Discussion of "Currency Pegs and Unemployment" by S. Schmitt-Grohe and M. Uribe

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Consider the full employment case: Balassa-Samuelson economy, full employment, full labour mobility, increases in tradable sector output increase relative prices.

Hence no role for demand in driving relative prices.

No costs of inflation (nominal wage rigidities as opposed to prices affect the marginal costs and the production frontier): this might bias the results in favor of generating positive inflation through devaluations.
Labour demand is always efficient, fluctuations in wages do not prevent firms from moving along the demand schedule: search costs would instead hinder the adjustment of vacancies to exchange rate fluctuations.

Labour supply: involuntary unemployment induced by downward nominal wage rigidity.

No endogenous participation decision which is relevant to judge the extent of involuntary unemployment.
Many countries join currency peg to gain credibility: this amplifies the costs of unexpected devaluations.

Change in policies (as the one features in the *full employment exchange rate regime*) should imply change in the expectations process.

The subgame-perfect equilibrium should result from a dynamic game between policy maker and agent.
Conclusions

- Interesting, elegant, clearly written paper
- Role for endogenous participation decisions
- Are devaluations dynamically sustainable?