

# Discussion of “Keynesian Mismanagement” (Ghassibe and Zanetti, 2023)

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December 12, 2023  
Networks in Economics Conference, UNSW

## Summary

- Really cool paper on a very important topic: use sectoral policies to mitigate market distortions in disaggregated and interconnected economies
- Builds a tractable and, at the same time, rich model: displays input-output linkages, sectoral government spending, sticky prices, and search and matching frictions
- Around frictionless economy, optimal sectoral government spending depends on
  - the substitutability  $\epsilon_i$  between private and public goods in consumption (increasing in  $\epsilon_i$ ) and
  - a weighted sum of deviations of sectoral spare capacity (large-sticky-low matching efficiency)

# Comments

1. Modeling assumptions
2. Mapping to the data
3. Scope for policy
4. Ramsey

# Assumptions

- Endogenous productivity  $A_i = \frac{f_i(x_i)}{1+\gamma(x_i)}$  case requires
  - same sectoral search frictions to firms, households, and government
- Is really the government subject to the same frictions households are?
  - (procurement) government solicits bids and proposals for work; after analysis, the government awards the contract to a bidder
  - $G_i$  is concentrated in long-term contracts with “steady” prices (Cox et al., 2023)
- More generally, could model other frictions (e.g., financial frictions or market power) as isomorphic to endogenous productivity (endogenous wedges)?

## Mapping model to the data

- Search and matching frictions imply spare capacity, but they might not be the main driver of spare capacity
- Take commodity markets, for example. Spare capacity is also driven by expectations of future demand and uncertainty
  - e.g., oil prices usually price in low spare capacity with a higher risk premium (market would not be prepared for a “crisis”)
- How to measure *congestion* adjusted cost shares (if necessary) then?

## Scope for policy

In the paper, I would provide a more in depth discussion of

- Standard (pecuniary) externalities in models with search and matching frictions
- Agents do not internalize that by visiting (posting a vacancy) they alter equilibrium tightness and prices
- Hosios condition (wage determination) for constrained efficiency  $\approx$  GZ condition on posted prices
  - flexible price case (complete pass through) is the same to bargaining power being equal to the workers contribution to surplus

# Ramsey

In practice, is  $G_i$  targeted towards mitigating output/input market frictions? Consider taxes/subsidies that correct for pecuniary externalities (Miranda-Pinto, 2018)

- Solve for primal Ramsey primal
  - Given set of constrained efficient allocation ( $C^*$ ) and frictions
  - Solve for set of sectoral subsidies/taxes and prices that attain  $C^*$
  - Here could easily be away from efficient allocation
  - Addressing the “little to be fixed” issue near efficiency

# Primal Ramsey

From Miranda-Pinto (2018). Wedges from working capital constraints (Bigio and La'O, 2020)

**Proof Lemma 1.**

Assume  $\epsilon_Q = \epsilon_M = 1$ . The system equations defined by (6) and (7), for all  $j$ , with sectoral subsidies  $(\{s_j^l, s_j^m\}_j)$  is described by the following set of  $2N$  equations

$$\begin{aligned} -\log P_j + \log(1 - s_j^l) &= \log a_j \psi_j + \log Q_j^* - \log L_j^* \\ \sum_{i=1}^N \omega_{ij} \log P_i - \log P_j + \log(1 - s_j^m) &= \log(1 - a_j) \psi_j + \log Q_j^* - \sum_{i=1}^N \omega_{ij} \log M_{ij}^*. \end{aligned}$$

In matrices, we have

$$A \cdot X = B,$$

where  $A$  is a matrix of dimension  $2N$  by  $N + K$ , where  $K$  is the number of endogenous variables, which is at least equal to  $N + 1$ ,  $N$  sectoral prices and one policy instrument, and at most equal to  $3N$ , when  $2N$  policy instruments are available. The vector  $X$  is

$$X = [\log P_1 \quad \dots \quad \log P_N \quad \log(1 - s^1) \quad \dots \quad \log(1 - s^N)],$$

A solution  $X = A^{-1}B$  relates sectoral subsidies and prices to IO network, input shares, etc



## Take away

- Very useful paper. After all, targeting  $G_i$  might be easier to implement than sectoral subsidies/taxes
- Very intuitive walk through the mechanisms and deviations from Samuelson's rule
- Looking forward to the *away from efficiency* optimal policy results