Discussion of "Market Polarization and the Phillips Curve" by J Andres, O Arce, and P Burriel CEMLA XXVI Meeting of the Central Bank Researchers Network 2021

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The opinions expressed are the author's and do not necessarily reflect those of the Federal Reserve System, the Board of Governors, or its staff.

Thanks

- Thanks to the organizers for the opportunity to discuss this paper.
- Thanks to authors for the interesting paper.

What they Do

- Add rich Industrial Organization to standard NK model.
- IO considerations:
  - Strategic Pricing (Bertrand)
  - Endogenous Technology Choice $\Longrightarrow$ Firm heterogeneity
  - Endogenous Market Structure (entry/exit, number of firms matters)
- Payoff:
  - Gives flattening Phillips curve
  - Match other macro moments (e.g. great moderation)
  - Match large number of firm/IO facts.

My Understanding of the Basic Mechanism

- Standard NK Phillips Curve Logic:
  - Firms have market power: monopolistic competition
    - $p =$ markup over cost.
  - A bump in inflation lowers real value of (sticky) nominal prices
  - Lower real prices increase demand.
  - Hence $\pi \uparrow \Longrightarrow y \uparrow$.
- Suppose, instead, Bertrand competition
  - $p =$ cost of follower firm.
- Shocks to leader's marginal cost have no effect!
- (Suspect that this intuition is not what's really going on...).

Comments:

- What is really going on?
  - Can read the equations, see the new term...
  - But still lack intuition for *why*...
  - Is there an Econ101 story you can put in the introduction (like mine about why Bertrand matters?)
- What is really driving change over time? Talk about lots of parameters:
  - Tech advantage of leader firm
  - Elasticity of substitution
  - Changing cost of tech investment
  - Changing concentration
- Which really is changing over time?
- Now, only two tech levels.
  Could you do endogenous growth, à la Klette and Kortum?
- "Sustitutability" $\longrightarrow$ "Substitutability"