The Optimal Inflation Rate under Downward Nominal Wage Rigidity

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In a nut-shell

- The model uses state-dependent pricing and state-dependent wage-setting
- The model allows for productivity growth and transaction cost
- The model features search and matching unemployment
- The bargaining mechanism gives rise to asymmetric wage rigidity
- It is shown that optimal inflation is positive and relatively high

The model

- Three sectors:
  - Wholesale sector with matching frictions and wage rigidity
  - Intermediate goods sector with price rigidity
  - Retail sector
- State dependent price setting
  - Firms calculate the gain from resetting the price
  - Compare to random cost of changing the price
  - But change their price at least every J periods

Wage setting

- Wages are set according to right to manage bargaining
- But not each period
- Both parties calculate the gain from renegotiation
- Renegotiation if for one party this gain is higher than the (random) disagreement cost
- Otherwise the wage stays the same
- The distribution of disagreements costs can be different for worker and firm - this gives rise to asymmetric wage ridigity

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- But: the exposition of the paper should be considerably improved

Model description

- At times very hard to follow
- Assumptions rarely motivated
- Rare interpretations (e.g., equations 8, 24)
- Structure could be improved
- It was never quite clear to me whether a firm has one or more workers (some equations suggest the latter (17, 18, 23), some the former (23))
- Parameters missing in the calibration section (e.g., σ_m, the elasticity of the matching function)

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- Wage of new hires random?
- What would happen under alternative price-setting regimes (Calvo staggering)?
- Subsidy to remove monopolistic distortion?
- Zero-lower bound?

Results

- No interpretation or explanation for the results
- Explain a bit how the model works
- Show welfare in dependence of inflation
- Is it coincidental that optimal inflation is zero with flexible starting wages?
- I would expect that with symmetric wage rigidity there is still a case for price stability
- Robustness?
- Distinguish better from Kim and Ruge-Murcia (forthcoming in JEDC)