Contents

	Preia	ice to Second Edition	X1
	Prefa	ice to First Edition	xiii
1	Introduction and Overview		1
	1.1	The Evolution of Macrodynamics	1
	1.2	Scope of the Book	3
	1.3	Outline of the Book	6
I	TRA	DITIONAL MACRODYNAMICS	15
2	A Dy	namic Portfolio Balance Macroeconomic Model	17
	2.1	Some Preliminary Concepts	17
	2.2	The Output Market	20
	2.3	The Financial Sector	27
	2.4	Equilibrium in Product and Money Markets	33
	2.5	The Supply Function	35
	2.6	The Phillips Curve	37
	2.7	Dynamics of Asset Accumulation	38
	2.8	Expectations	40
	2.9	A Complete Dynamic Macro Model	42
	2.10	Fixed Real Stock of Money Policy	46
	2.11	Constant Rate of Nominal Monetary Growth Policy	52
	2.12	Fixed Real Stock of Government Bonds Policy	54
	2.13	Conclusions: Some Methodological Remarks	58
п	RAT	IONAL EXPECTATIONS	65
3	Rational Expectations: Some Basic Issues		67
	3.1	The Rational Expectations Hypothesis	67
	3.2	Specification of Expectations in Continuous-Time Models	69
	3.3	The Cagan Monetary Model	75
	3.4	Forward-Looking Solution to Cagan Model	78
	3.5	Discrete-Time Cagan Model	86
	3.6	Bubbles	91
	3.7	Learning	92

4	Ratio	onal Expectations and Policy Neutrality	97
	4.1	The Lucas Supply Function	97
	4.2	A Complete Rational Expectations Macro Model	104
	4.3	The Lucas Critique and Policy Neutrality	106
	4.4	Robustness of Policy Neutrality Proposition	110
	4.5	Full Information Level of Output	115
	4.6	Alternative Information Set	- 116
	4.7	Persistence of Shocks and Business Cycles	124
	4.8	Conclusions	128
5	Nonuniqueness Issues in Rational Expectations Models		131
	5.1	The Taylor Model	132
	5.2	Nonuniqueness Due to Policy	135
	5.3	Critique of Minimum Variance Criterion	137
	5.4	The Minimum State Representation Solution	139
	5.5	Some Objections to the Minimum State Representation	
		Solution	143
	5.6	Characterization of Solutions of General Rational	
		Expectations Systems	145
	5.7	A Nonlinear Macrodynamic Model	147
	5.8	Endogeneity of Coefficients	150
	5.9	Some Final Comments	151
6	Macroeconomic Stabilization Policy under Rational Expectations		153
	6.1	Wage Indexation	154
	6.2	Monetary Instrument Problem	159
	6.3	Generalized Disturbances and the Role of Information	164
	6.4	A Rational Expectations Model of a Small Open	
		Economy	167
	6.5	General Solution	170
	6.6	Jointly Optimal Wage Indexation and Monetary Policies	173
	6.7	The Barro-Gordon Model	182
	6.8	Conclusions	185
7	Rational Expectations and Saddlepoint Behavior		187
	7.1	Saddlepoint Behavior	187
	7.2	Example 1: Cagan Model with Sluggish Wages	191

	7.3	Example 2: Term Structure of Interest Rates	199
	7.4	Example 3: Exchange Rate Dynamics	211
		Appendix	217
Ш	INT	ERTEMPORAL OPTIMIZATION	225
8	The 1	Representative Agent Model	227
	8.1	Introduction	227
	8.2	The Framework and Macroeconomic Equilibrium	228
	8.3	Sustainability of Equilibrium	237
	8.4	Unanticipated Permanent Increase in Government	
		Expenditure	240
	8.5	Temporary Increase in Government Expenditure	251
	8.6	Government Expenditure as a Productive Input	255
	8.7	Term Structure of Interest Rates	258
	8.8	Money in the Utility Function	263
	8.9	Population Growth	268
	8.10	The Representative Agent Model: Some Caveats	271
		Appendix	274
9	-	librium in a Decentralized Economy with Distortionary Taxes	
		nflation	279
	9.1	Introduction	279
	9.2	The Macroeconomic Structure	281
	9.3	Perfect Foresight Equilibrium	288
	9.4	Determination of Optimality Conditions for Households	289
	9.5	Determination of Optimality Conditions for Firms	292
	9.6	Equilibrium Structure and Dynamics of System	299
	9.7	Steady State	301
	9.8	Characterization of Alternative Steady States	303
	9.9	Dynamic Response to Monetary Expansion	308
	9.10	Interior Debt-Equity Ratio	311
	9.11	A Final Comment	314
10	A Dy	namic Analysis of Taxes	317
	10.1	Introduction	317
	10.2	The Framework	319

	10.3	Macroeconomic Equilibrium	327
	10.4	Steady-State Effects	329
	10.5	Transitional Dynamics	334
	10.6	The Dynamics of Policy Shocks	336
	10.7	Short-Run Effects of Increases in Tax Rates	337
	10.8	Tax Incidence	344
11	The F	Representative Agent in the International Economy	349
	11.1	Introduction and Overview	349
	11.2	Basic Monetary Model	350
	11.3	Real Model of Capital Accumulation	358
	11.4	Some Extensions	381
12	Optir	nal Monetary and Fiscal Policy	387
	12.1	A Simplified Intertemporal Model	388
	12.2	Optimal Government Policies: A General	
		Characterization	393
	12.3	Optimal Monetary Growth	395
	12.4	Optimal Monetary-Fiscal Package	399
	12.5	Recent Developments in Optimal Monetary Policy	400
	12.6	Optimal Taxation of Capital	401
	12.7	Externalities and Optimal Taxation of Capital	406
	12.8	Dynamic Inconsistency	409
IV	END	OGENOUS GROWTH MODELS	417
13	Endo	genous Growth Models and Balanced Growth Paths	419
	13.1	Introduction and Overview	419
	13.2	Externalities and Ongoing Growth	425
	13.3	Integrated Fiscal Policy and Endogenous Growth	428
	13.4	A Linear Endogenous Growth Model	431
	13.5	Productive Government Expenditure	448
	13.6	Tax Policy, Growth, and Government Budget Balance	453
	13.7	Long-run Balance, Welfare, and Optimal Fiscal Policy	460
	13.8	Endogenous Labor Supply	468
	13.9	Conclusions	480
		Appendix	482

14	Long	g-Run Growth and Transitional Dynamics	487
	14.1	Public and Private Capital	487
	14.2	Two-Sector Model of Endogenous Growth	502
,	14.3	The Ortigueira-Santos Model	514
	14.4	Non-Scale Models of Economic Growth	516
	14.5	A One-Sector NonScale Model	518
	14.6	A General Two-Sector Model of Growth	522
	14.7	Some Final Comments	532
V	CON	TINUOUS-TIME STOCHASTIC MODELS	537
15	Cont	inuous-Time Stochastic Optimization	539
	15.1	Introduction	539
	15.2	Some Basic Results from Continuous-Time Stochastic	
		Calculus	541
	15.3	A Basic Stochastic Intertemporal Model	547
	15.4	Two Examples	558
	15.5	Proportional Disturbances and Stochastic Growth	562
	15.6	Some Extensions	578
	15.7	**	
		Stochastic Methods to Economics	580
	15.8	Real Business Cycle Model	581
		Appendix	584
16		ochastic Intertemporal Model of a Small Open Economy	589
	16.1	Introduction	589
	16.2	The Analytical Framework	592
	16.3	Macroeconomic Equilibrium	602
	16.4	Equilibrium Properties	613
	16.5	Risk and the Equilibrium Growth Rate	619
	16.6	Applications to Issues in International Finance	625
	16.7	Monetary Policy and Optimal Exchange Rate	
		Management	631
	16.8	Optimal Debt Policy	635
		References	639
		Name Index	661
		Subject Index	665