
Index

- Adams, Gwyn, 293
aggregate consumption, 86, 88
aggregate demand:
 autoregressions for, 75, 77
 disaggregation of, 95–97
 employment and, 38–39
 interest rate and, 85–88
 in multicountry model, 67, 70, 75, 77, 78, 87, 95, 208
 production and, 67, 70, 78–79
 in single-country model, 38–39, 42
 wages and, 75, 77, 78–79
aggregate price level, 78–79, 80, 132
 see also price level, price
aggregate supply, *see* potential GNP
Alexander, Lewis, 293
Anderson, Theodore W., 133
Annual Report of the Council of Economic Advisers, 282
antirecession policy, 33
appreciation:
 inflation and, 207
 interest rate and, 272–73
 money supply and, 213
 trade account and, 210, 211, 214, 216
 see also exchange rates, exchange-rate policy
automatic stabilizers:
 oil-price shock of 1990 and, 288–89
 policy rules and, 4–5, 223, 250, 259
 systematic policies and, 288–89
autoregressive moving average (ARMA), 44, 45, 46, 48, 51, 52

Ball, Lawrence, 278
Bank of Japan, 8, 134, 211, 225, 226, 232–33, 235, 286

banks, central, *see* central banks
Barro, Robert J., 30
Baumol, William J., 13
Bayesian (least-squares) analysis, 268, 277, 278
Blanchard, Olivier, 5, 30–31
BLS (Bureau of Labor Statistics), 34
bond market, inflation and, 290–91
bonds, long-term, 70
Bray, Margaret, 278
Brayton, Flint, 98
Bretton Woods system, 137, 259
Bryant, Ralph, 98, 217, 257
budget deficit:
 automatic stabilizers and, 289
 exchange rates and, 216
 of Germany, 8, 290
 reduction of, 7, 259, 269–78
 structural vs. actual, 7
 of United States, 7, 11, 216, 269–78, 289
budget law, 7, 288, 289
Budget Summit (1990), 289
Bundesbank, 134, 232
Bureau of Labor Statistics (BLS), 34
Bush, George, 281–82

call-money rate, 225, 226
Calvo, Guillermo, 5
Canada, 6
 alternative policy rule effects in, 251–56
 consumption demand in, 86–88, 102
 correlation matrix of errors to the exchange-rate equations of, 116–29
 durables consumption in, 86, 87, 111
 expected sales and investments in, 104
 export demand in, 91–93, 104

- Canada (*continued*)
 export prices in, 82, 83
 fiscal expansion in, 170–73, 210–11
 fixed investment in, 89, 90
 fixed vs. flexible exchange rates in,
 229–34, 244, 254
 import demand in, 91–94, 105
 inventory investment in, 92
 investment demand in, 103
 monetary expansion in, 142–45, 207–9
 money demand in, 93–95, 105
 in multicountry model, 67, 69, 75–83,
 85–90, 92–97, 101–5, 110, 111,
 116–30, 142–45, 170–73, 207–11
 nondurables consumption in, 86, 87
 permanent income and consumption in,
 103
 policy coordination and, 248–49
 services consumption in, 86, 87, 88
 shocks and, 110, 111, 115–30
- capital markets, capital:
 demand for, 8
 international, 224–25
 in Italy, 84–85
 in multicountry model, 67, 68, 70, 89
- Carlozzi, Nicholas, 31, 222*n*
- central banks, 7, 8, 78, 134, 211, 212, 225
 of Germany (Bundesbank), 134, 232
 IMF, 6, 288
 of Japan, 8, 134, 211, 225, 226, 232–33,
 235, 286
 oil-price shocks and, 285, 286, 288
 policy coordination and, 244, 247–50
 policy rules and, 5, 244, 247–51
 of United States, *see* Federal Reserve
 System
- Cholesky decomposition algorithm, 133
- Chow, Gregory C., 31
- closed economy, two-country model and,
 24–25
- Cockerline, Jon, 98
- computer programs, 311–12
- confidence shocks, 281
- constant-growth rate rule, 280
- consumer price index (CPI), 62
- consumption:
 aggregate, 86, 88
 budget deficit and, 270, 272
 durables, *see* durables consumption
 fixed vs. flexible exchange rates and, 229
 Friedman-type equation for, 20
 impact of a change in permanent income
 on, 103
 in multicountry model, 67, 68, 70, 85–88,
 100–103, 108–11, 131, 206, 210
 nondurables, 70, 86, 87, 131, 206
 Sargan's test of overidentifying
 restrictions for, 100
 services, 70, 86, 88, 131
 shocks to, 108–11, 131
- consumption demand, 70, 85–88, 106, 107,
 222
- semi-elasticities of, 102
- Cooper, J. P., 256
- correlation matrix of errors to exchange-
 rate equations, 116–29
- Council of Economic Advisers, 281, 282,
 285, 288
- Cowles Commission, 22
- CPI (consumer price index), 62
- credibility, systematic policies and, 283–84
- credit controls, U.S., 111
- Crocket, Andrew, 293
- “crowding-in” effect, 25, 270
- crowding-out, 210, 275–77
- currency:
 appreciation of, 207, 210, 211, 213, 214,
 216, 272, 273
 depreciation, *see* depreciation
 exchange rates of, *see* exchange rates,
 exchange-rate policy
 import and export prices and, 79–82,
 91
 international monetary reform and, 6
see also specific currencies
- Dagli, C. Ates, 18, 75*n*, 312
- data series, used to estimate multicountry
 model, 295–310
- Davidon, W. C., 63
- Davidon-Fletcher-Powell technique, 44
- deficits:
 budget, *see* budget deficit
 trade, 208, 210, 214, 269, 272, 275
- demand:
 aggregate, *see* aggregate demand
 consumption, 70, 85–88, 102, 106, 107,
 222
 export, 70, 91–93, 104, 270
 fiscal expansion and, 168, 172, 176, 180,
 184, 188, 192, 204
 import, 70, 91–94, 105, 134, 270
 investment, 70, 88–91, 103, 222, 273
 labor-market, 40, 42
 monetary expansion and, 140, 144, 148,
 152, 156, 160, 164, 200, 206, 207,
 208, 212, 213
 money, *see* money demand
 wages and, 75
- depreciation:
 exchange rates and, 137, 206, 208, 213,
 224
 exports and, 208, 209–10, 213
 imports and, 82, 208, 210–11
 inflation and, 78–79, 134, 213
 interest rate and, 70, 207
 price level and, 79, 82, 275
- Depression, Great, 106
- Desert Storm, 286
- design of policy rules, 31, 53–59, 107, 113,
 115, 221–57, 281–82
 conclusions about, 251–56
 coordination in, 221, 244–50
 discretion in, 5, 30, 223, 281, 292
 domestic monetary policy and, 6–7, 221,
 247

- exchange rates and, 6, 221–49, 251, 252, 254–55
- international monetary system and, 6, 221–44
- questions about, 6–7
- rational expectations and, 222, 260
- steady-state covariance matrix of the endogenous variables and, 53–55
- wage shocks and, 57–59
- Deutsche mark, 115
- discretionary policy rules, 5, 30, 223, 281, 292
- “discretionary” spending, 289
- disinflation, 7, 59–62, 259, 261–69, 278
 - current and deferred wage changes during, 264, 267
- disposable income, 223
- disturbances, *see* shocks and disturbances
- Dobson, Wendy, 293
- dollar, Canadian, 115, 130
- dollar, U.S.:
 - appreciation of, 207, 210, 213, 214, 216, 272, 273
 - depreciation of, 134, 207, 208, 213, 275
 - exchange rates and, 6, 83, 115, 130, 206–7, 208, 211
 - international monetary reform and, 6 as standard, 137, 259
- domestic monetary policy:
 - coordination in, 247
 - design of, 6–7, 221, 247
- Dornbusch, Rudiger, 31
- Dornbusch model, 206
- durables consumption, 70, 86, 87, 213, 273
 - shocks and, 107–11, 131, 206, 210
- Eastern Europe, 6, 8, 259
- Econometrica*, 5, 63
- econometric models:
 - policy analysis in validation of, 61–62
 - see also* multicountry model; rational expectations; single-country model
- econometric policy evaluation, 32–63, 219–93
 - design of policy rules and, 53–59, 221–57
 - model validation with policy analysis and, 61–62
 - summary, retrospect, and prospect for, 62–63
 - transition to policy rules and, 59–61, 258–78
 - see also* single-country model
- Economic Report of the President* (1990), 281–86
- Economic Summit of G-7 countries, 244, 247
- elasticities:
 - export-demand, 104, 270
 - import-demand, 105, 270
 - interest rate, 115, 206, 270, 272
 - of money demand, 94, 105, 206, 208
- employment, 134
 - aggregate demand and, 38–39
 - full, 74, 259, 264
 - in single-country model, 32, 33, 38–39, 42
 - see also* unemployment; wages
- “entitlement” spending, 289
- Epple, Dennis, 31
- European Monetary System, 223, 259
- exchange rates, exchange-rate policy, 3, 6, 67, 70, 134
 - budget deficits and, 216
 - expected value of, 83
 - fiscal expansion and, 166, 170, 174, 178, 182, 186, 190, 202, 209, 211
 - fixed, *see* fixed exchange rates
 - flexible, *see* flexible exchange rates
 - import prices and, 81
 - interest rates and, 82–84, 225–27, 230, 232, 234–35
 - monetary expansion and, 138, 142, 146, 150, 154, 158, 162, 194–98, 206–7, 208, 211–12
 - policy design and, 6, 221–44, 251, 252
 - policy transition and, 270, 271, 274, 275, 276
 - shocks to, 106, 108, 115, 130, 222, 228–29, 235–44
 - target zones and, 223
 - see also* appreciation; depreciation
- expectations, rational, *see* rational expectations
- expected inflation, *see* inflation, expected
- expected sales, *see* sales, expected
- export demand, 70, 91–93, 104
 - elasticities of, 104, 270
- export prices, 68, 79–80, 82, 83, 91–93
 - shocks to, 132
- exports, 67, 70
 - depreciation and, 208, 209–10, 213
 - fiscal expansion and, 167, 168, 171, 172, 175, 176, 179, 180, 183, 184, 187, 188, 191, 192, 203, 204, 210, 211, 214, 215–16
 - fixed vs. flexible exchange rates and, 229, 230, 231
 - monetary expansion and, 139, 140, 143, 144, 147, 148, 151, 152, 155, 156, 159, 160, 163, 164, 199, 200, 207, 208
 - policy design and, 229, 230, 231, 253
 - shocks to, 108, 131, 132
 - variance of, 229–32
 - see also* net exports
- extended path method, 19–20, 109, 135
- factorization method, 18, 31, 44, 312
- Faddeeva, V. N., 133
- Fair, Ray C., 19, 63, 71*n*, 133
- federal funds rate, 225, 226, 280–81, 285
- Federal Reserve System (the Fed), 7, 8, 134, 225, 226, 235, 281, 291
 - systematic policy and, 285
 - transition to fiscal policy and, 273
- feedback rules, 4, 5, 39

- FIML (full-information maximum-likelihood) methods, 109
- financial-market shocks, 115, 130–31
defined, 108
- fiscal expansion:
 anticipated, 202–5, 213–14
 in Canada, 170–73, 210–11
 demand and, 168, 172, 176, 180, 184, 188, 192, 204
 exchange rates and, 166, 170, 174, 178, 182, 186, 190, 202, 209, 211
 exports and, 167, 168, 171, 172, 175, 176, 179, 180, 183, 184, 187, 188, 191, 192, 203, 204, 210, 211, 214, 215–16
 in France, 174–77, 210–11
 in Germany, 178–81, 210–11
 imports and, 167, 171, 175, 179, 183, 187, 191, 203, 210
 interest rates and, 166, 170, 174, 178, 182, 186, 190, 202, 209, 210, 214
 in Italy, 182–85, 210–11
 in Japan, 186–89, 210–11
 long-run effects of, 209
 output and, 166, 169, 170, 173, 174, 177, 178, 181, 182, 185, 186, 189, 190, 193, 202, 205, 209–11, 215
 prices and, 166, 167, 169, 170, 171, 173, 174, 175, 177, 178, 179, 181, 182, 185, 186, 187, 189, 190, 191, 193, 202, 203, 205, 209, 210, 211, 215
 real spending and, 209
 in United Kingdom, 190–93, 210–11
 in United States, 166–69, 202–5, 209–10, 213–14
- fiscal policy, 3, 223, 250
 budget-deficit reduction and, 269–73
 empirical overview of, 215–16
 international coordination of, 275–77
 multicountry model and, 67, 134–37, 166–93, 202–5, 209–11, 213–16
 nature of simulations and, 136–37
 oil-price shock of 1990 and, 288
 policy rules and, 4, 8, 223
 role of monetary policy in transition to, 273–75
 shocks and, 24–28, 135–37, 166–93, 202–5, 209–11, 213–14, 288
 transition to, 259, 261, 269–77
 two-country model and, 24–27
 see also fiscal expansion; policy rules; transition to policy rules
- Fischer, Stanley, 5, 30, 31, 256
- fixed exchange rates, 6, 135, 136–37, 211–12, 215
 flexible vs., 212, 229–36, 238, 240, 242, 244, 254
 interest-rate rules under, 226–27
 Japanese monetary expansion under, 194–97, 211–12
 long-run effects of, 211–12
 macroeconomic performance and, 229–35
 policy design and, 221–46, 254–55
 response coefficient changes and, 244, 246
 shocks and, 222, 228–29, 235–44
 in simulation results, 212
 in simulation with actual residuals, 235, 244
 two-country model with, 27–29
 world price index weight and, 244, 245
- fixed investment, 88–91, 206, 210
- Fleming, J. Marcus, 31
- Fletcher, R., 63
- flexible exchange rates, 135, 136, 211, 212, 215
 coordination and, 247–49
 fixed vs., 212, 229–36, 238, 240, 242, 244, 254
 interest-rate rules under, 225–26
 long-run effects of, 211–12
 macroeconomic performance and, 229–35
 policy design and, 221–49, 254–55
 response coefficient changes and, 244, 246
 shocks and, 222, 228–29, 235–44
 two-country model with, 25–27
 world price index weight and, 244, 245
- forecasting, as model-validation tool, 61
- foreign-exchange markets:
 intervention in, 224
 see also exchange rates, exchange-rate policy
- France, 6
 alternative policy rule effects in, 251–56
 consumption demand in, 86–88, 102
 correlation matrix of errors to the exchange-rate equations of, 116–29
 durables consumption in, 86–87
 expected sales and investments in, 104
 export demand in, 91–93, 104
 export prices in, 82, 83
 fiscal expansion in, 174–77, 210–11
 fixed vs. flexible exchange rates in, 229–34, 244, 254
 import demand in, 91–94, 105
 import prices in, 81, 82
 inventory investment in, 92
 investment demand in, 103
 monetary expansion in, 146–49, 207–9
 money demand in, 93–95, 105
 in multicountry model, 67, 69, 75–83, 85–97, 102–5, 146–49, 174–77, 207–11
 nondurables consumption in, 86, 87
 nonresidential investment in, 89, 90
 permanent income and consumption in, 103
 policy coordination and, 248–49
 residential investment in, 90, 91
 services consumption in, 88
 shocks and, 116–31
- Frenkel, Jacob A., 257

- Friedman, Milton, 5*n*, 30, 257, 280
 Friedman-type consumption equation, 20
 Frydman, Roman, 278
 Fukuda, Shin-Ichi, 222*n*
 full-information maximum-likelihood (FIML) methods, 109
- Gagnon, Joseph, 293
 Gauss-Siedel method, 19
 GDP, *see* gross domestic product
 generalized method of moments (GMM) estimator, 75*n*, 85, 99–101, 312
General Theory of Employment, Interest, and Money, The (Keynes), 291
- Germany, 6
 aggregate consumption in, 86, 88
 alternative policy rule effects in, 251–56
 budget deficit of, 8, 290
 central bank of (Bundesbank), 134, 232
 consumption demand in, 86–88, 102
 correlation matrix of errors to the exchange-rate equations of, 116–29
 exchange rates in, 208, 272
 expected sales and investments in, 104
 export demand in, 91–93, 104
 export prices in, 82, 83
 fiscal expansion in, 178–81, 210–11
 fixed investment in, 89, 90
 fixed vs. flexible exchange rates in, 212, 229–36, 238, 240, 242, 244, 254
 import demand in, 91–94, 105
 import prices in, 81, 82
 interest rates in, 8, 290–91
 investment demand in, 103
 inventory investment in, 92
 monetary expansion in, 150–53, 207–9, 212
 money demand in, 93–95, 105
 in multicountry model, 67, 69, 75–83, 85–90, 92–97, 102–5, 150–53, 178–81, 207–11
 permanent income and consumption in, 103
 policy coordination and, 248–49
 policy transition and, 270–77
 shocks and, 116–29
 trade surplus of, 272, 277
 unification of, 8, 290, 293
 world price index weight and, 244, 245
- GMM (generalized method of moments) estimator, 75*n*, 85, 99–101, 312
- GNP, *see* gross national product
 GNP deflator, 56, 62, 225
 Goldfeld, Stephen M., 44*n*
 Goldstein, Morris, 257
 goods-market shocks, 131
 defined, 108
- Gordon, David B., 30
 government spending:
 types of, 289
see also fiscal expansion; fiscal policy
- gradualist approach to monetary policy, 59–61
- Gramm-Rudman-Hollings budget law, 7, 288
- Great Depression, 106
- gross domestic product (GDP), 91, 97, 225, 270, 290
- gross national product (GNP):
 in multicountry model, 70, 75, 91, 97
 policy rules and, 57, 61, 250, 251
 nominal, 233, 234, 250, 251, 277, 286
 potential, 70, 95, 97
 real, 75, 272
see also output
- G-7 countries, 67
 econometric model of, *see* multicountry model
 policy coordination and, 244, 247
see also Canada; France; Germany; Italy; Japan; United Kingdom; United States
- Hall, Robert E., 5*n*, 85, 88
 Hall-Jorgenson investment equation, 20
 Hamada, Koichi, 222*n*
 Hansen, Lars Peter, 18, 31, 41, 75*n*, 98, 100, 101, 133
- Heller, Walter W., 291, 292
 Helliwell, John F., 98
 Hickman, Bert, 217
- historical shocks, policy rules and, 55–57
see also shocks and disturbances
- Holtham, Gerald, 217
 Hooper, Peter, 217
- IMF (International Monetary Fund), 6, 288
- import demand, 70, 91–94, 134
 elasticities of, 105, 270
 import prices, 68, 78–82, 91–93, 110
 domestic prices and, 79, 81*n*
 elasticity of, 81
 exchange rate and, 81
 fiscal expansion and, 167, 171, 175, 179, 183, 187, 191, 203
 fixed vs. flexible exchange rates and, 232, 234
 monetary expansion and, 139, 143, 147, 151, 155, 159, 163, 199
 policy design and, 232, 234, 254
 shocks to, 132
 variance of, 229–32
- imports, 70
 depreciation and, 82, 208, 210–11
 fiscal expansion and, 167, 168, 171, 172, 175, 176, 179, 180, 183, 184, 187, 188, 191, 192, 204, 210, 211, 214
 fixed vs. flexible exchange rates and, 229, 231
 monetary expansion and, 139, 140, 143, 144, 147, 148, 151, 152, 155, 156, 159, 160, 163, 164, 200, 207, 208
 policy design and, 229, 231, 253

- imports (*continued*)
 - shocks to, 108, 110, 131, 132
 - variance of, 229–32
- income:
 - consumption and, 103
 - disposable, 223
 - in multicountry model, 67, 103, 105
 - nominal, 5, 234; *see also* nominal-income rules
- inflation:
 - appreciation and, 207
 - bond market and, 290–91
 - depreciation and, 78–79, 134, 213
 - expected, 8, 25, 85, 86, 206, 210, 213, 225, 273, 280, 291
 - fixed vs. flexible exchange rates and, 232–34
 - interest rates and, 8, 225, 290–91
 - in multicountry model, 78, 79, 85, 97
 - oil-price shock of 1990 and, 285–87
 - output and, 59–62
 - policy evaluation and, 32–33, 55–57
 - policy rules and, 7, 25, 55–57, 59–62, 259–69, 273
 - shocks and, 130–31, 285–87
 - unemployment and, 62
 - zero, monetary policy rule with, 261–69, 278
 - see also* disinflation
- interest-rate parity, *ex ante*, 72, 115–30, 211
- interest rates, 29–30, 82–87
 - aggregate demand and, 85–88
 - appreciation and, 272–73
 - computation of error in, 85
 - in credible and systematic policies, 279
 - depreciation and, 70, 207
 - ex ante*, 72, 115–30, 211
 - exchange rates and, 82, 84, 225–27, 230, 232, 234–35
 - federal funds, 225, 226, 280–81, 285
 - fiscal expansion and, 166, 170, 174, 178, 182, 186, 190, 202, 209, 210, 214
 - under fixed exchange rates, 226–27, 230, 232, 234–35
 - under flexible exchange rates, 225–26, 230, 232, 234–35
 - inflation and, 8, 225, 290–91
 - long-term, *see* long-term interest rates
 - monetary expansion and, 138, 142, 146, 150, 154, 158, 162, 198, 206–8, 211, 212, 213
 - money demand elasticities with respect to income and, 105
 - nominal, 25, 29, 212, 213, 224, 225–26, 233, 234, 272, 273
 - oil-price shock of 1990 and, 285–86, 288
 - policy design and, 225–27, 230, 232, 234–35, 252, 254
 - policy transition and, 272, 273, 274, 276
 - real, *see* real interest rates
 - shocks to, 108, 113, 115, 130
 - short-term, *see* short-term interest rates
 - term structure of, 84–85, 115
- International Monetary Fund (IMF), 6, 288
- international monetary system:
 - assumptions about monetary policy rules and, 224–25
 - baseline and targets for price levels and real output and, 227
 - changes to, 259
 - fixed vs. flexible rates in, 223–44, 254–55
 - interest-rate rules and, 225–27
 - macroeconomic performance and, 229–35
 - policy design and, 6, 221–44
 - response coefficient changes and, 244, 246
 - shocks and, 228–29, 235–44
 - simulation with actual residuals and, 235, 244
 - variance-covariance matrix and, 227–28
 - world price index weight and, 244, 245
- inventory investment, 91, 92, 101, 210
 - shocks to, 131
- investment:
 - budget-deficit reduction and, 269, 270, 272
 - expected sales and, 104
 - fiscal policy and, 214
 - fixed, 88–91, 206, 210
 - fixed vs. flexible exchange rates and, 229, 231
 - gap between savings and, 8
 - Hall-Jorgenson equation for, 20
 - inventory, 91, 92, 101, 131, 210
 - monetary expansion and, 213
 - in multicountry model, 67, 70, 88–91, 100–101, 103, 104, 108, 131, 206, 210
 - nonresidential, 70, 89, 90
 - policy design and, 229, 231, 253
 - public infrastructure, 8
 - residential, 70, 89, 90, 91, 131
 - Sargan's test of overidentifying restrictions for, 100
 - shocks to, 108, 131
- investment demand, 70, 88–91, 222, 273
 - semi-elasticities of, 103
- Iraq, 6, 106, 284–86, 288
- Italy, 6
 - aggregate consumption in, 86, 88
 - alternative policy rule effects in, 251–56
 - capital markets in, 84–85
 - consumption demand in, 86–88, 102
 - correlation matrix of errors to the exchange-rate equations of, 116–29
 - expected sales and investments in, 104
 - export demand in, 91–93, 104
 - export prices in, 82, 83
 - fiscal expansion in, 182, 85, 210–11
 - fixed investment in, 89, 90
 - fixed vs. flexible exchange rates in, 229–34, 254
 - import demand in, 91–94, 105
 - import prices in, 81, 82

- inventory investment in, 92
 - investment demand in, 103
 - monetary expansion in, 154–57, 207–9
 - money demand in, 93–95, 105
 - in multicountry model, 67, 75–90, 92–97, 102–5, 116–31, 154–57, 182–85, 207–11
 - permanent income and consumption in, 103
 - policy coordination and, 248–49
 - shocks and, 116–31
 - term structure of interest rates in, 84–85
- Japan, 6
- alternative policy rule effects in, 251–56
 - call-money rate in, 225, 226
 - central bank of, 8, 134, 211, 225, 226, 232–33, 235, 286
 - consumption demand in, 86–88, 102
 - correlation matrix of errors to the exchange-rate equations of, 116–29
 - durables consumption in, 86–87
 - exchange rates in, 208, 272
 - expected sales and investments in, 104
 - export demand in, 91–93, 104
 - export prices in, 82, 83
 - fiscal policy in, 8, 186–89, 210–11
 - fixed exchange rates and, 194–97, 211–12
 - fixed vs. flexible exchange rates in, 212, 229–35, 237, 239, 241, 243, 244, 254
 - import demand in, 91–94, 105
 - import prices in, 81, 82, 110–11
 - inflation in, 232–33
 - inventory investment in, 91, 92
 - investment demand in, 103
 - monetary expansion in, 158–61, 194–97, 207–9, 212
 - money demand in, 93–95, 105
 - in multicountry model, 67, 68, 69, 73–97, 102–5, 110, 116–29, 158–61, 186–89, 194–97, 207–11
 - nondurables consumption in, 86, 87
 - nonresidential investment in, 90
 - oil shocks and, 286, 287
 - permanent income and consumption in, 103
 - policy coordination and, 247–49
 - policy transition and, 270–77
 - price level in, 208, 225
 - residential investment in, 90, 91
 - saving-investment gap reduction in, 8
 - services consumption in, 88
 - shocks and, 110, 116–29
 - trade surplus of, 8, 272, 275, 277
 - wage setting in, 67, 73–78
 - world price index weight and, 244, 245
- Keynes, John Maynard, 291
- Keynesian revolution, assessment of, 291, 292
- Klein, Lawrence, 137*n*, 217, 291, 292
- Kuwait, 6, 106, 284–86, 288
- Kydland, Finn, 5, 30–31, 292
- labor-market:
- aggregate demand and, 38–39
 - in single-country model, 40, 42
 - see also* unemployment; wages
- Lafrance, Robert, 98
- lags:
- import prices and, 81–82
 - in multicountry model, 68, 75, 79, 81, 82, 89
 - in single-country model, 38–39, 45
- Laidler, David, 292
- least-squares (Bayesian) analysis, 277
- legislation, budget and, 7, 288, 289
- limited-information estimation, 312
- “limit” rule, 289
- linear models, 9–18
- with more than one variable, 16–18, 31
 - with one variable, 9–16, 31
- liquidity shocks, 281
- long run:
- budget deficit reduction in, 272–73
 - elasticity of import prices in, 81
 - elasticity of money demand in, 94, 105
 - expected sales and investments in, 104
 - export-demand elasticities in, 104
 - fiscal expansion in, 209
 - fixed exchange-rates in, 211–12
 - import-demand elasticities in, 105
 - interest rates in, *see* long-term interest rates
 - monetary expansion in, 137, 206–9
 - money-demand elasticities in, 105
 - money supply increase in, 137
 - permanent income and consumption in, 103
 - semi-elasticities of consumption demand in, 102
 - semi-elasticities of investment demand in, 103
- long-term interest rates, 8, 70, 84–86, 115, 130, 206, 208, 213, 214
- policy transition and, 272, 273, 274, 276
 - systematic policy and, 290–91
- Lucas, Robert E., Jr., 5*n*, 20, 31, 63, 222, 278, 291–92
- Lucas critique, 20–22, 31, 51, 222, 257
- McCallum, Bennett, 15, 70*n*, 292
- McKibbin, Warrick, 222*n*, 257
- McKinnon, Ronald, 257, 278
- Marcet, Albert, 278
- Marquez, Jaime, 98
- Marschak, Jacob, 22
- Masson, Paul, 257
- maximum-likelihood techniques:
- full-information (FIML), 109
 - in single-country model, 40, 44, 46, 47, 74–75, 312
- Miller, Marcus, 70*n*

monetary expansion:

- anticipated, 198–201, 212–13
 - appreciation and, 213
 - in Canada, 142–45, 207–9
 - demand and, 140, 144, 148, 152, 156, 160, 164, 200, 206, 207, 208, 212, 213
 - depreciation and, 275
 - exchange rates and, 138, 142, 146, 150, 154, 158, 162, 194–98, 206–7, 208, 211–12
 - exports and, 139, 140, 143, 144, 147, 148, 151, 152, 155, 156, 159, 160, 163, 164, 199, 200, 207, 208
 - fixed exchange rates and, 194–97, 211–12, 215
 - in France, 146–49, 207–9
 - in Germany, 150–53, 207–9, 212
 - imports and, 139, 143, 147, 151, 155, 159, 163, 199
 - interest rates and, 138, 142, 146, 150, 154, 158, 162, 198, 206–8, 211, 212, 213
 - in Italy, 154–57, 207–9
 - in Japan, 158–61, 194–97, 207–9, 212
 - long-run effects of, 137, 206–9
 - output and, 138, 141, 142, 145, 146, 149, 150, 153, 154, 157, 158, 161, 162, 165, 198, 201, 206–9, 212–15, 250
 - prices and, 138, 139, 141, 142, 143, 145, 146, 149, 150, 151, 153, 154, 155, 157, 158, 159, 161, 162, 165, 198, 199, 201, 207, 211, 213, 214–15, 250
 - in United Kingdom, 162–66, 207–9
 - in United States, 138–41, 198–201, 206–7, 212–13
 - see also* unemployment; wages
- monetary policy, 3
- design of, 221–57
 - disinflation and, 7, 59–62
 - empirical overview of, 214–15
 - gradualist approach to, 59–61
 - medium- to long-run effects of, 215
 - multicountry model and, 67, 134–66, 194–201, 206–9, 211–15
 - nature of simulations and, 136–37
 - oil-price shock of 1990 and, 285–86
 - policy rules and, 5, 6–7, 24–30, 53–62, 221–57, 261–69, 281–92
 - shocks and, 6–7, 13, 24–28, 135–65, 194–201, 206–9, 212–13
 - short-run effects of, 214–15
 - in single-country model, 39, 42
 - transition to, 261–69
 - in transition to fiscal policy, 273–75
 - two-country model and, 24–30
 - see also* international monetary system; monetary expansion; policy rules; transition to policy rules
- money demand, 93–95, 206
- elasticities of, 94, 105, 206, 208
 - shocks to, 13, 14, 106, 108, 113, 115, 130

money supply:

- anticipated increase in, 212–13
 - anticipated shocks and, 15–16
 - appreciation and, 213
 - constant-growth rate rule for, 280
 - disinflation and, 59–62
 - effects of reduction of government purchases with increase in, 273–75
 - exchange rates and, 135
 - policy rules and, 4, 13–16
 - in single-country model, 33
 - unanticipated increase in, 137, 206–9
 - unanticipated shocks and, 13–15
- multicountry model, 32, 67–217, 290
- aggregate demand in, 67, 70, 75, 77, 78, 87, 95, 208
 - aggregate-price adjustment in, 78–79
 - consumption demand in, 85–88
 - consumption in, 67, 68, 70, 85–88, 100–103, 108–11, 131, 206, 210
 - data series used in estimation of, 295–310
 - equations in, 72–73
 - estimations and test procedures for, 99–101
 - export and import demand in, 91–94, 104–5
 - fiscal policy and, 67, 134–37, 166–93, 202–5, 209–11, 213–16
 - fixed investment in, 88–91
 - generalized method of moments (GMM) estimator in, 99–101
 - identities in, 95–97
 - import and export prices in, 79–82
 - inventory investment in, 91
 - key variables in, 69
 - monetary policy and, 67, 134–37, 166–93, 202–5, 209–11, 213–16
 - money demand in, 93–95
 - money in, 137
 - overview of, 67–71
 - policy design and, 221–57
 - potential GNP in, 97
 - sensitivity analysis of, 235–46
 - shocks and, 70, 107–33
 - single-country model vs., 67
 - summary of elasticities in, 102–5
 - wage determination in, 71–78
 - wage-price sector in, 33, 67
 - whole, 97–98
- Mundell, Robert, 31
- Mundell-Fleming model, 24, 27, 31, 206–9, 250
- Muth, J. F., 31
- National Bureau of Economic Research (NBER), 106
- net exports:
- fiscal expansion and, 167, 171, 175, 179, 183, 187, 191, 203, 210, 211
 - fixed vs. flexible exchange rates and, 229, 230, 232

- monetary expansion and, 139, 143, 147, 151, 155, 159, 163, 199, 207, 208
- policy design and, 229, 230, 232, 252
- policy transition and, 270, 272, 275, 277
- Newey, Whitney M., 101
- nominal GNP, 233, 234, 250, 251, 277, 286
- nominal income, 5, 234
- nominal-income rules, 5, 221, 247–56, 259, 279–80
- nominal interest rates, 25, 29, 212, 213, 224, 225–26, 233, 234, 272, 273
- nondurables consumption, 70, 86, 87, 131, 206
- nonlinear models, 18–20
- nonresidential investment, 70, 89, 90
- OECD, 288, 293
- oil-price shocks, 107, 111, 132
 - of 1990, 6–7, 106, 284–89
 - international macroeconomic policy and, 286–89
 - policy response to, 285–86
- Okun, Arthur M., 57, 61
- Okun's law, 38–39, 46, 62
- output, 134, 137
 - alternative policy rules and, 251, 252
 - baseline and targets for, 227
 - budget-deficit reduction and, 270, 272, 273, 275
 - design of policy rules and, 53–57
 - disinflation and, 59–62
 - fiscal expansion and, 166, 169, 170, 173, 174, 177, 178, 181, 182, 185, 186, 189, 190, 193, 202, 205, 209–11, 215
 - fixed vs. flexible exchange rates and, 229, 230, 234–37, 240–41, 244
 - gradualist approach to monetary policy and, 59–61
 - monetary expansion and, 138, 141, 142, 145, 146, 149, 150, 153, 154, 157, 158, 161, 162, 165, 198, 201, 206–9, 212–15, 250
 - in single-country model, 32, 33, 38–39
 - in two-country model, 27–30
 - wage determination and, 74
 - see also* gross national product
- patent laws, 282
- “pay-as-you-go” rule, 289
- Phelps, Edmund S., 256, 278
- Phillips, A. W., 5*n*, 256
- Phillips curve, 20, 267–68
- policy analysis, model validation with, 61–62
- policy rules, 3–31, 221–93
 - assumptions about, fixed vs. flexible exchange rates and, 224–25
 - automatic stabilizers and, 4–5, 223, 250, 259, 289
 - better, search for, 221, 250–55
 - bond market and, 290–91
 - compared, 55–57
 - credible and systematic policies and, 279–84
 - defined, 4–6, 30
 - design of, *see* design of policy rules
 - Lucas critique and, 20–22, 31
 - monetary policy and, 5, 6–7, 24–30, 53–62, 221–57, 261–69
 - new look for, 281–82
 - nominal-income, 5, 221, 247–56, 259, 279–80
 - operation of, 6, 8, 31
 - physical-design analogy for, 107
 - policy system vs., 281–82; *see also* systematic policies
 - price, 221, 225, 247, 249–56, 279–80
 - rational expectations and, 9–31
 - shocks and, 55–60, 106–33, 222–23, 228–29, 235–44, 251
 - short-term interest rate and, 70
 - steady-state covariance matrix of
 - endogenous variables and, 53–55
 - in stylized two-country model, 22–30
 - systematic policy vs., 281–82; *see also* systematic policies
 - transition to, *see* transition to policy rules
- policy system, *see* systematic policies
- Poole, William, 222*n*, 256
- potential GNP, 70, 95, 97
- Powell, M. J. D., 63
- Prescott, E. C., 5, 30–31, 292
- price level, price, 67, 137
 - aggregate, 78–79, 80, 132
 - alternative policy rules and, 251, 252, 254
 - anticipated shocks and, 16
 - baseline and targets for, 227
 - budget deficit and, 270, 271, 272, 276
 - depreciation and, 79, 82, 275
 - design of policy rules and, 54–55
 - determination of, 32–35, 222
 - export, 68, 79–80, 82, 83, 91–93, 132
 - fiscal expansion and, 166, 167, 169, 170, 171, 173, 174, 175, 177, 178, 179, 181, 182, 185, 186, 187, 189, 190, 191, 193, 202, 203, 205, 209, 210, 211, 215
 - fixed vs. flexible exchange rates and, 230, 232–33, 235, 238–39, 242–43, 244
 - import, *see* import prices
 - interest rates and, 225–26
 - monetary expansion and, 138, 139, 141, 142, 143, 145, 146, 149, 150, 151, 153, 154, 155, 157, 158, 159, 161, 162, 165, 198, 199, 201, 207, 211, 213, 214–15, 250
 - policy transition and, 270–76
 - in single-country model, 32–35, 37, 42, 46–48, 50, 51
 - sticky, 55, 68, 70
 - in two-country model, 27–30

- price rule, 221, 225, 247, 249–56, 279–80
- price shocks, 132
 defined, 108
 import, 82
 oil, *see* oil-price shocks
 unanticipated, 13–15
- production, in multicountry model, 67, 70, 78–79
- Quandt, Richard, 44*n*
- rational expectations, 9–30
 assumption of, 70–71, 135, 222, 260, 268
 computer programs and, 311–12
 linear models with more than one variable, 16–18, 31
 linear models with one variable, 9–16, 31
 nonlinear models, 18–20
 policy rules and, 222, 260
 stochastic modeling with, 9–20
 in two-country model, 22–30
see also multicountry model; single-country model
- real GNP, 75, 272
- real interest rates, 67, 91, 97, 134, 137, 225
 in closed economies, 25
 consumption demand and, 85, 86–87
 demand and, 70, 85, 86–87, 102, 103
 fiscal expansion and, 210, 212
 fixed vs. flexible exchange rates and, 232, 234–35
 monetary expansion and, 206, 208
 policy design and, 232, 234–35, 254
 policy transition and, 273
 semi-elasticities of consumption demand with respect to, 102
 semi-elasticities of investment demand with respect to, 103
 in two-country model, 25, 27, 29
- recession, 7, 32, 33, 62, 214, 223, 280
 budget deficit and, 269
 multicountry model and, 67–68
 oil-price shock and, 106
- Rehm, Dawn, 63
- residential investment, 70, 89, 90, 91, 131
- risk premia:
 in multicountry model, 70, 84, 85, 113, 115, 130, 228, 251
 shocks and, 113, 115, 130, 228
- Roberds, W., 31
- Sachs, Jeffrey, 222*n*, 257
- sales, expected, 213
 investments and, 104
 in multicountry model, 67, 88, 91, 104
- Samuelson, Paul, 291
- Sargan's test, 100, 101
- Sargent, Thomas J., 18, 31, 41, 278, 291–92
- Saudi Arabia, 285
- saving, 269, 272, 290
- saving-investment gaps, international coordination and, 8
- semi-elasticities:
 of consumption demand, 102
 of investment demand, 103
- sensitivity analysis of multicountry model:
 of response coefficients, 244, 246
 in simulation with actual residuals, 235–44
 of world price index weight, 244–45
- services consumption, 70, 86, 88, 131
- Shiller, Robert J., 84, 217
- shocks and disturbances, 70, 106–33
 anticipated, 11, 15–16, 136, 212–14
 changes in the stochastic structure and, 113
 confidence, 281
 consumption, 108–11, 131
 correlation of, 108, 113–32
 defining and computing of, 108–11
 durables consumption and, 107–11, 131, 206, 210
 exchange-rate, 106, 108, 115, 130, 222, 228–29, 235–44
 to exports, 108, 131, 132
 financial-market, 108, 115, 130–31
 fiscal policy and, 24–28, 135–37, 166–93, 202–5, 209–11, 213–14
 future, 107
 goods-market, 108, 131
 historical, policy rules and, 55–57
 to imports, 108, 110, 131, 132
 inflation and, 130–31
 to interest rates, 108, 113, 115, 130
 to investment, 108, 131
 liquidity, 281
 Lucas critique and, 20–22, 31
 monetary policy and, 6–7, 13, 24–28, 135–65, 194–201, 206–9, 212–13
 to money demand, 13, 14, 106, 108, 113, 115, 130
 oil price, *see* oil-price shocks
 policy design and, 55–59, 222–23, 228–29, 235–44, 251
 risk premia and, 113, 115, 130, 228
 in single-country model, 37–39, 42, 45, 46–48, 50
 standard deviations of, 113, 114
 structural residuals vs., 109–11
 temporary vs. permanent, 11
 in two-country model, 22–30
 unanticipated, 11–15, 57–59, 106–7, 135, 136
 variance-covariance matrix of, 108, 112–13, 131, 132–33
 wage, 57–59, 108, 132
- short run:
 elasticity of money demand in, 94, 105, 208
 expected sales and investments in, 104
 export-demand elasticities in, 104
 import-demand elasticities in, 105
 money-demand elasticities in, 105

- money supply increase in, 206
- permanent income and consumption in, 103
- semi-elasticities of consumption demand in, 102
- semi-elasticities of investment demand in, 103
- short-term interest rates, 70, 83, 84, 113, 115, 130, 206, 208, 212
 - policy design and, 224–27
 - policy transition and, 272, 273, 274, 276
- Shunto (Japanese spring wage offensive), 73–74, 77, 78
- single-country model, 32–52, 63
 - aggregate demand and employment in, 38–39, 42
 - ARMA and, 44, 45, 46, 48, 51, 52
 - effect of policy changes on reduced-form coefficients and, 50–52
 - empirical implementation and parameter estimates for, 44–51
 - estimation results in, 46–50
 - limitations of, 67
 - Lucas critique and, 51
 - maximum-likelihood techniques in, 40, 44, 46, 47, 74–75, 312
 - monetary policy rule and, 39
 - multicountry model vs., 67
 - nonsynchronized wage setting with different contract lengths in, 35
 - π -coefficients and, 35–38
 - solution and estimation techniques for, 40–44
 - structure of, 33–40
 - summary of the equations and the stochastic structure in, 39–40
 - VARMA and, 40–44, 46, 49, 51
 - wage and price determination in, 32–35
- Soviet Union, 6, 259
- staggered wage setting, 35, 73–78
- standard deviations of shocks to the equations, 113, 114
- sticky prices, 55, 68, 70
- stochastic modeling, with rational expectations, 9–20
- Structural Impediments Initiative, 8, 275
- supply, money, *see* money supply
- surplus, in trade, 8, 208, 272, 275, 277
- systematic policies, 279–93
 - automatic stabilizers and budget law revision in, 289
 - bond market and inflation and, 290–91
 - characterization of, 282–83
 - consensus rationale for, 283–84
 - credibility and, 283–84
 - oil-price shock of 1990 and, 284–89
 - policy rule vs., 281–82
- target zones, exchange rates and, 223
- taxes:
 - budget-deficit reduction and, 269, 270
 - policy rules and, 4–5, 223, 269
- Taylor, John B., 5, 15, 18, 19, 29, 31, 34–35, 37, 71*n*, 75*n*, 85, 133, 222*n*, 249*n*, 256, 257, 260, 278, 292
- technological change:
 - policy rules and, 6
 - shocks and, 130*n*
- trade balance:
 - appreciation and, 210, 211, 214, 216
 - depreciation and, 82, 208, 209–10, 213
 - fiscal policy effects on, 215–16
 - monetary policy effects on, 134, 215
- trade deficit, 208, 210, 214
 - budget-deficit reduction and, 269, 272, 275
- trade surplus, 8, 208, 272, 275, 277
- trade-off between output and price stability, 55
- transition to policy rules, 6, 31, 222, 258–78
 - analysis of, 259–61
 - calibration of wage-setting equations and, 261–69
 - conclusions about, 277
 - disinflation and, 59–61, 259, 278
 - examples of, 259–60
 - exchange rates and, 270, 271, 274, 275, 276
 - fiscal policy and, 259, 261, 269–77
 - international coordination of, 275–77
 - learning and, 260, 277, 278
 - questions for, 7–8
 - rigidities and, 260–61, 277
 - zero-inflation monetary policy rule and, 261–69, 278
- two-country model, 22–30, 135, 249*n*
 - changes in policy rules and, 29–30
 - fixed exchange rates and, 27–29
 - flexible exchange rates and, 25–27
 - policy instruments and, 24–29
- unemployment:
 - inflation and, 62
 - natural rate of, 62, 263, 268
 - policy transition and, 259, 260, 263, 267–68
 - in single-country model, 37, 45, 46
 - see also* labor market
- unemployment compensation, 4–5, 259
- United Kingdom, 6
 - alternative policy rule effects in, 251–56
 - consumption demand in, 86–88, 102
 - correlation matrix of errors to the exchange-rate equations of, 116–29
 - durables consumption in, 86, 87
 - expected sales and investments in, 104
 - export demand in, 91–93, 104
 - export prices in, 82, 83
 - fiscal expansion in, 190–93, 210–11
 - fixed vs. flexible exchange rates in, 229–35, 237, 239, 241, 243, 244, 254
 - import demand in, 91–94, 105
 - import prices in, 81, 82
 - inventory investment in, 92

- United Kingdom (*continued*)
 investment demand in, 103
 monetary expansion in, 162–66, 207–9
 money demand in, 93–95, 105
 in multicountry model, 67, 69, 75–83,
 85–97, 102–5, 162–66, 190–93,
 207–11
 nondurables consumption in, 86, 87
 nonresidential investment in, 90
 permanent income and consumption in,
 103
 policy coordination and, 248–49
 residential investment in, 90, 91
 services consumption in, 86, 87, 88
 shocks and, 115–31
- United States:
 alternative policy rule effects in, 251–56
 budget deficit of, 7, 11, 216, 269–78,
 289
 central bank of, *see* Federal Reserve
 System
 consumption demand in, 86–88, 102
 correlation matrix of errors to the
 exchange-rate equations of,
 116–29
 credit controls in, 111
 durables consumption in, 86–87, 111
 economic growth in, 7
 expected sales and investments in, 104
 export demand in, 91–93, 104
 export prices in, 82, 83
 fiscal expansion in, 166–69, 209–10
 fiscal expansion in, anticipated, 202–5,
 213–14
 fixed investment in, 89–91
 fixed vs. flexible exchange rates in, 212,
 229–36, 238, 240, 242, 244, 254
 import demand in, 91–94, 105
 import prices in, 80–82, 110–11
 inflation in, 7, 32, 225, 285–87
 interest rates in, 8, 115, 207, 211, 214,
 224, 272, 273, 290, 291
 inventory investment in, 92
 investment demand in, 103
 Japanese trade frictions with, 8
 monetary expansion in, 138–41, 206–7,
 212
 monetary expansion in, anticipated,
 198–201, 212–13
 money demand in, 93–95, 105
 in multicountry model, 45, 67, 68, 75–83,
 85–90, 92–97, 101–5, 108, 110–12,
 138–141, 166–69, 198–207, 209–10,
 212–14
 nondurables consumption in, 86, 87
 nonresidential equipment investment in,
 89
 nonresidential structures investment in,
 89
 oil-price shock of 1990 and, 285–88
 permanent income and consumption in,
 103
 policy coordination and, 247–49
 policy transition and, 261–77
 rational expectations models for, *see*
 single-country model; multicountry
 model
 recession in, 106
 residential investment in, 90
 services consumption in, 86, 87, 88
 shocks and, 106, 108, 110–12, 115–31
 systematic policies and, 280–91
 trade deficit of, 269, 272, 275
 union settlements in, 264, 265–66
 wages in, 77, 79
 world price index weight and, 244, 245
 zero-inflation policy rule in, 261–69
- variance-covariance matrix, 312
 design policy rules and, 53–55
 fixed vs. flexible exchange rates and,
 227–28
 imports and exports in, 229–32
 of shocks, 108, 112–13, 131, 132–33
 singularity of, 133
 steady-state, 53–55
- vector autoregressive moving average
 (VARMA), single-country model and,
 40–44, 46, 49, 51, 112
- Visco, Ignazio, 98
- wages, 67, 137
 aggregate demand and, 75, 77, 78–79
 determination of, 32–38, 68, 71–78,
 261–69
 fiscal expansion and, 167, 171, 175, 179,
 183, 187, 191, 203, 209
 fixed vs. flexible exchange rates and, 232,
 234
 in Japan, 67, 73–78
 microeconomic model of, 68
 monetary expansion and, 139, 143, 147,
 151, 155, 159, 163, 199, 206, 211,
 213
 nonsynchronized setting of, 35, 73–78
 policy design and, 54, 57–59, 232, 234,
 254
 policy transitions and, 261–69, 272
 shocks and, 57–59, 108, 132
 in single-country model, 32–42, 46–48,
 50, 51
 sticky, 55, 68, 70
 staggered setting of, 35, 73–78
 synchronized setting of, 73–78
 in United States, 77–79
- Wallis, K., 63
 West, Kenneth, 101
 Whiteman, Charles H., 18
 Williamson, John, 70*n*
 “Working Party 3,” 288
 World Bank, 6
- yen, Japanese, 6, 83, 206
- zero-inflation monetary policy rule, 261–69,
 278