A Model of
Macroeconomic
Activity
Volume I:
The Theoretical Model
A Model of Macroeconomic Activity

Volume I:
The Theoretical Model

Ray C. Fair

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Table of Contents

List of Tables ix

Preface xiii

Chapter One Introduction 1

1.1 The Purpose of the Study 1
1.2 An Outline of the Model 3
1.3 The Methodology of the Study 12
1.4 Suggestions to the Reader 16

Chapter Two Banks 19

2.1 The Basic Equations 19
2.2 The Formation of Expectations 22
2.3 Behavioral Assumptions 25
2.4 The Solution of the Control Problem 29
2.5 Some Examples of Solving the Control Problem of Bank $i$ 29
2.6 The Condensed Model for Banks 35

Chapter Three Firms 39

3.1 The Basic Equations 39
3.2 The Formation of Expectations
3.3 Behavioral Assumptions
3.4 The Solution of the Control Problem
3.5 Some Examples of Solving the Control Problem
   of Firm $i$
3.6 The Condensed Model for Firms

Chapter Four
Households
4.1 The Basic Equations
4.2 The Formation of Expectations
4.3 Behavioral Assumptions
4.4 The Solution of the Control Problem
4.5 Some Examples of Solving the Control Problems
   of the Households
4.6 The Condensed Model for Households

Chapter Five
The Government and the Bond Dealer
5.1 The Government
5.2 The Bond Dealer
5.3 The Condensed Model for the Government and
   the Bond Dealer

Chapter Six
The Dynamic Properties of the Model
6.1 The Complete Set of Equations for the Model
6.2 The Response of the Model to Shocks from a
   Position of Equilibrium
6.3 The Effects of Policy Changes from a
   Disequilibrium Position
6.4 The Long-Run Properties of the Model
6.5 Price and Wage Responses
6.6 The Relationship Between Demand Deposits
   and Aggregate Output

Chapter Seven
A Static-Equilibrium Version of the Model
7.1 Introduction
7.2 The Static-Equilibrium Version
7.3 The Solution of the Static Model
7.4 A Comparison of the Static Model to the
   Textbook Model
<table>
<thead>
<tr>
<th>Chapter Eight</th>
<th>Conclusion</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.1</td>
<td>Summary</td>
<td>181</td>
</tr>
<tr>
<td>8.2</td>
<td>Possible Extensions of the Model</td>
<td>186</td>
</tr>
<tr>
<td>8.3</td>
<td>Empirical Implications of the Model</td>
<td>190</td>
</tr>
<tr>
<td>8.4</td>
<td>Concluding Remarks</td>
<td>194</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Appendix</th>
<th>The Non-Condensed Version of the Model</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>195</td>
</tr>
</tbody>
</table>

References 219

Index 223

About the Author 225
### List of Tables

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2-1</td>
<td>Notation for Banks in Alphabetic Order</td>
<td>20</td>
</tr>
<tr>
<td>2-2</td>
<td>Parameter Values and Initial Conditions for the Control Problem of Bank $i$</td>
<td>30</td>
</tr>
<tr>
<td>2-3</td>
<td>Results of Solving the Control Problem of Bank $i$</td>
<td>32</td>
</tr>
<tr>
<td>2-4</td>
<td>Bank Equations for the Condensed Model</td>
<td>36</td>
</tr>
<tr>
<td>3-1</td>
<td>Notation for Firms in Alphabetic Order</td>
<td>40</td>
</tr>
<tr>
<td>3-2</td>
<td>Parameter Values and Initial Conditions for the Control Problem of Firm $i$</td>
<td>57</td>
</tr>
<tr>
<td>3-3</td>
<td>Results of Solving the Control Problem of Firm $i$</td>
<td>58</td>
</tr>
<tr>
<td>3-4</td>
<td>Firm Equations for the Condensed Model</td>
<td>65</td>
</tr>
<tr>
<td>4-1</td>
<td>Notation for Households in Alphabetic Order</td>
<td>76</td>
</tr>
<tr>
<td>4-2</td>
<td>Parameter Values and Initial Conditions for the Control Problems of Households 1 and 2</td>
<td>83</td>
</tr>
<tr>
<td>4-3</td>
<td>Results of Solving the Control Problem of Household 1</td>
<td>84</td>
</tr>
</tbody>
</table>
4-4 Results of Solving the Control Problem of Household 2

4-5 Results of Solving the Control Problems of Households 1 and 2 Based on a Cobb-Douglas Utility Function

4-6 Household Equations for the Condensed Model

5-1 Notation for the Government and the Bond Dealer in Alphabetic Order

5-2 The Government and Bond Dealer Equations for the Condensed Model

6-1 The Complete Notation for the Condensed Model in Alphabetic Order

6-2 The Complete Set of Equations for the Condensed Model

6-3 Flow-of-Funds Accounts for the Condensed Model: Stocks of Assets and Liabilities

6-4 National Income Accounts for the Condensed Model

6-5 Parameter Values, Initial Conditions, and Government Values for the Base Run in Table 6-6

6-6 Results of Solving the Condensed Model

7-1 Notation for the Static-Equilibrium Model in Alphabetic Order

7-2 The Equations of the Static-Equilibrium Model

7-3 Equations of the Static-Equilibrium Model by Blocks

7-4 Parameter Values, Government Values, and Values of LF, LH, and SD for the Base Run in Table 7-5

7-5 Results of Solving the Static-Equilibrium Model for the Endogenous VBG Case
<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>7-6</td>
<td>Results of Solving the Static-Equilibrium Model for the Endogenous $d_3$ Case</td>
<td>175</td>
</tr>
<tr>
<td>7-7</td>
<td>The Equations of the Textbook Model</td>
<td>178</td>
</tr>
<tr>
<td>A-1</td>
<td>The Complete Notation for the Non-Condensed Model in Alphabetic Order</td>
<td>195</td>
</tr>
<tr>
<td>A-2</td>
<td>The Complete Set of Equations for the Non-Condensed Model</td>
<td>199</td>
</tr>
<tr>
<td>A-3</td>
<td>Flow-of-Funds Accounts for the Non-Condensed Model: Stocks of Assets and Liabilities</td>
<td>206</td>
</tr>
<tr>
<td>A-4</td>
<td>National Income Accounts for the Non-Condensed Model</td>
<td>207</td>
</tr>
<tr>
<td>A-5</td>
<td>Parameter Values, Initial Conditions, and Government Values for the Base Run in Table A-6</td>
<td>210</td>
</tr>
<tr>
<td>A-6</td>
<td>Results of Solving the Non-Condensed Model</td>
<td>212</td>
</tr>
</tbody>
</table>
The work in this volume grew out of both my dissatisfaction with the standard static-equilibrium model that is found in most macroeconomic textbooks and my interest in the problem of basing macroeconomic theory on more solid microeconomic foundations. I was also interested in trying to incorporate into a general model of macroeconomic activity the recent work in economic theory that has been done on relaxing the assumptions of perfect information and the existence of tâtonnement processes that clear markets every period.

It soon became apparent as I began working on this project that the model that I had in mind would not be capable of being analyzed by standard analytic methods. I wanted to develop a macroeconomic model that was general, was based on solid microeconomic foundations, and was not based on the assumptions of perfect information and the existence of tâtonnement processes. I also wanted the model to account for wealth effects, capital gains effects, and all flow-of-funds constraints. Because of the likely complexity of any model of this sort, I decided at an early stage of the project to use computer simulation techniques to help analyze the properties of the model. The methodology that I followed is described in section 1.3.

One of the main dangers in building a model that is only feasible to analyze using computer simulation techniques is that the model becomes too detailed or complex for anyone other than the model builder to want to spend the time that it takes to understand the model. I clearly face this danger in the present case. However, I have tried to write this volume to make the model as intelligible as possible in as simple a way as possible. First, I have constructed a "condensed" version of the basic model, with the aim of making the model easier to understand. Second, I have constructed a "static-equilibrium" version
of the model, with the hope that this will put the basic model in a better perspective. Third, I have organized the discussion so that the different sectors are each discussed individually before the overall model is put together. The discussion of each sector is fairly self-contained, so that the reader can concentrate at first on the properties of each sector without having to comprehend the complete model. (I have, however, given a brief outline of the overall model in Chapter One.) Finally, I have relied heavily on the use of tables to present the model and have tried to make the tables fairly self-contained from the discussion in the text. One should be able to get a good picture of the overall model from a careful reading of the tables. The tables should also be useful for reference purposes.

There are, as discussed in Chapter Eight, many ways in which the present model might be extended. In many cases these extensions were not carried out here because of the desire not to increase the complexity of the model anymore than already existed. In future work, if the model does not turn out to be too unwieldy to comprehend, it would be of interest to carry out many of the extensions.

This volume is one of two. In Volume II an empirical model will be developed that is based on the theoretical model found in this volume. Because there is no unique way to specify an empirical version of the theoretical model, it seemed best to present the theoretical and empirical models in two separate volumes. The present volume can be read without reference to Volume II.

Neither volume has been written specifically as a textbook. It is possible, however, that either or both volumes could be used as texts in a graduate level macroeconomics course. Because of my unhappiness with the standard textbook model, I have used for the past two years parts of the present volume in a graduate level macroeconomics course that I have taught at Princeton.

I would like to thank a number of people for their helpful comments on an earlier draft of this volume. These include Alan S. Blinder, Gregory C. Chow, Robert W. Clower, Kenneth D. Garbade, Herschel I. Grossman, Edwin Kuh, and Michael Rothschild. I am also grateful to the National Science Foundation for financial support.

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A Model of Macroeconomic Activity
Volume 1: The Theoretical Model
References


Index

Alchian, Armen A., 17, 219
Amemiya, Takeshi, 194, 219
Athans, Michael, 13, 219

banks, 19-37
Barro, Robert J., 2, 17, 194, 219
behavioral assumptions
banks, 25-29
bond dealer, 98-101
firms, 49-54
government, 97
households, 79-81
Blinder, Alan S., xiv
bond dealer, 98-102
Branson, William H., 177, 180, 219
Brechling, F.P.R., 219
Brinner, Roger, 194, 220

Chow, Gregory C., xiv
Christ, Carl F., 17, 158, 176, 180, 219
Clower, Robert W., xiv, 1, 17, 219
Coen, Robert M., 10, 220
constrained decisions, 8, 182
constraints
goods, 8, 9, 52
hours, 8, 9, 52
loan, 8, 9, 45
control problems, solution of
banks, 29
firms, 54-56
households, 81, 82
decision variables
of banks, 5, 19
of the bond dealer, 6, 98
of firms, 5, 39
of the government, 4, 97
of households, 6, 75
Diamond, Peter A., 17, 220
distributional issues, 7, 14, 188

Eckstein, Otto, 194, 220
distributional issues, 190-194
equations of model
condensed, 36, 65-67, 88-90, 102, 106-109
non-condensed, 21-23, 42-47, 77, 78, 97-101, 199-205
static, 160, 161
excess capital, 11, 51, 63, 64
excess labor, 11, 51, 63, 64
excess reserves, 8
expectations, formation of
banks, 22-25
firms, 45-49
households, 78, 79
firms, 39-73
fiscal policy, 149
Fisher, Franklin M., 17, 220
flow-of-funds accounts, 114, 206
flow-of-funds constraints, 10, 113
Garbade, Kenneth D., xiv,
Gauss-Seidel algorithm, 16, 168
Gepts, S., 17, 220
Goldfeld, Stephen M., 194, 220
Gordon, Donald F., 17, 220
Gordon, Robert J., 194, 220
government, 97, 98, 101, 102
government budget constraint, 4, 97
Grossman, Herschel I., xiv, 1, 2, 17, 219, 220
Hahn, F.H., 219
Hay, George A., 10, 220
Henderson, James M., 95, 220
Hickman, Bert G., 10, 220
Holt, Charles C., 10, 221
households, 75-95
Hynes, Allan, 17, 220
information flows, 4, 7-9
Jaffee, Dwight M., 194, 220
Kelejian, Harry H., 194, 220
Keynes, John Maynard, 1, 157, 221
Koriliras, Payayotis G., 2, 17, 221, 222
Kuh, Edwin, xiv
Leijonhufvud, Axel, 1, 17, 221
long-run properties, 149-152
Lucas, Robert E., Jr., 10, 17, 221
Maccini, Louis J., 2, 10, 11, 17, 182, 221
Maddala, G.S., 194, 221
methodology, 12-17
Mills, Edwin S., 10, 221
Modigliani, Franco, 10, 221
monetary policy, 149
Mortensen, Dale T., 11, 17, 182, 221
Muth, John F., 10, 221
Nadiri, M. Ishag, 10, 221
national income accounts, 116, 207, 208
Nelson, Forest D., 194, 221
Nordhaus, William D., 17, 221
objective function
of banks, 4, 16
of the bond dealer, 6, 99-101
of firms, 4, 49
of households, 4, 79
parameter values, 30, 57, 83, 119, 169, 210
Patinkin, Don, 1, 221
Phelps, Edmund S., 1, 2, 11, 17, 182, 221
price and wage responses, 152, 153
properties of model
condensed, 116-155
non-condensed, 211-217
static, 170-177
Quandt, Richard E., 95, 194, 220, 221
Rapping, Leonard A., 17, 221
Rosen, Sherwin, 10, 221
Rothschild, Michael, xiv, 17, 222
Simon, Herbert A., 10, 221
simulation results
banks, 31-35
condensed model, 116-147
firms, 57-64
households, 82-88
non-condensed model, 211-217
static model, 168-177
Solow, Robert M., 2, 17, 222
Stigler, George J., 1, 222
Stiglitz, Joseph E., 2, 17, 222
summaries of model, 3-12, 35, 62-64, 146, 147, 181-186
technology, 10, 39, 42-44
textbook model, 177-179
Tucker, Donald P., 2, 17, 222
unconstrained decisions, 8, 182
unemployment rate, 115
variables in model
condensed, 104-106
non-condensed, 195-198
static, 159
Winter, Sidney S., Jr., 11, 17, 182, 221
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