

Multisector Growth Models

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Theory and Application

 Springer

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Contents

Preface	xi
Acknowledgement	xiii
1 Introduction: Orientation and Focus	1
1.1 Introduction	1
1.2 Organization of the book	4
2 The Preliminaries	9
2.1 Microeconomic foundations	10
2.1.1 Consumer preferences	10
2.1.2 Production technologies	13
2.2 The Heckscher-Ohlin-Samuelson model	18
2.2.1 The behavior of households	19
2.2.2 The price taking firm	20
2.2.3 Characterization of equilibrium	21
2.2.4 Comparative statics	23
2.3 Generalizing the basic model	27
2.3.1 The case where $M_t = N$	28
2.3.2 The case where $M_t < N$	28
2.3.3 Comparative statics	29
2.4 The special case of a home (non-traded) good	30
2.4.1 The environment	31
2.4.2 Behavior of households and firms	31
2.4.3 The characterization of equilibrium	32
2.4.4 Selected comparative statics	34
2.5 Appendix: determinants of home-good price	40
3 The Two Sector Ramsey Model	45
3.1 The model environment	46
3.1.1 Household behavior	46
3.1.2 Production	52

3.2	Equilibrium	53
3.2.1	Definition and characterization of equilibrium	53
3.2.2	Selected comparative statics	58
3.3	Growth in efficiency and number of workers . . .	61
3.3.1	The behavior of households	61
3.3.2	Production	64
3.3.3	Equilibrium	65
3.3.4	Comparative statics	66
3.4	An algebraic example	67
3.5	A numerical example	70
3.5.1	Parameter estimation	71
3.5.2	Empirical results	72
3.6	Conclusion	76
4	The Three-Sector Ramsey Model	79
4.1	The model environment	80
4.1.1	No-arbitrage between capital and land assets	81
4.1.2	Intra-temporal behavior of the household .	82
4.1.3	Firm behavior	84
4.1.4	Equilibrium	86
4.1.5	Selected comparative statics	91
4.2	Stone-Geary preferences	93
4.2.1	Household behavior	94
4.2.2	Equilibrium	95
4.3	A numerical example	98
4.3.1	Parameter estimation	98
4.3.2	Empirical results	99
4.4	Conclusion	105
4.5	Appendix: income and expenditure distribution .	106
4.5.1	Distinguishing individual expenditure from that of the representative household	108
4.5.2	Distinguishing individual income from that of the representative household	109

5	Extensions to the Three-Sector Model	113
5.1	Intermediate inputs of production	114
5.1.1	Firms	115
5.1.2	Equilibrium with intermediate inputs of production	116
5.1.3	Comparative statics	120
5.2	Vertical market structures	122
5.2.1	Firms	122
5.2.2	Intra-temporal equilibrium	123
5.2.3	Inter-temporal equilibrium	126
5.2.4	An alternative specification	127
5.3	Composite capital	128
5.3.1	Asset pricing and the Euler condition . . .	129
5.3.2	Specification of composite capital	131
5.3.3	Intra-temporal equilibrium	133
5.3.4	Inter-temporal equilibrium	134
5.3.5	Discussion	136
5.4	Government	137
5.4.1	Government consumption and revenues . .	138
5.4.2	Firms	140
5.4.3	Intra-temporal equilibrium	141
5.4.4	Inter-temporal equilibrium	144
5.5	A numerical example	146
5.5.1	Parameter estimation	146
5.5.2	Empirical results	147
5.5.3	Multiplier effects of a technology shock . .	152
5.6	Conclusions	155
6	The Extended Three-Sector Model	159
6.1	The model	159
6.1.1	Households	160
6.1.2	Government	164
6.1.3	Firms	165
6.1.4	Intra-temporal equilibrium	167
6.1.5	Reducing the dimensionality of the system	170
6.1.6	Inter-temporal equilibrium	173

6.2	Numerical analysis	174
6.2.1	Parameter estimation	175
6.2.2	Validation	176
6.2.3	Empirical results	182
6.3	Trade reform	188
6.4	Conclusion	195
7	A Three-Sector – Two-Country World	199
7.1	A two-country world with capital mobility	201
7.1.1	Households and firms	202
7.1.2	Basic identities	205
7.1.3	Equilibrium	206
7.1.4	Reducing the dimensionality of the model	208
7.1.5	Inter-temporal equilibrium	211
7.2	A two-country world without capital mobility	214
7.2.1	Households and firms	214
7.2.2	Equilibrium	215
7.2.3	Reducing the dimensionality of the model	217
7.2.4	Inter-temporal equilibrium	219
7.3	Numerical examples	222
7.3.1	The capital mobility model	223
7.3.2	Model without capital mobility	230
7.4	Conclusions	235
8	Data Issues and the Social Accounting Matrix	239
8.1	Introduction	239
8.2	A two-sector, closed economy SAM	242
8.2.1	A non-technical description of the two-sector SAM	243
8.2.2	A more technical description of the two-sector SAM	246
8.2.3	Using the SAM to calibrate the empirical two-sector model	249
8.3	A three-sector, open economy SAM	257
8.3.1	Using the SAM to calibrate the empirical three-sector model	262

8.4	A three-sector, open economy SAM with intermediate products	265
8.4.1	Using the SAM to calibrate the empirical three-sector model with intermediate inputs	265
8.5	A three-sector SAM with composite capital and government	270
8.5.1	Using the SAM to calibrate the empirical three-sector model with government and composite capital	271
8.6	Conclusion	278
8.7	Appendix: Sector definitions	279
9	Solution Methods in Transition Dynamics	283
9.1	Time-elimination method	283
9.1.1	L'Hopital's rule approach	288
9.1.2	Eigenvalues-eigenvectors approach	289
9.1.3	Mathematica code	296
9.2	Backward integration method	301
	References	305
	Author Index	313
	Subject Index	315

Preface

The primary objective of this book is to advance the state of the art in specifying and fitting to data structural multi-sector dynamic macroeconomic models, and empirically implementing them. The fundamental construct upon which we build is the Ramsey model. A most attractive feature of this model is the insights it provides into the dynamics of an economy in transition to long-run equilibrium. With some exceptions, Ramsey models are highly aggregated – typically single sector models. However, interest often lies in understanding the forces of economic growth across multiple sectors of an economy and on how policy impacts likely play out over time. Such analyses call for more disaggregated models that can be fit to country or regional data. This book shows how to: (i) extend the basic model to multiple sectors, (ii) how to adapt the basic model to account for policy instruments, and (iii) fit the model to data, and obtain equilibrium values both forward and backward in time from the data points to which the model is initially fit.

Although extremely helpful in understanding economic growth and structure, theory alone is not sufficient; we also need to confront theory with data. Fitting growth models to data has been greatly facilitated by advances in numerical algorithms and computer technology. The ease of obtaining numerical solutions using procedures that are relatively robust across a broad range of model specifications is important because the differential equations of even the single sector, two factor, closed economy Ramsey model are essentially analytically intractable. The methods advanced here, and illustrated with numerical examples, are easily used in the classroom. Our experience suggests this material is accessible to advanced undergraduate and beginning graduate students, and easily managed by those working in agencies and bureaus familiar with general equilibrium concepts. An un-

derstanding of the subtleties of control theory and numerical algorithms is not required, but familiarity with a programming language such as Mathematica is essential. Over the past several years, we have had students choose a country, conduct a growth accounting exercise, formulate the country data into an elementary social accounting matrix format, fit a model to data, and then obtain a numerical solution using off-the-shelf software. We found that such assignments greatly strengthens students' grasp of theoretical concepts and helps them link these concepts to real economies. Grasping the theory and knowing how to implement the theory to obtain empirical insights into real problems provides them a form of human capital that they are unlikely to attain so easily in other ways.

The book is organized by first reviewing the fundamentals of duality theory of the consumer and firm, which is then used to review the standard two-sector, two-factor Heckscher-Ohlin-Samuelson model of a small open economy. Using duality theory, Chapter 3 introduces the two sector closed economy Ramsey model in a rather structured fashion, and concludes with an empirical example. Chapter 4 develops a three-sector, open economy model with a non-traded good sector. Chapters 5 and 6 extend the three-sector model in several directions: intermediate factors of production; capital stock composed of the output of all sectors of the economy; government consumption with taxes and lump-sum transfers from households. Chapter 7 concludes with a two country "world" model. In each chapter, the model presentation follows a similar pattern and builds off the structure of the previous chapter. Each modeling chapter concludes with an empirical example using the same data set. The book concludes with two chapters that discuss how the data are organized to facilitate the fitting of models to data, and the strategy used to facilitate the solution of each model's system of differential equations.

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