

# CONTENTS

<i>Editor's Biography</i>	<i>xix</i>
<i>Contributors</i>	<i>xxi</i>
<i>Group Photos</i>	<i>xxvii</i>
<i>Preface</i>	<i>xxix</i>
<i>Acknowledgements</i>	<i>xxx</i>

## **Volume 2A**

### **Section 1. The Facts of Economic Growth and Economic Fluctuation 1**

#### **1. The Facts of Economic Growth 3**

C.I. Jones

1. Growth at the Frontier	5
2. Sources of Frontier Growth	9
3. Frontier Growth: Beyond GDP	23
4. The Spread of Economic Growth	31
5. Conclusion	61
Acknowledgments	62
References	62

#### **2. Macroeconomic Shocks and Their Propagation 71**

V.A. Ramey

1. Introduction	72
2. Methods for Identifying Shocks and Estimating Impulse Responses	74
3. Monetary Policy Shocks	88
4. Fiscal Shocks	111
5. Technology Shocks	135
6. Additional Shocks	151
7. Summary and Conclusions	152
Acknowledgments	154
References	154

#### **3. Macroeconomic Regimes and Regime Shifts 163**

J.D. Hamilton

1. Introduction: Economic Recessions as Changes in Regime	164
2. Econometric Treatment of Changes in Regime	169
3. Economic Theory and Changes in Regime	187

4. Conclusions and Recommendations for Researchers	196
Appendix	197
Acknowledgments	198
References	198
<b>4. The Macroeconomics of Time Allocation</b>	<b>203</b>
<b>M. Aguiar, E. Hurst</b>	
1. Introduction	204
2. Trends in Market Work	205
3. A Theory of Time Use	210
4. Time-Use Data	217
5. Long-Run Trends in Time Use	220
6. Life Cycle Variation in Time Use	239
7. Conclusion and Discussion	250
Acknowledgments	252
References	252
<b>5. Who Bears the Cost of Recessions? The Role of House Prices and Household Debt</b>	<b>255</b>
<b>A. Mian, A. Sufi</b>	
1. Introduction	256
2. Who Bears Recession Risk? Existing Research	258
3. Zip Code-Level Consumption Measures	270
4. Housing Net Worth Shock and the Great Recession	274
5. Models Most Closely Related to These Facts	287
6. Aggregate Evidence on Household Debt	290
7. Conclusion	292
Acknowledgments	293
References	293
<b>6. Allocative and Remitted Wages: New Facts and Challenges for Keynesian Models</b>	<b>297</b>
<b>S. Basu, C.L. House</b>	
1. Introduction	298
2. Defining “The Wage”	302
3. Background and Related Literature	303
4. The Benchmark Model	314
5. Empirical Measures of Real Wages	324
6. Comparing the Model and the Data	339
7. Conclusion	348
Acknowledgments	351
References	351

<b>7. Fiscal and Financial Crises</b>	<b>355</b>
M.D. Bordo, C.M. Meissner	
1. Introduction	356
2. Historical Overview	358
3. Financial and Fiscal Crises: A Long-Run Review of Theoretical Developments	361
4. Empirics of Financial Crises Over the Long Run	372
5. Fiscal Crises, Banking Crises, and the Fiscal Crisis Trilemma	399
6. Conclusions	403
Acknowledgments	406
References	406
<b>Section 2. The Methodology of Macroeconomics</b>	<b>413</b>
<b>8. Dynamic Factor Models, Factor-Augmented Vector Autoregressions, and Structural Vector Autoregressions in Macroeconomics</b>	<b>415</b>
J.H. Stock, M.W. Watson	
1. Introduction	418
2. DFMs: Notation and Summary of Econometric Methods	421
3. DFMs for Macroeconomic Monitoring and Forecasting	440
4. Identification of Shocks in Structural VARs	443
5. Structural DFMs and FAVARs	471
6. A Quarterly 200+ Variable DFM for the United States	478
7. Macroeconomic Effects of Oil Supply Shocks	496
8. Critical Assessment and Outlook	514
Acknowledgments	517
References	517
<b>9. Solution and Estimation Methods for DSGE Models</b>	<b>527</b>
J. Fernández-Villaverde, J.F. Rubio-Ramírez, F. Schorfheide	
1. Introduction	530
<b>Part I. Solving DSGE Models</b>	<b>531</b>
2. Solution Methods for DSGE Models	531
3. A General Framework	534
4. Perturbation	540
5. Projection	577
6. Comparison of Perturbation and Projection Methods	619
7. Error Analysis	620
<b>Part II. Estimating DSGE Models</b>	<b>627</b>
8. Confronting DSGE Models with Data	627
9. Statistical Inference	650
10. The Likelihood Function	662

11. Frequentist Estimation Techniques	672
12. Bayesian Estimation Techniques	693
13. Conclusion	712
Acknowledgments	713
References	713
<b>10. Recursive Contracts and Endogenously Incomplete Markets</b>	<b>725</b>
<b>M. Golosov, A. Tsyvinski, N. Werquin</b>	
1. Introduction	726
2. A Simple Model of Dynamic Insurance	728
3. Advanced Topics	773
4. Applications	810
5. Conclusion	836
Acknowledgments	837
References	837
<b>11. Macroeconomics and Household Heterogeneity</b>	<b>843</b>
<b>D. Krueger, K. Mitman, F. Perri</b>	
1. Introduction	845
2. The Great Recession: A Heterogeneous Household Perspective	848
3. A Canonical Business Cycle Model with Household Heterogeneity	857
4. Calibration of the Benchmark Economy	863
5. Evaluating the Benchmark Economy	870
6. Cross-Sectional Household Heterogeneity and the Aggregate Dynamics of Consumption and Investment in a Severe Crisis	880
7. Inequality and Aggregate Economic Activity	899
8. Conclusion	908
Appendices	909
Acknowledgments	917
References	918
<b>12. Natural Experiments in Macroeconomics</b>	<b>923</b>
<b>N. Fuchs-Schündeln, T.A. Hassan</b>	
1. Introduction	924
2. Verification: The Permanent Income Hypothesis	928
3. Quantification: The Fiscal Multiplier	947
4. Identification: Causal Factors in Economic Growth	956
5. Critical Assessment and Outlook	989
Appendix	993
Acknowledgments	1005
References	1005

<b>13. Accounting for Business Cycles</b>	<b>1013</b>
P. Brinca, V.V. Chari, P.J. Kehoe, E. McGrattan	
1. Demonstrating the Equivalence Result	1018
2. The Accounting Procedure	1035
3. Applying the Accounting Procedure	1040
4. Conclusion	1058
Appendix	1060
Acknowledgments	1062
References	1062
<b>14. Incomplete Information in Macroeconomics: Accommodating Frictions in Coordination</b>	<b>1065</b>
G.-M. Angeletos, C. Lian	
1. Introduction	1067
2. Framework	1076
3. Imperfect Coordination	1085
4. Global Games: Theory	1098
5. Global Games: Applications	1112
6. Coordination and Synchronization	1125
7. Beauty Contests: Theory	1135
8. Beauty Contests: Applications	1157
9. Efficiency and Policy Implications	1200
10. Conclusion	1209
Appendix. Proofs	1211
Acknowledgments	1231
References	1231
<b>15. New Methods for Macro-Financial Model Comparison and Policy Analysis</b>	<b>1241</b>
V. Wieland, E. Afanasyeva, M. Kuete, J. Yoo	
1. Introduction	1243
2. Literature on Model Comparison and Policy Robustness	1244
3. A Systematic Approach to Model Comparison	1255
4. Practical Problems and a New Platform	1259
5. Comparing Fiscal and Monetary Policy Transmission Using the New Platform	1270
6. Comparing Implications of New Macro-Financial Models	1286
7. How to Assess Policy Robustness: An Illustrative Example	1312
8. Critical Assessment and Outlook	1315
Acknowledgments	1316
References	1316

**Volume 2B**

<b>Section 3. Financial-Real Connections</b>	<b>1343</b>
<b>16. Wholesale Banking and Bank Runs in Macroeconomic Modeling of Financial Crises</b>	<b>1345</b>
M. Gertler, N. Kiyotaki, A. Prestipino	
1. Introduction	1346
2. The Growth and Fragility of Wholesale Banking	1349
3. Basic Model	1358
4. Numerical Experiments	1373
5. Anticipated Runs	1379
6. Two Productive Assets and Spillover Effects	1385
7. Government Policy	1388
8. Summary and Directions for Future Research	1397
Appendices	1398
References	1423
<b>17. Housing and Credit Markets: Booms and Busts</b>	<b>1427</b>
V. Guerrieri, H. Uhlig	
1. Introduction	1428
2. A Stark Model	1432
3. Related Literature: Households' Leverage	1446
4. A Simple Model of Catastrophes	1453
5. Related Literature: Sentiments and Bubbles	1466
6. A Simple Model of Sentiments	1472
7. Evidence	1481
8. Conclusions	1491
Acknowledgments	1492
References	1493
<b>18. Macro, Money, and Finance: A Continuous-Time Approach</b>	<b>1497</b>
M.K. Brunnermeier, Y. Sannikov	
1. Introduction	1498
2. A Simple Real Economy Model	1504
3. A Model with Price Effects and Instabilities	1510
4. A Simple Monetary Model	1532
5. Critical Assessment and Outlook	1539
Acknowledgments	1542
References	1543

<b>19. Housing and Macroeconomics</b>	<b>1547</b>
<b>M. Piazzesi, M. Schneider</b>	
1. Introduction	1549
2. Facts	1553
3. Theory	1568
4. Theory vs Data	1602
Acknowledgments	1634
References	1635
<b>20. Term Structure of Uncertainty in the Macroeconomy</b>	<b>1641</b>
<b>J. Borovička, L.P. Hansen</b>	
1. Introduction	1642
2. Mathematical Framework	1644
3. Asset Pricing over Alternative Investment Horizons	1646
4. Relation to Impulse Response Functions	1654
5. Discrete-Time Formulas and Approximation	1661
6. Continuous-Time Approximation	1668
7. Models with Financial Constraints in Continuous Time	1673
8. Directions for Further Research	1685
Appendices	1687
Acknowledgments	1694
References	1694
<b>21. Quantitative Models of Sovereign Debt Crises</b>	<b>1697</b>
<b>M. Aguiar, S. Chatterjee, H. Cole, Z. Stangebye</b>	
1. Introduction	1698
2. Motivating Facts	1700
3. Environment	1707
4. Benchmark Models	1720
5. Benchmark Results with Nonlinear Default Costs	1723
6. Rollover Crises	1742
7. Extensions and Literature Review	1746
8. Conclusion: Where We've Been and Where We Need to Go?	1752
Acknowledgments	1753
References	1753

<b>Section 4. Models of Economic Growth and Fluctuations</b>	<b>1757</b>
<b>22. RBC Methodology and the Development of Aggregate Economic Theory</b>	<b>1759</b>
E.C. Prescott	
1. Introduction	1760
2. A Brief History of Business Cycles	1761
3. The Nature of the Discipline	1770
4. Major Developments and Their Applications Post-1995	1775
5. Intangible Capital Expands the Applicability of the Theory	1779
6. Concluding Comments	1784
References	1785
<b>23. Families in Macroeconomics</b>	<b>1789</b>
M. Doepke, M. Tertilt	
1. Introduction	1790
2. The Family and the Macroeconomy in the Short and Medium Run	1794
3. The Family and Economic Growth	1837
4. The Family and the Political Economy of Institutional Change	1861
5. Conclusion	1877
Appendices	1879
Acknowledgments	1882
References	1882
<b>24. Environmental Macroeconomics</b>	<b>1893</b>
J. Hassler, P. Krusell, A.A. Smith, Jr.	
1. Introduction	1895
2. Limited Natural Resources and Sustainability Concerns	1899
3. Climate Change: The Natural-Science Background	1912
4. A Static Global Economy-Climate Model	1938
5. Dynamic IAMs	1986
References	2004
<b>25. The Staying Power of Staggered Wage and Price Setting Models in Macroeconomics</b>	<b>2009</b>
J.B. Taylor	
1. Introduction	2010
2. An Updated Empirical Guide to Wage and Price Setting in Market Economies	2011
3. Origins of the Staggered Wage and Price Setting Model	2019
4. A Canonical Staggered Price and Wage Setting Model	2020



5. Generalizations and Extensions	2026
6. Derivation of Staggered Price Setting When Firms Have Market Power	2028
7. Price and Wage Setting Together	2031
8. Persistence of Inflation and Indexing	2032
9. Taylor Contracts and Calvo Contracts	2033
10. State-Dependent Models and Time-Dependent Models	2035
11. Wage-Employment Bargaining and Staggered Contracts	2036
12. Staggered Contracts vs Inattention Models	2036
13. Critical Assessment and Outlook	2037
Acknowledgment	2038
References	2039

## **26. Neoclassical Models in Macroeconomics** **2043**

G.D. Hansen, L.E. Ohanian

1. Introduction	2044
2. The Importance of Low Frequency Components in Macroeconomic Data	2047
3. Cass-Koopmans: The Foundation of Simple Models	2060
4. Neoclassical Models of the US Post-Korean War Economy	2061
5. Neoclassical Models of Depressions	2087
6. Neoclassical Modeling of Large Fiscal Shocks: The US World War II Economy	2106
7. Neoclassical Models of Productivity Shocks	2114
8. Neoclassical Models of Inequality	2118
9. Neoclassical Macroeconomics: Critical Assessments and Future Directions	2121
10. Conclusions	2124
Acknowledgments	2124
References	2124

## **27. Macroeconomics of Persistent Slumps** **2131**

R.E. Hall

1. The Slump Following the 2008 Financial Crisis	2133
2. Driving Forces	2138
3. Propagation Mechanisms	2147
4. Fiscal Driving Force and Multiplier	2153
5. Other Issues	2153
6. A Model	2154
7. Application to the U.S. Economy	2160
8. Crisis and Slump	2169
9. Persistence	2172
10. Concluding Remarks	2173
Acknowledgments	2175
References	2176

<b>Section 5. Macroeconomic Policy</b>	<b>2183</b>
<b>28. Challenges for Central Banks' Macro Models</b>	<b>2185</b>
J. Lindé, F. Smets, R. Wouters	
1. Introduction	2186
2. Common Features of Central Bank Models	2189
3. A Benchmark Model	2191
4. Empirical Performance of Benchmark Models During the Great Recession	2203
5. Augmenting the Benchmark Model	2218
6. State of Macroeconomic Modeling: Critical Assessment and Outlook	2246
Appendices	2249
Acknowledgments	2257
References	2257
<b>29. Liquidity Requirements, Liquidity Choice, and Financial Stability</b>	<b>2263</b>
D.W. Diamond, A.K. Kashyap	
1. Introduction	2264
2. Literature Review	2268
3. Baseline Model	2275
4. Basel-Style Regulatory Options	2285
5. Extensions	2294
6. Conclusion	2298
Acknowledgments	2301
References	2301
<b>30. Understanding Inflation as a Joint Monetary–Fiscal Phenomenon</b>	<b>2305</b>
E.M. Leeper, C. Leith	
1. Introduction	2307
2. Endowment Economies with Ad Hoc Policy Rules	2314
3. Production Economies with Ad Hoc Policy Rules	2333
4. Endowment Economies with Optimal Monetary and Fiscal Policies	2346
5. Production Economies with Optimal Monetary and Fiscal Policies	2372
6. Empirical Considerations	2382
7. Practical Implications	2394
8. Critical Assessment and Outlook	2401
Acknowledgments	2409
References	2409
<b>31. Fiscal Multipliers: Liquidity Traps and Currency Unions</b>	<b>2417</b>
E. Farhi, I. Werning	
1. Introduction	2418
2. Multipliers and Summary Multipliers	2423

3. A Closed Economy	2427
4. National Multipliers in a Liquidity Trap	2429
5. An Open Economy Model of a Currency Union	2438
6. National and Local Fiscal Multipliers in Currency Unions	2442
7. Liquidity Constraints and Non-Ricardian Effects	2450
8. Outside-Financed Fiscal Multipliers	2456
9. Taking Stock: Some Summary Multiplier Numbers	2461
10. Country Size, Aggregation, and Foreign Government Spending	2465
11. Conclusion	2468
Appendices	2469
References	2491
<b>32. What is a Sustainable Public Debt?</b>	<b>2493</b>
P. D'Erasmus, E.G. Mendoza, J. Zhang	
1. Introduction	2494
2. Empirical Approach	2498
3. Structural Approach	2521
4. Domestic Default Approach	2557
5. Critical Assessment and Outlook	2588
6. Conclusions	2590
Appendix: Details on Measurement of Effective Tax Rates	2592
Acknowledgments	2593
References	2593
<b>33. The Political Economy of Government Debt</b>	<b>2599</b>
A. Alesina, A. Passalacqua	
1. Introduction	2600
2. Optimal Debt Policies: A Brief Review	2602
3. Deficits and Elections	2610
4. Social Conflict: War of Attrition and Riots	2613
5. Debt as a Strategic Variable	2617
6. The Common Pool Problem	2618
7. Intergenerational Redistribution	2625
8. Rent Seeking	2628
9. Budget Rules	2631
10. Budget Institutions	2636
11. Questions for Future Research	2640
Acknowledgments	2646
References	2646
<i>Index</i>	2653