Discussion of

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Non-Essential Business Cycles

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Overview

- Proposes and brings corroborating evidence on a novel BC amplification mechanism

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- Components
  1. (New evidence) Non-essential (luxury, $\partial Q^E/\partial I > 1$) goods-producing sectors are more sensitive to BC fluctuations than essential (inferior/normal, $\partial Q^E/\partial I \leq 1$) sectors.
  2. (New evidence) Workers in non-essential sectors earn less than those in essential sectors (note, not frontline vs. not-frontline during COVID)
  3. (Assumption) Workers in non-essential sectors have higher MPC (hand-to-mouth)

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  3. (Assumption) Workers in non-essential sectors have higher MPC (hand-to-mouth)
- New theoretical model: The three-way interaction of the components amplify business cycles

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  - Well-executed paper
- Comments/questions:
  1. Relationship to relevant literature
  2. Heterogeneity in price (and wage) rigidity
  3. Earnings and MPC
  4. (Bit unfair:) Why should we care?

Trading down vs essential-non-essential sectors

- Related story: trading down (Jaimovich, Rebelo and Wong, 2019)
  - Households substitute to lower-quality goods in recessions
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- Different, but related story: within-sector versus across-sectors substitution
- Relative relevance of the two mechanisms: elasticity of substitution within sectors can be potentially much higher than across sectors: trading down potentially more important

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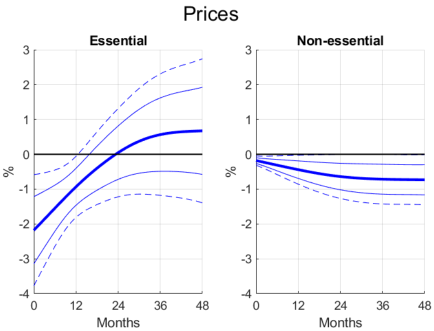
- Heterogeneity can affect amplification: If prices of essentials drop during downturn, it leaves room for non-essential spending to drop less
- Response to essential vs. non-essential prices to monetary policy shocks: significant difference



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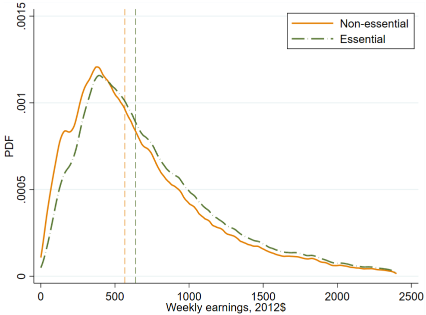
- Heterogeneity can affect amplification: If prices of essentials drop during downturn, it leaves room for non-essential spending to drop less
- Microdata (Nakamura and Steinsson, 2008): essential frequency is 39% $\gg$ 21% average (includes used car (100%), gas (67%))

Essential sector	weight	Frequency
Rent	5.5%	N/A
Used car	5.53%	100%
Communication	2.59%	34%
Food at home	11.63%	16%
Utilities	5.21%	40%
Children's clothes	0.96%	3.7%
Gas and v. maint.	6.14%	67.4%
Health	4.9%	6.35%
Personal care	0.97%	4.83%
Essential	37.9%	39.2%

Earning distribution across sectors

- A surprising result of the paper is that earnings in non-essential sectors are lower than earnings in essential sectors



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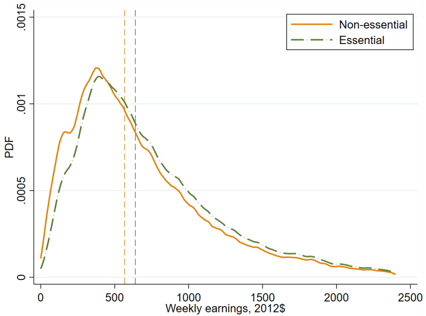

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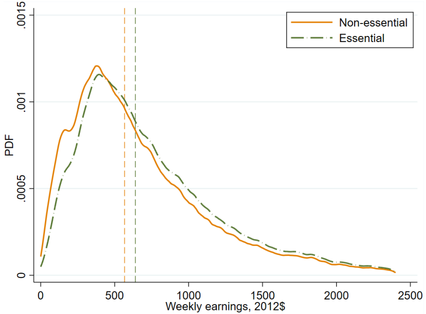
- Story: is this the consequence of some features of these sectors, or this just happens to be the case?



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- The model assumes that low productivity/low earning agents have high MPC
- Assumption is reasonable: MPC decreases with income on average
- However, from previous research - including some of the authors' - we know that income is not a sufficient statistic: high-income (wealthy) hand-to-mouth agents
- No smoking gun: The paper does not show that MPC of workers in non-essential sectors are higher than MPCs of workers in essential sectors, even though - as far as I understand - this is essential for most of the quantitative effects in the model

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- A good story improves the attractiveness of theoretical frameworks
- However, if the goal is to arrive at the simplest realistic model: textbook New Keynesian DSGE and HANK models capture key business cycle co-movements.
- Open question: which new key business cycle fact/puzzle can this model explain?

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- Comments/wishlist
  - Importance relative to within sector trading down
  - Robustness to heterogeneity in price and wage stickiness
  - Any way to get closer to directly show that non-essential workers have high MPC?
  - Any puzzles solved?

References I

Jaimovich, Nir, Sergio Rebelo, and Arlene Wong (2019) "Trading Down and the Business Cycle," *Journal of Monetary Economics*, Vol. 102, pp. 96–121.

Nakamura, Emi and Jón Steinsson (2008) "Five Facts about Prices: A Reevaluation of Menu Cost Models," *The Quarterly Journal of Economics*, Vol. 123, pp. 1415–1464.