Contents

Preface v
Contributors xvii

1 Symbolic Optimization **1**
Hal R. Varian

1.1 Notation 1
1.2 Unconstrained Optimization 3
1.3 Constrained Optimization 10
1.4 Graphics 16
1.5 Integrability 17
1.6 Symbolic Dynamic Programming 20
1.7 Numeric Dynamic Programming 24
1.8 Summary 25
1.9 References 25

2 Designing an Incentive-Compatible Contract **26**
Todd Kaplan and Arijit Mukherji

2.1 Description of the Problem and a Summary of the Theory 26
2.2 Preferences: the Single-Crossing Property 27
2.3 Incentive Compatible Contracts with Finitely Many Types 30
2.4 A Comprehensive Illustration of the Finite Case 39
2.5 Approximating the Continuous Problem through Interpolation 43
2.6 Continuous Screening Problems 45
2.7 Non-linear Pricing with Two Types of Consumers 50
2.8 References 57

3 Economic Dynamics **58**
John C. Eckalbar

3.1 Systems with One Dynamic Variable 59
3.2 Systems with Two Dynamic Variables 63
3.3 Three Dimensional Systems 73
3.4 Lyapunov Functions 75
3.5 Catastrophe 76
3.6 Conclusion 78
3.7 References 78

4 Perturbation Solution Methods for Economic Growth Models **80**
Kenneth L. Judd and Sy-Ming Guu

4.1 Introduction 80
4.2 Approximations 81
4.3 Optimal Growth Models 82
4.4 Continuous-Time Stochastic Growth 93
4.5 Discrete-Time Growth 98
4.6 Extensions and Conclusions 102
4.7 References 103

5 General Equilibrium Models **104**
Asahi Noguchi

5.1 The Basic Model 104
5.2 Solving the Model 106
5.3 Presenting the Graph 109
5.4 Program Extensions 115
5.5 Acknowledgment 123
5.6 References 123

6 Symbolic Algebra Programming for Analyzing the Long Run Dynamics of Economic Models **124**
Gary S. Anderson

6.1 Introduction 124
6.2 Numerical Routines vs Symbolic Routines 125
6.3 Complicated Dynamics are Potentially Present in Traditional Economic Models 130
6.4 Nonlinear Dynamic Economic Model Specification 131
6.5 A General Methodology for Analyzing the Asymptotic Properties of Nonlinear Dynamic Economic Models 133
6.6 Numerical Implementation 138
6.7 Symbolic Implementation 139

6.8 The Analytic Implementation of the Anderson-Moore Saddle Point Analysis Routine Applied to the Example Nonlinear Models 139
6.9 Symbolic Algebra Programming Facilitates a Deeper Analysis of an Overlapping Generations Model 142
6.10 References 146

7 A Program for Finding Nash Equilibria **148**
John Dickhaut and Todd Kaplan

7.1 Introduction 148
7.2 Examples 152
7.3 Sessions 154
7.4 Performance 164
7.5 Conclusion 166
7.6 References 166

8 Cooperative Games **167**
Michael Carter

8.1 Modelling Cooperative Games 167
8.2 Some Examples 169
8.3 Imputations and Solutions 171
8.4 The Core 175
8.5 The Nucleolus 180
8.6 The Shapley Value 185
8.7 Conclusion 189
8.8 References 191

9 Mathematica and Diffusions **192**
J. Michael Steele and Robert A. Stine

9.1 Introduction 192
9.2 Review of Diffusions and Itô's Formula 193
9.3 Basic Mathematica Operations 195
9.4 Deriving the Black-Scholes Formula 200
9.5 More Mathematica Details and Examples 207
9.6 Summary and Concluding Remarks 211
9.7 References 213

10 Itovsn3: Doing Stochastic Calculus with Mathematica **214**
Wilfrid S. Kendall

10.1 Introduction 214
10.2 Basic Implementation of Itovsn3 220

10.3 Documentation for Itovsn3 224
10.4 Application to a Hedging Problem 234
10.5 Conclusion 237
10.6 References 237

11 Bounded & Unbounded Stochastic Processes 239
Colin Rose

11.1 Overview 239
11.2 The Normal Distribution 240
11.3 Exchange Rate Target Zones 246
11.4 Irreversible Investment Under Uncertainty 253
11.5 Simulating Random Processes 256
11.6 References 265
11.7 Acknowledgments 265

12 Option Valuation 266
Ross M. Miller

12.1 Introduction 266
12.2 The Black-Scholes Model 267
12.3 Risk Management Using the Black-Scholes Model 272
12.4 Options as Objects 277
12.5 Valuing Options with Financial Decision Trees 280
12.6 Concluding Remarks 285
12.7 References 285

13 Nonlinear Systems Estimation: Asset Pricing Model Application 286
Stephen J. Brown

13.1 Introduction 286
13.2 Nonlinear Systems Estimation 286
13.3 Equity Asset Pricing Models 289
13.4 Summary 298
13.5 References 299

14 Econometrics.m: A Package for Doing Econometrics in Mathematica 300
David A. Belsley

14.1 Introduction 300
14.2 User's Guide 302
14.3 Examples 317
14.4 Development Notes 335
14.5 Related Experimental Packages 339
14.6 References 343

15 Bayesian Econometrics: Conjugate Analysis and Rejection Sampling **344**
Eduardo Ley and Mark F.J. Steel

15.1 Introduction 344
15.2 Conjugate Analysis 345
15.3 A Rejection Sampling Approach to Demand Analysis 354
15.4 Concluding Remarks 365
15.5 Appendix 366
15.6 References 367

16 Time Series Models and Mathematica **368**
Robert A. Stine

16.1 Introduction 368
16.2 Interactive Manipulations 370
16.3 Using the Arima Package 377
16.4 Numerical Methods and Estimation 394
16.5 Discussion 405
16.6 References 406

17 Decision Analytica: An Example of Bayesian Inference and Decision Theory Using Mathematica **407**
Robert J. Korsan

17.1 Summary 407
17.2 A Touch of History 408
17.3 An Overview of Decision Analysis 409
17.4 The Mathematica Packages—InfluenceDiagram.m and JohnsonDistributions.m 413
17.5 Influence Diagrams 413
17.6 The Wildcatter's Problem, A Prototypical Decision Problem 423
17.7 A Full Decision Analysis 430
17.8 What Hath Mathematica Wrought? 453
17.9 Acknowledgment 454
17.10 Appendix I: DecisionAnalytica`InfluenceDiagram` 454
17.11 Appendix II: DecisionAnalytica`JohnsonDistributions` 456
17.12 References 457