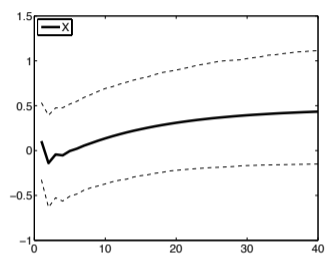
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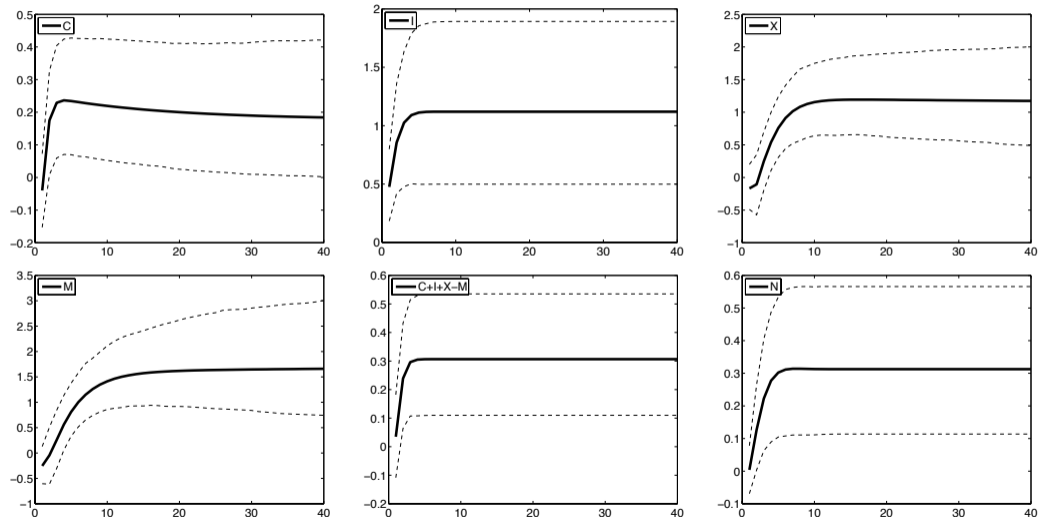
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The response to a US technological news in the US

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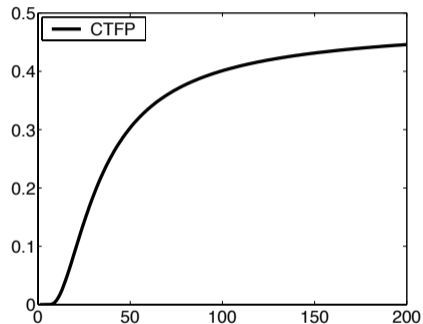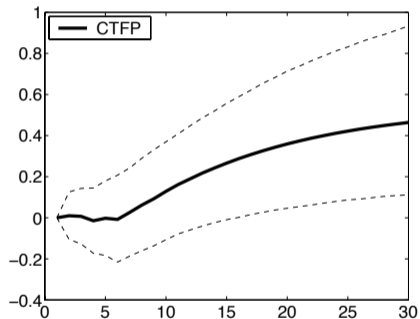The response to a US technological news in the US

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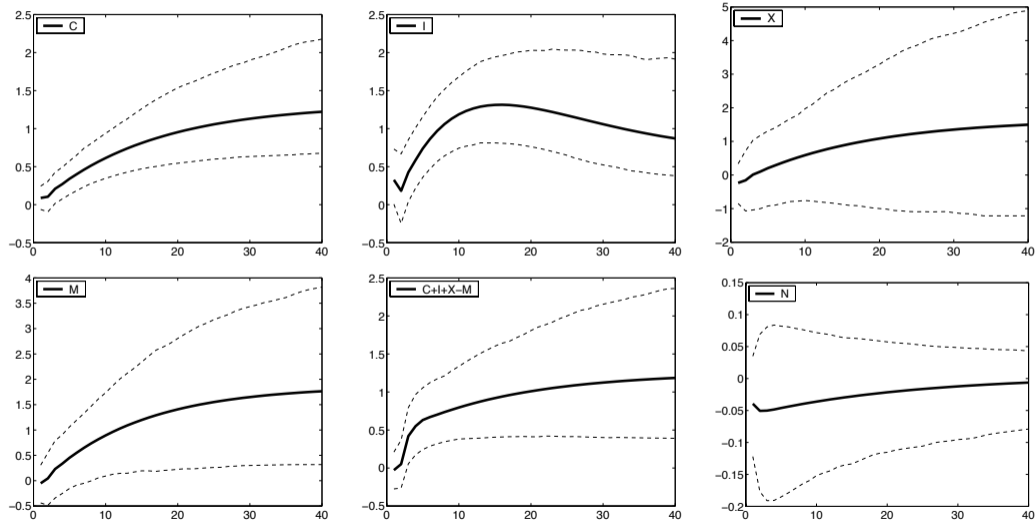The response to a US technological news in Canada

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The response to a German technological news in Germany

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The response to a German technological news in Austria