



GENERAL EQUILIBRIUM ECONOMIC MODELLING  
LANGUAGE AND SOLUTION FRAMEWORK  
VERSION 1.0.2

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# INTRODUCTION

`gEcon` is a framework for developing and solving large scale dynamic (stochastic) & static general equilibrium models. It consists of model description language and an interface with a set of solvers in R.

Publicly available toolboxes used in RBC/DSGE modelling require users to derive the first order conditions (FOCs) and linearisation equations by pen & paper (e.g. Uhlig’s tool-kit, [Uhlig 1995]) or at least require manual derivation of the FOCs (e.g. Dynare, [Adjemian *et al.* 2013]). Derivation of FOCs is also required by GAMS [Brooke *et al.* 1996] and GEMPACK [Harrison *et al.* 2014] — probably the two most popular frameworks used in CGE modelling. Owing to the development of an algorithm for automatic derivation of first order conditions and implementation of a comprehensive symbolic computations library, `gEcon` allows users to describe their models in terms of optimisation problems of agents. To authors’ best knowledge there is no other publicly available framework for writing and solving DSGE & CGE models in this natural way. Writing models in terms of optimisation problems instead of the FOCs is far more natural to an economist, takes off the burden of tedious differentiation, and reduces the risk of making a mistake. `gEcon` allows users to focus on economic aspects of the model and makes it possible to design large-scale (100+ variables) models. To this end, `gEcon` provides template mechanism (similar to those found in CGE modelling packages), which allows to declare similar agents (differentiated by parameters only) in a single block. Additionally, `gEcon` can automatically produce a draft of L<sup>A</sup>T<sub>E</sub>X documentation for a model.

The model description language is simple and intuitive. Given optimisation problems, constraints and identities, computer derives the FOCs, steady state equations, and linearisation matrices automatically. Numerical solvers can be then employed to determine the steady state and approximate equilibrium laws of motion around it.

`gEcon` was initially (2012–2015) developed at the Department for Strategic Analyses at the Chancellery of the Prime Minister of the Republic of Poland as a part of a project aiming at construction of large scale DSGE & CGE models of the Polish economy. Since March 1, 2015 `gEcon` is no longer developed and maintained at the Chancellery of the Prime Minister, but it is still maintained and developed by its original authors.

## ABOUT CURRENT RELEASE

`gEcon` 1.0 was released on October 9, 2016. This version concluded four years of `gEcon` development and testing. R code had been reviewed and reorganised, all reported bugs (mostly in the template and reference mechanisms) had been fixed.

`gEcon` 1.0.2 was released on December 5, 2016. This patch comes with an additional option `output R Jacobian` that allows users to turn off Jacobian generation for large models.

## WHY R?

All popular DSGE toolboxes work within Matlab/Octave environments. The decision to break up with this tradition was carefully weighted. Firstly, all vector programming languages/environments (Matlab, Octave, R, Ox) are built atop low level linear algebra and other numerical libraries like BLAS and LAPACK. The main differences between them fall into the following categories: language features, number of extensions (libraries/packages), support, and user base. Matlab and Octave offer much more functionality through their toolboxes in fields such as differential equations, optimisation etc. On the other hand, R language is more flexible (not everything has to be a matrix!) and it has many more packages intended for analysis of economic data. Flexibility of the language and natural synergies between economic modelling and econometric work have made R the environment of choice for this project.

## CONTACT

Please send bugs, suggestions and comment to Grzegorz Klima at [gklima@users.sourceforge.net](mailto:gklima@users.sourceforge.net) putting **gEcon** in the e-mail subject.

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# 1 GETTING STARTED — YOUR FIRST MODEL IN gEcon

## 1.1 A SAMPLE MODEL ECONOMY

As an example we will solve a classical RBC model with capital adjustment costs. Our model economy is populated by a continuum of households (with an infinite planning horizon) with identical time-separable preferences. At time  $t$  a representative agent experiences instantaneous utility from consumption and leisure given by:

$$u(C_t, L_t^{(s)}) = \frac{\left(C_t^\mu (1 - L_t^{(s)})^{1-\mu}\right)^{1-\eta}}{1-\eta}, \quad (1.1)$$

where  $C_t$  is consumption,  $L_t^{(s)}$  is labour input (labour supply),  $\eta > 0$  the coefficient of relative risk aversion. Each period the representative agent is endowed with one unit of time,  $N_t = 1$ .  $1 - L_t^{(s)}$  denotes leisure.

Households own production factors (capital and labour) and lend them to firms. Household's capital stock evolves according to:

$$K_t^{(s)} = (1 - \delta)K_{t-1}^{(s)} + I_t, \quad (1.2)$$

where  $K_t^{(s)}$  is the supply of capital stock<sup>1</sup>,  $I_t$  is the investment and  $\delta$  is the depreciation rate.

They divide their income (from capital and labour) between consumption, investments, and capital installation costs. In each period they choose between labour and leisure and between consumption and investment. A representative household maximizes expected discounted utility at time 0:

$$U_0 = \mathbb{E}_0 \left[ \sum_{t=0}^{\infty} \beta^t u(C_t, L_t^{(s)}) \right],$$

which is recursively given by the following equation:

$$U_t = u(C_t, L_t^{(s)}) + \beta \mathbb{E}_t [U_{t+1}]. \quad (1.3)$$

Optimisation is done subject to the following budget constraint:

$$C_t + I_t + \chi(I_t, K_{t-1}^{(s)})K_{t-1}^{(s)} = W_t L_t^{(s)} + r_t K_{t-1}^{(s)} + \pi_t \quad (1.4)$$

and the law of motion of capital described by the equation (1.2). Here  $W_t$  stands for real wages,  $r_t$  — real interest rate or cost of capital,  $\pi_t$  — profits generated by firms,  $0 < \beta < 1$  is the discount factor and  $\chi(I_t, K_{t-1}^{(s)})$  denotes capital's installation costs, where

$$\chi(I_t, K_{t-1}^{(s)}) = \psi \left( \frac{I_t}{K_{t-1}^{(s)}} - \delta \right)^2. \quad (1.5)$$

In our model economy there is also a continuum of firms, each producing a homogeneous good using the same technology operating on competitive product and factor markets. Firms rent capital and labour from households and pay for it. Technology is available to them for free and is given by the Cobb-Douglas production function:

$$Y_t = Z_t \left(K_t^{(d)}\right)^\alpha \left(L_t^{(d)}\right)^{1-\alpha}, \quad (1.6)$$

---

<sup>1</sup>At the end of period  $t$ . Timing convention is that the value of a control variable at time  $t$  is decided at time  $t$ . This means that  $K_t^{(s)}$  is the capital stock at the end of period  $t$  (at the beginning of period  $t + 1$ ). Firms at time  $t$  rent capital from stock  $K_{t-1}^{(s)}$ .

where  $K_t^{(d)}$  is the demand for capital stock at time  $t$ ,  $L_t^{(d)}$  is the demand for labour and  $0 < \alpha < 1$  stands for the capital share.  $Z_t$ , the total factor productivity, is exogenously evolving according to:

$$\log Z_t = \phi \log Z_{t-1} + \epsilon_t, \quad \epsilon_t \sim i.i.d.N(0; \sigma^2), \quad (1.7)$$

where  $0 < \phi < 1$  is an autocorrelation parameter.

Each period a representative firm maximises its profits  $\pi_t$ , treating production factors' prices as given:

$$\max_{K_{t-1}^{(d)}, L_t^{(d)}, \pi_t} \pi_t, \quad (1.8)$$

where  $\pi_t = Y_t - W_t L_t^{(d)} - r_t K_{t-1}^{(d)}$ , subject to technology constraint given by (1.6).

Labour, capital and goods markets clear:<sup>2</sup>

$$L_t^{(d)} = L_t^{(s)}, \quad (1.9)$$

$$K_t^{(d)} = K_{t-1}^{(s)}, \quad (1.10)$$

$$C_t + I_t = Y_t.$$

### 1.1.1 CALIBRATION

Our parameter choices are standard in literature. A list of calibrated parameter values is presented in the table 1.1.

**Table 1.1:** Benchmark parameter values

Parameter	Value	Interpretation
$\alpha$	0.36	Share of physical capital in the final good technology
$\beta$	0.99	Subjective discount factor
$\delta$	0.025	Depreciation rate of physical capital
$\eta$	2.0	Relative risk aversion parameter
$\mu$	0.3	Consumption weight in utility function
$\phi$	0.95	Persistence of $Z$
$\psi$	0.8	Installation costs coefficient

## 1.2 LANGUAGE

Now, let us see how easily and intuitively we can write the described model in the **gEcon** language, solve it, and analyse its behaviour.

An input model accepted by **gEcon** should be saved as a text file with the **.gcn** extension, which can be created in any text editor. In this section we will show how to write our example model in the **gEcon** language. A formal specification and further rules governing the **gEcon** syntax are presented in chapter 3.

An equilibrium model in the **gEcon** language is divided into blocks (usually corresponding to agents in the economy) which are consistent with the logic of the model. Each block begins with the keyword **block** followed by its name.

<sup>2</sup>For explanation of timing convention regarding capital stock ( $K$ ) confront the footnote on the previous page.



Model blocks themselves are divided into several sections (**definitions**, **controls**, **objective**, **constraints**, **identities**, **shocks**, and **calibration**), each having a pretty natural interpretation to an economist.

Let us see how it works on the example from the previous section. There are two optimising agents: a representative consumer and a representative firm. The consumer's block will be called **Consumer** and it will contain information about her optimisation problem. Firstly, for clearer exposition we will provide the definition of instantaneous utility in **definitions** section. The consumer problem is described in three sections: **controls** (list of control variables), **objective** (objective function given in a recursive form), and **constraints** (budget constraint and the law of capital's motion). Calibration of the parameters relevant to this block may be set in the **calibration** section or omitted in a **.gcn** file and later set while solving the model in R. A correctly written consumer's block is presented below:

```

block CONSUMER
{
  definitions
  {
    u[] = (C[] ^ mu * (1 - L_s[]) ^ (1 - mu)) ^ (1 - eta) / (1 - eta);
  };
  controls
  {
    K_s[], C[], L_s[], I[];
  };
  objective
  {
    U[] = u[] + beta * E[][U[1]];
  };
  constraints
  {
    I[] + C[] = r[] * K_s[-1] + W[] * L_s[] -
              psi * K_s[-1] * (I[] / K_s[-1] - delta)^2 + pi[] : lambda_c[];
    K_s[] = (1 - delta) * K_s[-1] + I[];
  };
  calibration
  {
    delta = 0.025;
    beta = 0.99;
    eta = 2;
    mu = 0.3;
    psi = 0.8;
  };
};

```

Basic rules governing the **gEcon** syntax can be easily noticed. The content of separate blocks and block sections should be enclosed in curly brackets (**{}**). All variables lists and equations should be ended with a semicolon (**;**). Such an ending is optional for sections and blocks<sup>3</sup>. Variable names are followed by square brackets (**[]**) containing a lead or a lag relative to time  $t$  with empty brackets standing for  $t$ . Parameters are denoted using their names only.

Since version 0.7.0, Lagrange multipliers are added to constraints and objective functions automatically. However, you can still declare your own multipliers (like **lambda\_c** in the example above).<sup>4</sup> A relevant equation should be followed then by a colon (**:**) and a corresponding Lagrange multiplier's name (followed by square brackets in the same way as the remaining model variables).

Having constructed the first block of our model, let us now move on to the second optimising agent i.e. a representative firm. We will call its block **Firm**. Firm's block will consist of sections: **controls**, **objective** and **constraints**,

<sup>3</sup>Semicolons after sections and blocks were mandatory up to the 0.4.0 version.

<sup>4</sup>Explicitly declaring Lagrange multipliers may prove useful in models, in which multiplier of one agent appears in other model blocks (e.g. RBC model where the representative firm owns capital and there is no principal-agent problem). One can also explicitly declare Lagrange multipliers which have interesting economic interpretation (e.g. Tobin's  $q$  in the RBC model with capital's installation costs).

and `calibration` (pinning down parameter  $\alpha$ ). A properly written block for a representative firm looks as follows:

```

block FIRM
{
  controls
  {
    K_d [], L_d [], Y [], pi [];
  };
  objective
  {
    PI [] = pi [];
  };
  constraints
  {
    Y [] = Z [] * K_d [] ^ alpha * L_d [] ^ (1 - alpha);
    pi [] = Y [] - L_d [] * W [] - r [] * K_d [];
  };
  calibration
  {
    r [ss] * K_d [ss] = 0.36 * Y [ss] -> alpha;
  };
};
    
```

As one can infer from code snippets above, parameter values can be set in two ways in `gEcon`. In fact, `gEcon` distinguishes between two sorts of parameters: free and calibrated ones. While the first have their values assigned arbitrarily, the latter can be calibrated in process of solving for the steady state of the model — based on information about relations between parameters and steady-state values of variables. To grasp the difference, look at the code snippets above. The `calibration` section in the `block Consumer` contains free parameters only, while the parameter `alpha` in the `block Firm` is an example of a calibrated parameter. Its value will be determined in the process of solving the model based on a steady-state capital share in product.

How to include parameters in the model in `gEcon` depends on the type of parameters we are dealing with. `gEcon` gives flexibility with respect to free parameters, which may be either declared in calibration section in a `.gcn` file (like parameters in the `block Consumer` above) or omitted and set there while solving the model in R. However, even if set in a file, they can still be overwritten in R later. In contrast, calibrated parameters have to be declared in a `.gcn` file in the `calibration` section (like `alpha` in the `block Firm` above), however one may set their values later in `gEcon`, by switching off the calibration facility. The functionalities concerning parameters and variables available in R will be explained in detail in section 1.4 of this chapter and in the chapter 7.

Returning to our example model, in order to close it we need a block with market clearing conditions which we will call `Equilibrium`. Such a block will contain the `identities` section only. Although we have listed three equations for market clearing conditions in section 1.1, we need to put only two of them in the `Equilibrium` block. The third one, clearing goods markets, will be *implicit* taken into account by Walras law — it can be derived from other equations.<sup>5</sup> The `Equilibrium` block of our model is presented in the following code snippet:

```

block EQUILIBRIUM
{
  identities
  {
    K_d [] = K_s [-1];
    L_d [] = L_s [];
  };
};
    
```

<sup>5</sup>See e.g. [Mas-Colell *et al.* 1995].

Exogenous variables and shocks to the system should (but do not have to) be defined in **gEcon** in a separate block. Exogenous shocks will be listed in **shocks** section. As our model described above contains only one exogenous variable, one shock, and the relevant block — called here **Exog** — will be quite simple:

```

block EXOG
{
  identities
  {
    Z[] = exp(phi * log(Z[-1]) + epsilon_Z []);
  };
  shocks
  {
    epsilon_Z [];
  };
  calibration
  {
    phi = 0.95;
  };
};

```

This finishes formulation of our model. However, it contains some redundant variables, e.g. by market clearing conditions supply of production factors is equal to the demand for them. Additionally, we have explicitly named the Lagrange multiplier on the budget constraint but it is not used anywhere else in the model. Moreover, because of the perfect competition assumption the profits of firms in the model will be 0. These remarks lead to a conclusion that five variables can be eliminated from the model:  $K_t^d$ ,  $L_t^d$ ,  $\lambda_t^c$ ,  $\pi_t$ , and  $\Pi_t$ . **gEcon** offers automatic reduction of model variables. To use this feature you have to list the variables in question within the **tryreduce** section of the **.gcn** file, just before the first model block. This is shown in the following listing:

```

tryreduce
{
  K_d [], L_d [], lambda_c [], pi [], PI [];
};

```

This finishes the process of writing our model in the **gEcon** language. Now just put together the **tryreduce** section and the four blocks, save it as a **.gcn** file, say **rbc\_ic.gcn**, and that's it! Once the whole model described in section 1.1 has been written properly in the **gEcon** language, it is ready to be loaded and solved from R by **gEcon**.

The entire code for this example can be found on the **gEcon** website at <http://gecon.r-forge.r-project.org/>.

### 1.3 READING MODEL FROM R

In order to read the model from R, assuming you have installed the **gEcon** R package (for instructions see chapter 2), you need to do just two things:

1. First of all, you have to load the **gEcon** package in R, running:

```
library(gEcon)
```

2. Secondly, you should use the **make\_model** function, taking as an argument the path and the name of the **.gcn** file you have created. Assigning the return value of this function to a desired variable in R, you will obtain an object of the **gecon\_model** class, which can be further processed with the functions from the **gEcon** package. To illustrate this, for our example model the command:

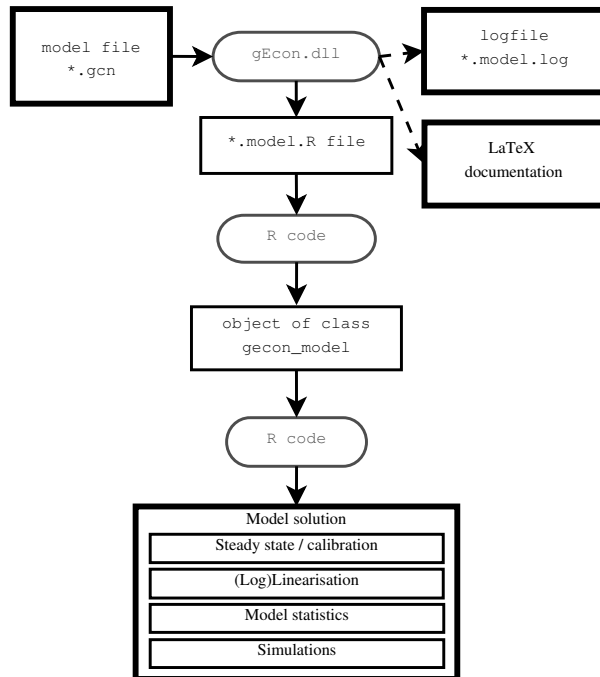


Figure 1.1: gEcon workflow

```
rbc_ic <- make_model("PATH_TO_FILE/rbc_ic.gcn")
```

will create an object named `rbc_ic` (of class `gecon_model`) in our workspace in R.

The `make_model` function first calls dynamic library implemented in C++ which parses the `.gcn` model file. Then, first order conditions are derived, on the basis of an algorithm described in chapter 5. Matrices are derived after collecting all model equations, steady state equations, and linearisation, which will be later used to determine steady state and approximate equilibrium laws of motion around it. It is worth mentioning that apart from saving appropriate information in a newly returned `gecon_model` object, the `make_model` function generates a `.model.R` output file containing all the derived functions and matrices constituting a model. A `.model.R` output file is saved in the same directory in which the `.gcn` file has been saved. As a bonus `gEcon` can automatically produce a draft of  $\text{\LaTeX}$  documentation of the model which allows user to check model's automatically derived first order conditions as well as its equilibrium and steady-state relationships. This `gEcon` functionality is described in the section 1.7. `gEcon` workflow is presented in figure 1.1 below.

This is only a short description of the process of preparing a model for solving it in R. Further details concerning the class `gecon_model` and the derivation of FOCs can be found in chapters 6 and 5. In general, all models' elements are held in appropriate slots of `gecon_model` objects. Functions provided for solving and analysing models (described in detail in chapters 7-10) are methods of this class and usually change relevant slots for further use or retrieving information from them.

Having read our model into an object of the `gecon_model` class we can proceed to solve and analyze its static and dynamic properties.

## 1.4 FINDING THE STEADY STATE

As mentioned above, in the process of creating a model object in R steady-state relationships are derived.

A basic `gEcon` function for finding the steady state of a model offering users interface to non-linear solvers, is the `steady_state`. However, before using it, you should make sure that you have assigned your desired values to all free parameters in the model. If you skip this step and some free parameters remain unspecified, `gEcon` will produce an error message. As described in the section 1.2 you can assign values to free parameters either in a model file — just as we did declaring values of parameters `beta`, `delta`, `eta`, `mu`, `psi` and `phi` in our example `rbc_ic.gcn` file — or using the `set_free_par` function in R. If we had not declared values of free parameters in our `.gcn` file we could do this now in R using the function `set_free_par`. Doing both, you will overwrite the values from the file with the values passed to R. So, taking an example of our model, running now a command:

```
rbc_ic <- set_free_par(rbc_ic, list(eta = 3, mu = 0.2))
```

would change values of the parameters `eta` and `mu`. You could reverse this by setting a logical argument `reset` to `TRUE` in `set_free_par`, i.e. running:

```
rbc_ic <- set_free_par(model = rbc_ic, reset = TRUE)
```

#### KEEP IN MIND

Most functions in the `gEcon` package in R have many different parameters, whose values can be changed. In order to see a complete documentation with a full list of options available for any function, you should call its name preceded by `?` or `??`, e.g. `?set_free_par` or `??steady_state`.

Since the values of all free parameters appearing in our example model have been set in a `.gcn` file you may try to find its steady state, without invoking the `set_free_par` function. In order to do this, you should use the `steady_state` function and run:

```
rbc_ic <- steady_state(rbc_ic)
```

After invoking this code you should see `Steady state has been FOUND` printed on the console. The `steady_state` function has some additional arguments controlling non-linear solver behaviour (for a complete list of arguments available type `?steady_state`).

#### KEEP IN MIND

In order to make further use of computed results (e.g. obtained steady-state values) and information passed to the object of the `gecon_model` class (e.g. values assigned arbitrarily to parameters), it is crucial not only to run the functions but also to assign their return values to the model, i.e. the object of the `gecon_model` class. Only in this way a new information is stored and then you can proceed to further stages of solving and analysing the model.

Now, if you wish to see the results, i.e. computed steady-state values of our model's variables and calibrated parameters which have been computed, run use the `get_ss_values` and `get_par_values` functions:

```
get_ss_values(rbc_ic)
get_par_values(rbc_ic)
```

and you will have them printed on the console and returned as functions' values. The default option is to print (and return) the values of all the variables and parameters, unless you pass a list or a vector of a chosen subset to the functions.

It is worth mentioning that initial guesses of steady-state values which are close to final results usually improve the chance and speed of finding solution. You may pass initial values to model's variables and calibrated parameters by means of the `initval_var` and `initval_calibr_par` functions, respectively. However, a non-linear solver available in `gEcon` (through the `steady_state` function) often manages to find steady state for a model using values which are assigned to all variables and parameters by default — and this was the case of our example model `rbc_ic`.

So, we have computed the steady state for our model. Obviously, it is dependent on the values assigned to the free parameters, which you may change easily with the `set_free_par` function. However, `gEcon` offers you an additional functionality in terms of computing the steady state: an option to decide how you want to treat the parameters originally defined as calibrated ones without having to change a `.gcn` file.

In order to take advantage of this `gEcon` facility, a `calibration` option in the `steady_state` function should be used. It is a logical argument, which indicates if calibrating equations — provided they exist in a model — should be taken into account in the computation of the steady state. If `TRUE`, which is its default value, calibrating parameters are treated analogously to variables and their value is determined based on calibration equations — and this was the case with the `alpha` parameter in our example. However, if you set the `calibration` option to `FALSE`, `alpha` would be treated as a free parameter and its calibrating equation would be omitted while solving for the steady state. But you should not forget about assigning a desired value to it, say 0.4, which you can do by using the `initval_calibr_par` function — as switching off a calibration facility makes `gEcon` treat initial values of calibrated parameters as if they were the values of free parameters. In order to do this you should run the following code:

```
rbc_ic <- initval_calibr_par(model = rbc_ic, calibr_par = c(alpha = 0.4))
rbc_ic <- steady_state(model = rbc_ic, calibration = FALSE)
```

All the remaining options available in the `steady_state` function (except for `calibration`) refer to the process of solving the system of non-linear equations. Changing them may be especially useful while encountering troubles with finding the steady state. As we did not experience them with our example model, we do not devote more attention to this issue here. For more information see chapter 7 and in the `gEcon` package documentation.

## 1.5 SOLVING FOR DYNAMICS

Now, having computed the steady state of our model, we can solve for its dynamics. As `gEcon` uses perturbation method for solving dynamic equilibrium models, your model will need to be linearised or log-linearised before it is solved.

However, with `gEcon` you will not have to do it by hand nor substitute natural logarithms for variables in your `.gcn` file. `gEcon` offers you the `solve_pert` function which, in short, linearises or log-linearises a model, transforms a model from its canonical form to a form accepted by solvers of linear rational expectations models, and solves the first order perturbation. For a detailed description of `gEcon` solution procedure see chapter 8 and the documentation of the `gEcon` package in R. To cut a long story short, all you need to solve our example model for its dynamic equilibrium is run the following line of code:

```
rbc_ic <- solve_pert(rbc_ic)
```

as we set all the function's argument but the first one to their default values. After invoking one of this code line you should see 'Model has been SOLVED' printed on the console.

You should note that we solved our example model in its log-linearised version, which is very convenient for further analyses as variables after log-linearisation may be interpreted as percent deviations from their steady-state values. However, you may easily switch to solving the model in a linearised version — using the function's logical `loglin` argument (with a default value set to `TRUE`), which controls for the sort of perturbation's linearisation. If you set it to `FALSE` in the above function, i.e. run:

```
rbc_ic <- solve_pert(model = rbc_ic, loglin = FALSE)
```

then model would be linearised only. Apart from the option to choose or change the type of model's linearisation, **gEcon** offers you also the facility to diversify variables depending on the type of linearisation. After setting `loglin = TRUE`, you may declare a vector of variables that should be linearised only, by means of an `not_loglin_var` argument. So, if you wanted to have all the variables log-linearised in our example model except for, say,  $r$ , you should run:

```
rbc_ic <- solve_pert(model = rbc_ic, loglin = TRUE, not_loglin_var = c("r"))
```

and that's it!

In order to see the results of the first order perturbation you should use the `get_pert_solution` function, which prints (and returns if assigned to a variable) computed recursive laws of motion of the model's variables:

```
get_pert_solution(rbc_ic)
```

If you are interested in the eigenvalues of the system or checking Blanchard-Kahn conditions, which can be especially useful in debugging a model, you should make use of the `check_bk` function, which takes a model object as an argument. For more details on this function as well as the `solve_pert` function see chapter 8 and the documentation of **gEcon** package in R.

#### KEEP IN MIND

Invoking the following recap functions with a model object as an argument at every stage of solving and analysing your model with **gEcon** you will see:

- `show` — basic information and diagnostics of the model and the stage of its solving process,
- `print` — more detailed information and diagnostics of the model and the stage of solution process,
- `summary` — the results of computations carried out so far.

## 1.6 RESULTS — CORRELATIONS AND IRFs

Now, after we have solved the model, we can specify the structure of shocks, simulate it, and check if relationships between the variables or their reactions to shocks indicated by the model are consistent with the data. **gEcon** enables you to compute indicators most commonly used in RBC/DSGE literature, such as means, variances, correlations, or impulse response functions.

Once again, you do not have to change anything in the original `.gcn` file in order to perform stochastic simulations of the model and analyse its variables' properties. All you need to do is pass a shock covariance matrix to your `gecon_model` object and call a few **gEcon** functions.

In order to set the covariance matrix of shocks in a model you should use the `set_shock_cov_mat` function. Since in our example `rbc_ic` model there is only one shock, we will have an 1-element covariance matrix containing only the shock's variance. The following command sets covariance matrix to 0.01:

```
rbc_ic <- set_shock_cov_mat(model = rbc_ic,
                           cov_matrix = matrix(c(0.01), 1, 1),
                           shock_order = "epsilon_Z")
```

You can also set or change chosen elements in the covariance using the `set_shock_distr_par` function. This function allows to work with easily interpretable parameters, such as standard deviations and correlations instead of whole covariance matrix. In order to do the same as above by using the `set_shock_distr_par` function, you should run:

```
rbc_ic <- set_shock_distr_par(model = rbc_ic,
                             distr_par = list("sd(epsilon_Z)" = 0.1))
```

This function is described in detail in chapter 9.

Having set the covariance matrix of shocks, we can compute the statistics of model's variables and correlation matrices using the `compute_model_stats` function, by running the following command:

```
rbc_ic <- compute_model_stats(model = rbc_ic,
                              n_leadlags = 6,
                              ref_var = 'Y')
```

The function computes correlation matrices of variables' series, using spectral or simulation methods and, optionally, filtering series with the Hodrick-Prescott filter. The most of its options refer to the computation method chosen and its parameters which are described in detail in chapter 9 and the `gEcon` package documentation.

The function `compute_model_stats` computes the following statistics:

- basic statistics (means, standard deviations and variances of variables),
- correlations:
  - correlation matrix of all the model's variables,
  - correlations of variables with the reference variable and its lead and lagged values,
- autocorrelations — correlations of variables with their own lagged values,
- variance decomposition — ascription of variables' variability to different shocks,

from which we can subsequently choose only the information we are interested in. In order to have all the computation results stored for further use you should remember to assign the function return value to our object of the `gecon_model` class. If you want `gEcon` to compute additionally correlations of variables with the reference variable and relative standard deviations, you should pass a chosen variable's name through the `ref_var` argument, just as we did with `Y` in our example above. The `n_leadlags` option allows you to control for the number of lags in the autocorrelation table and leads and lags used for computation of correlations with the reference variable.

#### KEEP IN MIND

Changing values of any settings in an object of the `gecon_model` class that may impact results makes `gEcon` automatically clear the information which has already been stored and which could be affected by the changes. So, e.g. assigning new values to the parameters will clear all the information passed to the object after making the model, whereas changing values in a shock matrix will clear only the results of stochastic simulations. You should note that changing the values which could affect the steady-state results, e.g. free parameters, will force you to recompute the model but the steady-state values obtained prior to the change will be stored as new initial values of the variables.

Now, if you wish to see the computed statistics for our example model, use the `get_model_stats` function and run:



```
get_model_stats(rbc_ic)
```

The function prints all the results by default. Naturally, you can choose for printing only some of the results available, setting the remaining ones to `FALSE` (see the `gEcon` package documentation in R for a complete list of arguments available). The function `get_model_stats` prints the results on the console and optionally returns them — if you assign its return value to any variable.

#### KEEP IN MIND

At every stage of analysing a model with `gEcon` you can get the information about its variables, parameters, and shocks by using the `var_info`, the `par_info` and the `shock_info` functions respectively. The first allows you to choose the subset of variables you are just interested in and see of which equations they are part of, whether they are state variables or not, as well as examine all the computation results concerning them. The second provides information about the incidence of parameters in the equations and calibrating equations, values, and types of the parameters. The third gives you an option to choose the subset of shocks of interest and see in which equations they appear and how their covariance matrix looks like.

Last but not least, you may want to analyse the impulse response functions (IRFs) of variables in your model. `gEcon` offers you this facility and in order to take advantage of it, you need to call the `compute_irf` function. It computes IRFs for requested sets of variables and shocks, returning an object of class `gecon_simulation`. It is important to assign the function to a new object, so as to have the results stored and make use of them. For example, if you want to compute IRFs for the variables  $C$ ,  $K_s$ ,  $Z$ ,  $Y$ ,  $L_s$  and  $I$  of our `rbc_ic` model, you should run the following:

```
rbc_ic_irf <- compute_irf(model = rbc_ic,
                        variables = c('C', 'K_s', 'Z', 'Y', 'L_s', 'I'),
                        sim_length = 40)
```

As `gEcon` stores information concerning IRF in another class, a newly created object — `rbc_ic_irf` — will be of `gecon_simulation` class. The `path_length` argument allows you to specify the number of periods for which IRFs should be computed. All the options of this function are described thoroughly in chapter 9 and in the `gEcon` package documentation.

Now, if you call the `plot_simulation` function:

```
plot_simulation(rbc_ic_irf)
```

you will see the IRFs for the specified variables plotted. This function has a logical argument `to_eps`, and if you set it to `TRUE`, i.e. call:

```
plot_simulation(rbc_ic_irf, to_eps = TRUE)
```

the IRFs will be saved on your disk — in the `plots` subfolder created in the directory where the `rbc_ic.gcn` file has been saved.

## 1.7 AUTOMATIC GENERATION OF MODEL DOCUMENTATION IN L<sup>A</sup>T<sub>E</sub>X

`gEcon` can automatically generate a draft of model documentation (optimisation problem, constraints, identities, FOCs, and steady-state equations). To use this feature you only have to include the following lines *at the beginning* of your model file:

```
options
{
  output LaTeX = TRUE;
};
```

On successful call to `make_model` a  $\text{L}^{\text{A}}\text{T}_{\text{E}}\text{X}$  document named just as your model file (with extension `.tex`) will be created. For details, see [3.3.2](#).

Additionally, `gEcon` offers the facility of saving the results. This functionality is described in section [10.5](#).

**KEEP IN MIND**

All the files created in the process of making, solving, and analysing a model in `gEcon` are saved in the same directory in which the original `.gcn` file has been saved.

## 2 INSTALLATION INSTRUCTIONS

### 2.1 REQUIREMENTS

`gEcon` requires R version  $\geq 3.0.0$  with the following packages: `Matrix`, `MASS`, `nleqslv`, `Rcpp` and `methods`. `gEcon` has been tested on Windows (32-bit and 64-bit), Linux (32-bit and 64-bit), and Mac (64-bit) platforms, but it should also run on other systems on which R works.

### 2.2 INSTALLATION

In order to use `gEcon` you should install `gEcon` R package. You can do this in two ways:

- through the command line interface<sup>1</sup> — after changing a current working directory to the folder where `gEcon` package has been saved, it is sufficient to run a command:  
> R CMD INSTALL `gEcon_x.x.x.zip` (Windows binary)  
or  
> R CMD INSTALL `gEcon_x.x.x.tgz` (Mac binary)  
or  
> R CMD INSTALL `gEcon_x.x.x.tar.gz` (source code — Un\*x/Linux),
- directly from R using installation options available in the GUI used.

**Note:** Windows & Mac users should use a precompiled binary package with the extensions `.zip` and `.tgz` by default. If you wish to build a package from source under Windows you have to install `Rtools` first. Under Mac successful installation from source may require editing the R `Makeconf` file (setting proper FORTRAN compiler and link flags).<sup>2</sup>

**Note:** When installing `gEcon` from source you might see (depending on compiler settings) some compiler warnings. If such appear, please ignore them.

### 2.3 SYNTAX HIGHLIGHTING

Syntax highlighting is a very useful feature of many advanced text editors. Currently, `gEcon` provides users with highlighting configuration files for two editors: Notepad++ (under Windows) and Kate (under Linux with KDE).

After installing the `gEcon` package, start R session, load the `gEcon` package and type:

```
> path.package("gEcon")
```

This will show you where `gEcon` has been installed. Syntax files will be found there, in the `syntax` subdirectory.

---

<sup>1</sup>Under Windows you start the command line by executing `cmd.exe`.

<sup>2</sup>Eg. under OS X 10.9.5 with R 3.1.1 installed this file is located in the `/Library/Frameworks/R.framework/Versions/Current/Resources/etc` directory.

### 2.3.1 NOTEPAD++

Start Notepad++ and go to the menu **Language** -> **Define your language...**. In the popup window choose **Import**. Go to the **gEcon** installation path, then subdirectory **syntax**, and choose the **gEcon\_notepadpp.xml** file. Press the button **Ok** if import is successful and restart Notepad++.

### 2.3.2 KATE

Go to the subdirectory **syntax** in the **gEcon** installation path. Copy the **gEcon\_kate.xml** file to the directory: `~/.kde/share/apps/katepart/syntax` or `~/.kde4/share/apps/katepart/syntax`, where `~` denotes your home directory. Restart Kate.

**Note:** If directory `~/.kde/share/apps/` or `~/.kde4/share/apps/` exists, but it does not have subdirectory **katepart**, create it and then create **syntax** subdirectory.

## 2.4 EXAMPLES

Sample models (`.gcn` files) are distributed with **gEcon**. First check where **gEcon** was installed by typing (after loading the **gEcon** package):

```
> path.package("gEcon")
```

In the **examples** subdirectory you will find some sample models.

## 3 MODEL DESCRIPTION LANGUAGE

### 3.1 SYNTAX BASICS

#### 3.1.1 NUMBERS

**gEcon** supports both integers and floating point numbers. Integers other than 0 may not begin with the digit 0. Valid integer token should be 0 or match the following pattern:

```
[1-9][0-9]*
```

Floating point numbers have decimal sign (.) preceded or followed by digit(s). Notation with exponents is also allowed as in  $2.e-2$ . Valid floating point number token should match any of the three patterns:

```
[0-9]\.[0-9]+([eE][+-]?[0-9]+)?  
[0-9]+\.[0-9]+([eE][+-]?[0-9]+)?  
\.[0-9]+([eE][+-]?[0-9]+)?
```

#### 3.1.2 VARIABLES AND PARAMETERS

Each variable and parameter name should begin with a letter. **gEcon** is case sensitive and supports Latin alphabet only. Digits are allowed in names (after initial letter). Underscores are allowed only inside variable/parameter name and should not be doubled. The regular expression for a valid parameter/variable name is:

```
[a-zA-Z](_[a-zA-Z0-9])*
```

Underscores are used to divide variable/parameter names into sections which in  $\text{\LaTeX}$  output are put as upper indices. Greek letters are parsed in  $\text{\LaTeX}$  output properly. For instance `delta_K_home` is a valid **gEcon** parameter name and becomes  $\delta^{K^{\text{home}}}$  in  $\text{\LaTeX}$  output.

Variables are represented by their names followed by square brackets ([]) possibly with an integer inside and parameters are represented solely by the names. Using the same name for a parameter and a variable is an error. Empty brackets denote value of a variable at time  $t$ , any index inside brackets is relative to  $t$ . For example `Pi_firm_home[1]` is a valid **gEcon** variable name and becomes  $\Pi_{t+1}^{\text{firm}^{\text{home}}}$  in  $\text{\LaTeX}$  output. However, while current version of **gEcon** allows to include all the variables in any lags, it does not allow to declare variables in leads  $> 1$ . Only variables denoting the objective functions as well as the exogenous variables are allowed to appear in models in leads (of a maximal value equal to 1, though).

A name followed by time index `[ss]`, `[SS]`, `[-inf]`, `[-Inf]` or `[-INF]` denotes the steady-state value of a variable. Since the introduction of template mechanism to the language (see chapter 4) variables and parameters can be indexed, for details see section 4.2.

#### 3.1.3 RESERVED KEYWORDS

The following keywords are reserved in **gEcon** language:

<code>E</code>	(conditional expectation operator, see section 3.1.7)
<code>KRONECKER_DELTA</code>	(the Kronecker delta, see section 4.4)
<code>SUM</code>	(sum over an index set, see section 4.3.2)
<code>PROD</code>	(product over an index set, see section 4.3.2)
<code>options</code>	(see section 3.3)
<code>indexsets</code>	(see section 4.1)
<code>tryreduce</code>	(see section 3.4)
<code>block</code>	(see section 3.5)
<code>definitions</code>	(see section 3.5.1)
<code>controls</code>	(see section 3.5.2)
<code>objective</code>	(see section 3.5.2)
<code>constraints</code>	(see section 3.5.2)
<code>focs</code>	(see section 3.5.2)
<code>identities</code>	(see section 3.5.3)
<code>shocks</code>	(see section 3.5.4)
<code>calibration</code>	(see section 3.5.5)

### 3.1.4 COMMENTS

`gEcon` supports single line comments beginning with: `#`, `%`, or `//`.

### 3.1.5 FUNCTIONS

Currently the following functions are available in `gEcon`:

<code>sqrt</code> (square root)		
<code>exp</code> (exponential function)	<code>log</code> (natural logarithm)	
<code>sin</code> (sine)	<code>cos</code> (cosine)	<code>tan</code> (tangent)
<code>asin</code> (arc sine)	<code>acos</code> (arc cosine)	<code>atan</code> (arc tangent)
<code>sinh</code> (hyperbolic sine)	<code>cosh</code> (hyperbolic cosine)	<code>tanh</code> (hyperbolic tangent)

Function names cannot be used as variable or parameter names.

Function arguments should be enclosed in parentheses as in `exp(Z[])`.

### 3.1.6 ARITHMETICAL OPERATIONS

`gEcon` supports four basic arithmetical operations (`+`, `-`, `*`, `/`) as well as powers (`^`). Please note that power operator is right associative (as in R but not Matlab), i.e. `2^3^2` is equal to 512 and not 64.

The natural precedence of arithmetical operators can be changed by parentheses as in `2 * (3 + 4)`.

### 3.1.7 CONDITIONAL EXPECTATION OPERATOR

`gEcon` uses the following convention for conditional expectation operator:

`E[lag] [expression]`,

where `lag` may be an integer or empty field implying expectation conditional on information at time  $t$ . For example, `E[] [U[1]]` is understood as  $E_t [U_{t+1}]$ .

It should be noted that in `gEcon` all of the leading variables (in relation to time  $t$ ) appearing in stochastic models have to be put under a conditional expectation operator.

## 3.2 ORGANISATION OF gEcon INPUT FILE

A model file should be divided into block(s) corresponding to optimising agents in the model and block(s) describing equilibrium relationships. Each model file must have at least one model block. Additionally, any `.gcn` file may begin with the `options` block, determining the behaviour of the `gEcon` library. The `options` block can be followed by the `indexsets` block (for details see section 4.1) and `tryreduce` block containing a list of variables selected for symbolic reduction.

In model blocks describing economic agents and equilibrium relationships the `block` keyword has to be followed by a block name, which should obey the same naming rules as parameter/variable names. The contents of any block should begin with an opening brace (`{`) and be closed by a brace (`}`) which can be followed by a semicolon (`;`). Semicolons after closing braces are not mandatory.

A typical `gEcon` model file would look as follows:

```
options {
  ...
};

indexsets {
  ...
};

tryreduce {
  ...
};

block Name1 {
  ...
};

block Name2 {
  ...
};

...

block NameN {
  ...
};
```

## 3.3 OPTIONS

A set of options determines the behaviour of the `gEcon` package. The general form of (un)setting an option is:

*option* = *Boolean value* ;

Accepted as Boolean values are `true`, `TRUE`, `false`, and `FALSE`.

The following set of options is currently supported:

<code>backwardcomp</code> (ignored)	<code>output R</code> (ignored)	<code>output LaTeX</code>
<code>verbose</code>	<code>output R long</code>	<code>output LaTeX long</code>
<code>output logfile</code>	<code>output R Jacobian</code>	<code>output LaTeX landscape</code>

### 3.3.1 GENERAL OPTIONS

The `verbose` option (set to `false` by default) makes `gEcon` print detailed information about the model construction process.

The `backwardcomp` (present since the 0.7.0 release) is currently ignored.

### 3.3.2 CONTROLLING `gEcon` OUTPUT

Aside from an `.model.R` file produced by a call to the `make_model` function, `gEcon` can generate  $\LaTeX$  documentation and text logfiles for the model. A particular type of output can be turned on/off by:

```
output output_type = Boolean value ;
```

Admissible output types are: `logfile` and `LaTeX` (or `latex`). `gEcon` actually admits an option `output R` but this option is ignored. By default additional output files are not created.

Each type of output can have some additional settings (detailed in the following paragraphs). Specific properties of a given output type can be set via:

```
output output_type output_property = Boolean value ;
```

#### R OUTPUT FILE

`gEcon` writes the steady state and perturbation equations to a `.model.R` file without using the names of variables, but using their indices instead. In this way, the output file size as well as the time needed by `R` to parse the model are reduced. However, the user may force `gEcon` to print full names by setting `output R long = true`, which makes the generated `.model.R` file larger, yet human readable.

By default, `gEcon` derives Jacobian of steady-state/equilibrium equations to be used by the `steady_state` function (see section 7.3). In case of large models (say, 1000+ variables and calibrated parameters), derivation of Jacobian can be time consuming and use significant memory resources. Users may disable Jacobian derivation by setting `output R Jacobian = false`.

#### LOGFILE

When the option `output logfile` is set to `true`, `gEcon` generates (on successful call to the `make_model` function) a text logfile containing all information about the model (optimisation problems, FOCs, derived equilibrium and steady-state equations, information about variables and parameters).

**Note:** A (partial) logfile is always written (irrespective of the `output logfile` setting) on errors that occurred during derivation and collection of model equations. Logfile is also generated when all warnings cannot be displayed. Inspection of this file may prove helpful for debugging purposes.

#### $\LaTeX$ OUTPUT FILE

When  $\LaTeX$  output is turned on (via `output LaTeX = true` setting), then on a call to the `make_model` function three `.tex` files are created (in the same directory in which the `.gcn` file is located):

- `model_name.tex` — the main  $\LaTeX$  file taking the two remaining files as inputs,
- `model_name.model.tex` — a draft of the model documentation (optimisation problems, FOCs, final model equations, etc.),
- `model_name.results.tex` — the file to which model results are written from `R` interface level (for details see section 10.5).



In some models (especially those with complicated consumer’s utility function) equations can become pretty long and will not fit within the page in the  $\text{\LaTeX}$  output. In such cases setting the `output LaTeX landscape` option to `true` (`false` is the default) will make `gEcon` create  $\text{\LaTeX}$  document with equations printed on pages oriented horizontally.

Given models written using the `gEcon` template mechanism (for details see chapter 4),  $\text{\LaTeX}$  documentation files may turn out to be quite lengthy. An output file can be shortened by setting the option `output LaTeX long` to `false` (by default it is set to `true`) — a model is documented then in a “templated” form instead of an expanded one.

### 3.3.3 AN EXAMPLE

The following code makes `gEcon` print diagnostic messages, create  $\text{\LaTeX}$  documentation file, a text logfile, and a `.R` file with full names of variables.

```
options {
  verbose = true;
  output latex = true;
  output logfile = true;
  output R long = true;
};
```

## 3.4 VARIABLE REDUCTION

Handbook formulation of general equilibrium model may introduce many variables which are redundant from the computational point of view, e.g. Lagrange multipliers, both supply and demand for a particular good, which are equal by the market clearing conditions. In the example from chapter 1, the demand and supply for production factors are equal (equations (1.9) and (1.10)). One of the variables for each factor can always be eliminated from equilibrium conditions. Reduction in the number of variables improves chances of finding the steady state and reduces computational complexity of steady-state and perturbation solution.

The standard approach is to reduce variables manually, but `gEcon` can assist the user in this task. It employs symbolic reduction algorithm in order to try and eliminate the variables requested by the user. This takes off the burden of reformulating equilibrium equations and reduces the risk of making a mistake.

By default `gEcon` tries to reduce all the internally generated variables (Lagrange multipliers and lagged variables). This is done in a two-stage process. Internally generated Lagrange multipliers are checked for the possibly of reduction just after the FOCs are determined. At this stage Lagrange multipliers are reduced only if they can be substituted with an expression without any variables in leads or lags. The second stage reduction takes place after all the equations in the model have been collected.

User-declared variables can be selected for reduction within the `tryreduce` block. Variables listed in this block have to be separated by a comma (,) and the list must be closed with a semicolon (;). The reduction of user-declared variables takes place in the second stage, i.e. after all equations have been collected. The following code, added to the code of the model from chapter 1, generates output with variables  $L_t^{(d)}$  and  $K_t^{(d)}$  substituted with  $L_t^{(s)}$  and  $K_t^{(s)}$  in the equilibrium conditions:

```
tryreduce {
  L_d[], K_d[];
};
```

When using `gEcon` template mechanism, variables listed for reduction have to be properly indexed, for details please refer to section 4.3.1.

**Note:** When specifying the variables for reduction, the user has to be cautious about the timing of variables. In the example above, one should not specify the  $K_t^{(s)}$  for reduction, as the model generated in this way would have a sunspot solution. This is because the new state variable representing the capital stock ( $K_t^{(d)}$ ) would not appear in the model equations in lag, but in lead. Such formulation of the model is not compatible with the rational expectations solver used in `gEcon`.

## 3.5 MODEL BLOCKS

Each model block describes one type of optimising agent in a model economy or set of equilibrium identities.

Model blocks are divided into sections. Each block must at least have a pair of `controls` and `objective` sections or `identities` section. All other sections are optional. Sections must be ordered as follows: `definitions`, `controls`, `objective`, `constraints`, `identities`, `shocks`, `calibration`.

Each section begins with a keyword (from the list above) and an opening brace (`{`). Sections are closed by a closing brace (`}`) and optionally a semicolon (`;`).

### 3.5.1 DEFINITIONS

This section is optional. Every definition should be of the form:

*variable* = *expression*;

or

*parameter* = *constant expression*;

Expressions on the right hand side are substituted for variables/parameters on the left hand side in all the remaining sections within a block. It may be useful for example to use `u[]` for instantaneous utility of a consumer or `pi[]` for firms profit in a given period after previously defining them in the `definitions` section. Variables or parameters that are 'defined' in this way in one block will not be substituted in other blocks. They cannot be declared as controls or shocks within a given block.

A sample `definitions` section might look as follows:<sup>1</sup>

```
definitions {
    u[] = b / e * log(a * C_m[]^e + (1 - a) * C_h[]^e) + (1 - b) * log(1 - N_m[] - N_h[]);
};
```

If more than one variable/parameter are defined in the section, relevant expressions are substituted in order of their definitions. It should be noted that a variable which has been already 'defined' cannot appear on the right hand side of the consecutive definitions.<sup>2</sup>

### 3.5.2 OPTIMIZING AGENT SECTIONS

Each block describing optimisation problem should have `controls` section with a list of control variables and `objective` section with agent's objective function. Constraints on the problem should be listed in an optional

<sup>1</sup>This is an example from consumer's block in a RBC model with home production.

<sup>2</sup>E.g. whereas it is allowed to define variables `Y[]` and `EL[]` as follows:

```
definitions {
    Y[] = K[]^alpha * EL[]^(1-alpha);
    EL[] = A[] * L[];
};
```

changing the order of the equations will cause an error.

`constraints` section.

`gEcon` forms the Lagrangian for each agent, based on objective function and constraints. In `gEcon` releases prior to 0.7.0, multipliers for each element of the Lagrangian had to be named explicitly. Since version 0.7.0, it is no longer mandatory for the user to name multipliers. `gEcon` automatically creates them<sup>3</sup> and then reduces after first order conditions derivation (if possible). Users can still declare multipliers on their own and use them in model equations. There is only one restriction: multipliers cannot be declared on time aggregator in static optimisation problems (e.g. in the firm’s problem from section 1).

**Note:** It is recommended not to specify Lagrange multipliers manually (if it is not necessary). If a model file contains multipliers specified by the user, a larger system of equations determining steady state will be generated and numerical solver may not find solution of the system given initial values used so far. Explicitly declared multipliers will not be reduced unless listed in `tryreduce` block (see section 3.4).

## CONTROL VARIABLES

Control variables list must contain at least one variable and be finished with a semicolon (;). Variables should be separated by a comma (,). Time index of all control variables in a list must equal 0.

A sample `controls` section may look as follows:

```
controls {
    K[], L[], Y[];
};
```

`gEcon` does not allow objective variables and Lagrange multipliers of agents to be control variables of other agents. It also warns when the same variable is a control variable in two different problems. However, in some cases (optimisation subject to optimal actions of other agents, eg. in Nash bargaining or Ramsey problems) such constructs are necessary. To this end, `gEcon` provides the so-called “reference mechanism”. In general, reference to a control, objective variable, or Lagrange multiplier of other agent has the following form:

*variable @ referenced\_block\_name*

Only previously declared blocks can be referenced.

## OBJECTIVE FUNCTION

`gEcon` automatically derives first order conditions for dynamic problems with objective function given in a recursive manner and for static ones (see chapter 5).

Objective function should be provided in the following way:

*objective\_variable = time\_aggregator\_expression;*

or alternatively with a Lagrange multiplier explicitly specified by the user:

*objective\_variable = time\_aggregator\_expression : Lagrange\_multiplier;*

Multipliers should not be declared in static optimisation problems. The time index of both the objective function and the Lagrange multiplier should be 0. Time aggregator expression may contain expected value of some variables and objective function in lead 1 conditional on information at time  $t$ . Objective function may appear on the right hand side only in lead 1. Objective variable of one agent cannot be objective or control variable of any other agent.

A sample `objective` section may look as follows:<sup>4</sup>

<sup>3</sup>Naming convention for automatically generated multipliers is  $\lambda^{\text{NAME\_OF\_BLOCK}^i}$ , where  $i$  stands for the number of constraint in a given block.

<sup>4</sup>This is consumer’s problem with exponential discounting and logarithmic utility from consumption.

```
objective {
  U[] = log(c[]) + beta * E[] [U[1]];
};
```

## CONSTRAINTS

Economic problems involve different sorts of constraints on optimisation problems of agents. Constraints are expressed in the `gEcon` language in the following fashion:

```
expression = expression;
```

or alternatively with a Lagrange multiplier explicitly named by the user:

```
expression = expression : Lagrange_multiplier;
```

A sample `constraints` block might look as below:<sup>5</sup>

```
constraints {
  I[] + C[] = r[] * K_s[-1] + W[] * L_s[] + pi[] : lambda_C[];
  K_s[] = (1 - delta) * K_s[-1] + I[];
};
```

In some cases, optimisation is done subject to optimal actions of other agents or subject to identities from other block, eg. in Nash bargaining or Ramsey problems. Referencing other agent's (block's) objective variable declaration, constraints, identities and first order conditions is necessary in these situations. In order to automatically add the aforementioned equations to the constraint list one has to use the "referencing mechanism" as follows:

```
objective @ referenced_block_name ;
constraints @ referenced_block_name ;
identities @ referenced_block_name ;
focs @ referenced_block_name ;
```

The `focs` keyword stands for first order conditions.

Lagrange multipliers are inserted by `gEcon` automatically and cannot be explicitly named by the user in this case. Only previously declared blocks can be referenced.

### 3.5.3 IDENTITIES

If `controls` and `objective` sections are not present in a block this section becomes mandatory. Identities are simply equations that hold in any time at any state. This block is especially useful for market clearing conditions or description of exogenous (to the agents) processes. For instance, first order conditions derived manually may be entered into the model as identities.

Identities are given in a simple way:

```
expression = expression ;
```

A very simple `identities` block with a market clearing condition is given below:

```
identities {
  L_d[] = L_s[];
};
```

---

<sup>5</sup>This is the budget constraint of a representative consumer/household owning and supplying capital and labour.

### 3.5.4 SHOCKS

Shocks are exogenous random variables. Since it is technically impossible to infer from model equations which variables are exogenous, shocks have to be declared by the user. The `shocks` section serves this purpose. Shocks should have 0 time index and must be separated by a comma (,). A complete shock list must be closed with a semicolon (;).

When shocks are used in expressions they should also have 0 time index.

A sample declaration of two shocks  $\epsilon_t^1, \epsilon_t^2$  is listed below:

```
shocks {
  epsilon_1[], epsilon_2[];
};
```

**Note:** In `gEcon` versions prior to 0.7.0 shocks had to be separated by a semicolon. Declaring shocks in such a way is currently not supported.

`gEcon` assumes shocks to have a joint normal distribution with zero expected value. Shock distribution parameters can be set at the R interface level as described in section 9.1.

### 3.5.5 CALIBRATION

There are two types of parameters in `gEcon`: so-called free parameters, which value may be changed by the user at R level and do not have to be set in the model file, and calibrated parameters. The values of calibrated parameters are determined alongside the steady-state values of variables based on steady-state relationships. Calibrating equations and free parameter values are provided by the user in the `calibration` section.

Free parameter values are set as follows:

```
parameter = numeric.expression ;
```

The calibrating equation should contain parameters and/or the steady-state values of variables. As `gEcon` is unable to infer which parameters should be determined based on a given relationship, calibrating equation should be followed by the `->` operator and a list of parameters. The syntax for calibrating equations is the following:

```
parameter_or_steady_state_expression = parameter_or_steady_state_expression -> parameter_1, ..., parameter_N ;
```

A sample calibration block is presented below. Parameter  $\beta$  is a free parameter set to  $(1.01)^{-1}$  and technology parameter  $\alpha$  is calibrated based on the steady-state capital share in product:

```
calibration {
  beta = 1 / 1.01;
  r[ss] * K_d[ss] = 0.36 * Y[ss] -> alpha;
};
```

## 4 TEMPLATES

Most economic models used in applied work (especially CGE models) have many similar agents (firms, consumers) that solve problems of the same type and differ only in the value of some parameters. Writing such models using only language features described in the previous chapter is a tedious process and subject to high risk of making a mistake.

The problem of automatically replicating part of a code with different parametrisations has a long history in programming language design. Two solutions have been proposed and successfully implemented in many languages: preprocessor macros and templates (generic programming). The first approach, with the most prominent example of C language preprocessor, allows users to declare so-called macros which are expanded *before* (hence name) actual code is compiled (analysed). Such a two-stage process is easier to implement, but has fundamental flaws: code compiled (analysed) is different from what the user has actually written, any error in the initial code is multiplied as many times as macro is expanded, which makes debugging difficult. In the context of `gEcon` language, the fact that expansion of the code takes place before analysis would mean deriving FOCs as many times as optimising agent block is replicated. Still, preprocessor macros offer a valid solution to an important problem and in the economic modelling software have been implemented e.g. in Dynare [Adjemian *et al.* 2013]. Templates (generic programming) have been introduced later (e.g. in C++ programming language) and address the aforementioned issues by extending the language in question instead of building on top of it. This means that “templated” code is analysed in the same way as regular code is and the process of “expansion” takes place at the end of compilation (code analysis). Such approach has been taken in the `gEcon` project. “Templated” (indexed) blocks are analysed only once and equations are expanded after equilibrium relationships (e.g. FOCs) have been derived.

### 4.1 INDEX SETS

#### 4.1.1 DECLARATIONS

Before using template mechanism, the user has to properly declare sets over which the variables and parameters will be indexed. Such declarations should be placed in the `indexsets` section of the `.gcn` file. Each set declaration should be followed by a semicolon (;).

The syntax for standard declaration of a set is as follows:

```
set_name = { elements_list } ;
```

Valid set names should obey the same rule as valid variables and parameters names. The *elements\_list* is a list of indices in a set quoted using single quotation marks (') and separated by commas (,). Valid index values may be formed by any combination of numbers and letters and single underscores (except for the beginning and the end), i.e. should match the following regular expression:

```
[a-zA-Z0-9](_?[a-zA-Z0-9])*
```

`gEcon` allows to generate sequences of letters or numbers that can be used for indexing. The sequences can be created by one of the following expressions:

```
{ number .. number }  
{ capital_letter .. capital_letter }  
{ small_letter .. small_letter }
```

**gEcon** allows to create ascending sequences only. Numbers and letters should be quoted using single quotation marks ('). The sequences of numbers or letters can be concatenated with prefixes and suffixes using tilde (~) operator to form more meaningful names.

A sample `indexsets` block, in which a set of three sectors is declared in two ways described in this section, may look as follows:

```
indexsets
{
    SECTORS = {'sector_a', 'sector_b', 'sector_c'};
    SECTORS_STAR = 'sector_' ~ {'a' .. 'c'};
}
```

Sets cannot be redeclared. Redclaration of any set will cause an error.

#### 4.1.2 SET OPERATIONS

New sets can be also created by performing set operations on other sets. **gEcon** supports three set operations: union (operator |), intersection (operator &), and asymmetric difference (operator \).

The intersection operator has precedence over the union and difference operators. The latter operators are evaluated from left to right. The parentheses may override the default precedence.

**Note:** Tilde operator has precedence over set algebraic operators. The following expression presents this rule:

```
SECTORS_BAR = 'sector_' ~ {'a' .. 'e'} & 'sector_' ~ {'b' .. 'f'};
```

Two sets (from `sector_a` to `sector_e` and from `sector_b` to `sector_f`) are created initially and then **gEcon** finds their intersection (a set of indices from `sector_b` to `sector_e`).

#### 4.1.3 SET VALIDATION

**gEcon** allows user to verify if the required sets have been declared properly by imposing some relation between two sets. All the validating expressions should be written in the `indexsets` section of `.gcn` file and be followed by a question mark (?).

**gEcon** evaluates the validating expressions and prints an error message if any of expressions turns out to be false.

A relation between two sets can be imposed by writing:

```
set_A relation set_B ?
```

Three types of relations are supported by **gEcon**: equality (==), inequality (!=) and improper set inclusion (<=).

In writing validating expressions an empty set (denoted by 0) may become useful.

#### AN EXAMPLE

Consider a large-scale model of an open economy with two types of goods (sectors): tradables and non-tradables. These goods (sectors) will be indexed over two sets `TRADABLE` and `NONTRADABLE`. All goods (sectors) in the economy are indexed over set `ECONOMY`. One expects the following relations to hold for sets of tradable, non-tradable sectors, and the set of all the sectors in the economy:

- the tradable and non-tradable sectors are non-empty,
- the tradable and non-tradable sectors should be subsets of the set of all sectors in the economy,

- no sector can be both in tradable and non-tradable sets,
- sum of tradable and non-tradable sectors should yield the set of all sectors in economy.

These conditions may be stated in gEcon language as follows:

```

TRADABLE != 0? # tradables are non-empty
NONTRADABLE != 0? # non-tradables are non-empty
TRADABLE <= ECONOMY? # tradables are subset of all sectors
NONTRADABLE <= ECONOMY? # non-tradables are subset of all sectors
TRADABLE & NON_TRADABLE == 0? # empty intersection (intersection equal to empty set)
TRADABLE | NON_TRADABLE == ECONOMY? # sum equal to all sectors in the economy
    
```

**Note:** It is highly recommended to make use of validation option whenever possible. If validation was not used in the example above and any of tradable sectors were misspelled, the number of equations in the model would be different than the number of variables, which would lead to an error. Such an error would be difficult to debug. If validation was used, gEcon would return information about the relations that are not satisfied.

## 4.2 INDEXED VARIABLES AND PARAMETERS

Indices of parameters and variables should be provided in gEcon within angle brackets (< and >). Multiple indices should be separated by commas (,). Indexed parameters are referred to as follows:

*parameter\_name*<*index\_list*>

Variables should be indexed as:

*variable\_name*<*index\_list*>[*time\_index*]

gEcon makes distinction between fixed and free indices. This distinction is pretty natural. Suppose  $x$  is a vector, then in expression denoting the  $i$ th element ( $x_i$ )  $i$  is a free index and 7 in expression denoting the 7th element ( $x_7$ ) is a fixed one. The names of free indices should obey the same rules as the names of variables, parameters, and sets. Fixed indices should be quoted using single quotation marks ('). The examples below should make these rules clear:

```

alpha<s>           # parameter alpha indexed with free index s
alpha<'AGR'>       # parameter alpha indexed with fixed index 'AGR'
Y<c>[]            # variable Y (at time 0) indexed with free index c
Y<'PL'>[]         # variable Y (at time 0) indexed with fixed index 'PL'
EX<'PL',c>[]     # variable EX (at time 0) indexed with fixed index 'PL' and free index c
eta<'PL','DE'>   # parameter eta indexed with fixed index 'PL' and fixed index 'DE'
    
```

These expressions will be displayed in L<sup>A</sup>T<sub>E</sub>X output as:  $\alpha^{(s)}$ ,  $\alpha^{(AGR)}$ ,  $Y_t^{(c)}$ ,  $Y_t^{(PL)}$ ,  $EX_t^{(PL,c)}$ ,  $\eta^{(PL,DE)}$ .

In an object of `gecon_model` class (created through a call to `make_model`) the names of indexed parameters and variables are transformed so that they can be used in R easily (when setting initial values for steady state / equilibrium solvers, retrieving information about variables and parameters etc.). The general rule is that each (fixed) index is appended to the parameter / variable name after a double underscore (``\_``). For instance:

```
alpha<'AGR'>, Y<'PL'>[], eta<'PL','DE'>
```

become:

```
alpha__AGR, Y__PL, eta__PL__DE
```

gEcon supports up to 4 indices for both parameters and variables.



## 4.3 INDEXING EXPRESSIONS

### 4.3.1 INDEXING VARIABLES AND EQUATIONS

Any expression involving free indices cannot be properly processed without knowing the sets to which the free indices belong. To connect a free index with an index set a so-called indexing expression should be used. The general form of such an expression is:

`<index_name::set_name>`

Suppose consumer chooses between many goods. Let us denote her consumption of good  $g$  as  $C\langle g\rangle[]$ . Goods belong to set `GOODS`. To list consumption of all the goods (e.g. in `controls` section) one should use the following expression:

`<g::GOODS> C<g>[]`

This is understood by `gEcon` as  $\left(C_t^{(g)}\right)_{g \in \text{GOODS}}$

Indexing expressions should also be used in equations that are supposed to hold for all indices belonging to some set. Again, let `GOODS` denote the set of all goods in the economy,  $C\langle g\rangle[]$  consumption of good  $g$ . Let  $Y\langle g\rangle[]$  denote production of good  $g$ . Market clearing condition (in closed economy) should then be written (somewhere in the `identities` section) in the form:

`<g::GOODS> C<g>[] = Y<g>[];`

This is understood by `gEcon` as  $g \in \text{GOODS}: C_t^{(g)} = Y_t^{(g)}$ .

`gEcon` currently accepts up to two indexing expressions preceding a variable or an equation except for the `tryreduce` block, where up to four indexing expressions are allowed.

In many applications, an index should run over all elements of a set but one. For example, total export of the  $i$ -th country is a sum of exports from the  $i$ -th country to all countries in the model but not to itself — the  $i$ -th country. Forcing the index not to take the value of another may be achieved in `gEcon` by using indexed expression with backslash operator (`\`) followed by a free or fixed index:

`<index_name::set_name\free_index>`

`<index_name::set_name\'fixed_index\'>`

### 4.3.2 SUMS AND PRODUCTS

`gEcon` supports sums and products over indices belonging to some set. These operations are written in a natural way using indexing expressions:

`SUM<index_name::set_name>(expression)`

`PROD<index_name::set_name>(expression)`

The frequently used Cobb-Douglas and CES (constant elasticity of substitution) functions may be written using `SUM` and `PROD` as follows:

`CD[] = PROD<f::FACTORS>(C<f>[] ^ alpha<f>);`

`CES[] = (SUM<g::GOODS>(share<g> * D<g>[] ^ ((eta - 1) / eta))) ^ (eta / (eta - 1));`

`gEcon` will understand these expression as:

$$CD_t = \prod_{f \in \text{FACTORS}} C_t^{(f)\alpha^{(f)}}$$

and

$$CES_t = \left( \sum_{g \in GOODS} share^{(g)} D_t^{(g)(\eta-1)/\eta} \right)^{\eta/(\eta-1)}.$$

Indexing expressions used in sums and products can involve skipping some index as in:

```
SUM<index_name::set_name\free_index>(expression)
SUM<index_name::set_name\'fixed_index'\>(expression)
PROD<index_name::set_name\ free_index>(expression)
PROD<index_name::set_name\'fixed_index'\>(expression)
```

As an example, recall the definition of total exports from the  $i$ th country as a sum of exports to all the countries except to itself (assuming COUNTRIES were declared as an index set):

```
<i::COUNTRIES> EX<i> = SUM<j::COUNTRIES\i>EX<i,j>
```

Sums and products follow standard rules. In particular, product over an empty set is taken to be 1, and sum over an empty set equals zero.

**Note:** The double sums, double products, and sum of products can be written without taking the argument into parentheses. However, one has to be vary about product of sums. In that case one has to use internal and external parentheses:

```
PROD<i::SET>(SUM<j::SET>(a<i,j>[]))
```

Otherwise gEcon will not parse the expression properly and an error will occur.

### 4.3.3 BLOCK TEMPLATES

The template mechanism in gEcon allows the user to write down general form of maximisation problems for similar agents, which are expanded automatically.

Blocks are expanded over the sets of indices. The indexing expressions must be placed after the block keyword but before the name of a block. The syntax is as follows:

```
block <i::SET_1><j::SET_2> name
{
    # sections
}
```

As a rule indices from block declaration must be used for indexing variables in the definitions section, controls and objective variables (but do not have to be used in constraints nor identities). In the example above indices  $i$  and  $j$  must appear in the variables on left hand side in the definitions sections, objective variable and all control variables.

Index exclusion can be applied in block templates declarations just like in equations, sums and products.

The maximum number of indices in a block declaration is two.

### 4.3.4 POTENTIAL SOURCES OF ERRORS

#### STRAY INDICES

Consider the following equation:

```
SUM<i::SET\k>SUM<j::SET> X<i,j>[] = Y<i>[];
```

The equation above cannot be properly expanded without knowledge about the index  $k$ . If it is not assigned to any index set (in front of the equation or in the block declaration), `gEcon` will call it a “stray” index and will stop on error. All indices are checked before any further computations are performed.

#### MISSING INDICES

Consider the following example:

```
block <c::country> Consumer
{
  # other sections
  objective
  {
    U<c>[] = u<c>[] + beta * E[] [U[1]];
  }
}
```

Here the objective ( $U[]$ ) on the right hand side is missing the index  $c$ . `gEcon` treats  $U[]$  as a different variable than  $U<c>[]$  and the problem as *static* (no time aggregation, since  $U<c>[]$  does not appear on the right hand side). Errors of this type cannot be automatically diagnosed by `gEcon`. In most cases they will lead to different numbers of variables and equations or the inability to find steady state / equilibrium.

#### DUPLICATED INDICES IN NESTED INDEXING EXPRESSIONS

Another potential mistake when using template mechanism in `gEcon` can be made by using the same index twice in nested indexing expressions. Consider a bit contrived example:

```
block <a::SET_A> F00
{
  # other sections
  identities
  {
    SUM<a::SET_B> B<a>[] = 0;
  }
}
```

Here  $a$  is the index in a sum within a block template parametrised with the same index. `gEcon` cannot tell whether  $a$  corresponds to the set `SET_B` in the sum or the set `SET_A` from the block declaration. Such code will cause an error.

## 4.4 THE KRONECKER DELTA AND THE RULES OF DIFFERENTIATION

The Kronecker delta is a double-indexed symbol returning one if indices coincide and zero otherwise:

$$\delta^{i,j} = \begin{cases} 1 & : i = j \\ 0 & : i \neq j \end{cases} . \quad (4.1)$$

In what follows we will write the Kronecker delta using the standard indexing convention of `gEcon`, i.e. putting indices in angle brackets.

The Kronecker delta in `gEcon` is written as:

`KRONECKER_DELTA<index_1, index_2>`

The Kronecker delta of two fixed indices is automatically evaluated to 0 or 1.

The Kronecker delta makes writing rules of differentiation very simple. Suppose  $x^{(i)}$  is differentiated with respect to  $x^{(j)}$ . We have:

$$\frac{\partial x^{(i)}}{\partial x^{(j)}} = \delta^{(i,j)},$$

i.e. the derivative is 1 if indices are the same and zero otherwise. Given variables with two indices the derivative is equal to 1 if both indices coincide:

$$\frac{\partial x^{(i,j)}}{\partial x^{(k,l)}} = \delta^{(i,k)} \delta^{(j,l)}.$$

These rules can be generalised for arbitrary number of indices.

The rules of differentiation of sums and products are obvious:

$$\frac{\partial}{\partial x^{(j)}} \sum_{i \in I} y^{(i)} = \sum_{i \in I} \frac{\partial y^{(i)}}{\partial x^{(j)}},$$

$$\frac{\partial}{\partial x^{(j)}} \prod_{i \in I} y^{(i)} = \left( \prod_{i \in I} y^{(i)} \right) \left( \sum_{i \in I} \frac{1}{y^{(i)}} \frac{\partial y^{(i)}}{\partial x^{(j)}} \right).$$

Although rules are pretty clear, care should be taken when differentiating sums and products. Consider the following trivial example:

$$\frac{\partial}{\partial x^{(i)}} \sum_{i \in I} x^{(i)} y^{(i)} = ?$$

Here the index  $i$  is used as an index of the variable with respect to which the derivative is taken but also as an index in the summation. Since summation is not changed with the change of indices and the derivative of a sum is the sum of derivatives, we can restate and solve our problem as follows:

$$\frac{\partial}{\partial x^{(i)}} \sum_{i \in I} x^{(i)} y^{(i)} = \frac{\partial}{\partial x^{(i)}} \sum_{i' \in I} x^{(i')} y^{(i')} = \sum_{i' \in I} \frac{\partial x^{(i')} y^{(i')}}{\partial x^{(i)}} = \sum_{i' \in I} \delta^{(i',i)} y^{(i')}.$$

The strategy outlined above is the one that `gEcon` uses when differentiating sums and products — sums and products are reindexed before differentiation whenever the indices collide. Indices created by `gEcon` have underscore appended (in `LATEX` the prime symbol `'`), so they will never coincide with any user-declared index.

In our example the result of differentiation was  $\sum_{i' \in I} \delta^{(i',i)} y^{(i')}$ . If we knew that the index  $i$  runs over the same set  $I$ , the complicated expression could be reduced to just  $y^{(i)}$ .<sup>1</sup> This type of “Kronecker delta reduction” is automatically done by `gEcon` and allows to obtain legible FOCs in problems written using sums and products.

<sup>1</sup>In order to convince yourself that this really is the case, consider a simple example:

$$\begin{aligned} \frac{\partial}{\partial x^{(1)}} \sum_{i' \in \{1,2,3\}} x^{(i')} y^{(i')} &= \frac{\partial}{\partial x^{(1)}} (x^{(1)} y^{(1)} + x^{(2)} y^{(2)} + x^{(3)} y^{(3)}) = \frac{\partial x^{(1)} y^{(1)}}{\partial x^{(1)}} + \frac{\partial x^{(2)} y^{(2)}}{\partial x^{(1)}} + \frac{\partial x^{(3)} y^{(3)}}{\partial x^{(1)}} = y^{(1)} + 0 + 0. \\ \frac{\partial}{\partial x^{(2)}} \sum_{i' \in \{1,2,3\}} x^{(i')} y^{(i')} &= \frac{\partial}{\partial x^{(2)}} (x^{(1)} y^{(1)} + x^{(2)} y^{(2)} + x^{(3)} y^{(3)}) = \frac{\partial x^{(1)} y^{(1)}}{\partial x^{(2)}} + \frac{\partial x^{(2)} y^{(2)}}{\partial x^{(2)}} + \frac{\partial x^{(3)} y^{(3)}}{\partial x^{(2)}} = 0 + y^{(2)} + 0. \\ \frac{\partial}{\partial x^{(3)}} \sum_{i' \in \{1,2,3\}} x^{(i')} y^{(i')} &= \frac{\partial}{\partial x^{(3)}} (x^{(1)} y^{(1)} + x^{(2)} y^{(2)} + x^{(3)} y^{(3)}) = \frac{\partial x^{(1)} y^{(1)}}{\partial x^{(3)}} + \frac{\partial x^{(2)} y^{(2)}}{\partial x^{(3)}} + \frac{\partial x^{(3)} y^{(3)}}{\partial x^{(3)}} = 0 + 0 + y^{(3)}. \end{aligned}$$

## 4.5 AN EXAMPLE — PURE EXCHANGE MODEL

A pure exchange model is a basic example of general equilibrium model. In our example there will be two agents (denoted by  $a \in \{A, B\}$ ) and three goods (denoted by  $g \in \{1, 2, 3\}$ ) in the economy. Each consumer is endowed with some amounts of three different goods (agent's  $a$  endowment of good  $g$  is denoted by  $e^{(a,g)}$ ). There are no production opportunities but the agents can freely trade with their endowments maximising utility ( $U^{(a)}$ ) from consumption ( $C^{(a,g)}$  denotes the consumption of good  $g$  by agent  $a$ ) given by the Cobb-Douglas function (with parameters  $\alpha^{(a,g)}$ ):

$$U^{(a)} = C^{(a,1)\alpha^{(a,1)}} C^{(a,2)\alpha^{(a,2)}} C^{(a,3)\alpha^{(a,3)}} = \prod_{g=1}^3 C^{(a,g)\alpha^{(a,g)}}. \quad (4.2)$$

Each agent faces budget constraint ( $p^{(g)}$  is the price of good  $g$ ):

$$p^{(1)}C^{(a,1)} + p^{(2)}C^{(a,2)} + p^{(3)}C^{(a,3)} = p^{(1)}e^{(a,1)} + p^{(2)}e^{(a,2)} + p^{(3)}e^{(a,3)}, \quad (4.3)$$

or equivalently:

$$\sum_{g=1}^3 p^{(g)}C^{(a,g)} = \sum_{g=1}^3 p^{(g)}e^{(a,g)}. \quad (4.4)$$

All markets clear:

$$\sum_{a \in \{A, B\}} C^{(a,g)} = \sum_{a \in \{A, B\}} e^{(a,g)}, \quad \forall g \in \{1, 2, 3\}. \quad (4.5)$$

The equilibrium for this economy is a set of prices  $(p^{(g)})_{g \in \{1,2,3\}}$  and allocations  $(C^{(a,g)})_{a \in \{A, B\}, g \in \{1,2,3\}}$  such that the allocations maximise agents' utilities under budget constraints and markets clear. In equilibrium only relative prices are determined. For numerical solution, one of the prices has to be set as a *numeraire* (let us assume  $p^{(1)} = 1$ ). By the Walras law one of the market clearing conditions is redundant and will be omitted when writing model using gEcon.

The code snippet below presents the implementation of this model in gEcon. The naming convention for the variables, parameters, and indices corresponds to the model description above. Additionally, `e_calibr<a,g>` are parameters determining the initial endowments of agents. In EQUILIBRIUM section, the price of the first good (*numeraire* good) is set to 1. The market clearing conditions are given for all goods but first.

```

indexsets
{
  goods = { '1' .. '3' };
  agents = { 'A', 'B' };
};

block <a::agents> AGENTS
{
  controls
  {
    <g::goods> C<a,g> [];
  };
  objective
  {
    U<a>[] = PROD<g::goods>(C<a,g>[] ^ alpha<a,g>);
  };
  constraints
  {
    SUM<g::goods>(p<g>[] * C<a,g>[]) = SUM<g::goods>(p<g>[] * e<a,g>[]);
  };
  identities
  {

```

```

        <g:: goods> e<a,g>[] = e_calibr<a,g>;
    };
};
block EQUILIBRIUM
{
    identities
    {
        # numeraire
        p<'1'>[] = 1;
        # goods market clearing
        <g:: goods\ '1' > SUM<a:: agents>(C<a,g>[]) = SUM<a:: agents>(e<a,g>[]);
    };
};

```

The formulation of the model is very compact but general. In fact, if the index sets were modified appropriately, one could obtain a pure exchange model for arbitrary  $n$  agents and  $m$  goods without any additional effort.

# 5 DERIVATION OF FIRST ORDER CONDITIONS

First order conditions for optimisation problems are derived automatically in `gEcon` by means of an algorithm developed and implemented for this purpose. The algorithm is applicable to most common optimisation problems encountered in dynamic stochastic models. It is fairly general and can be extended to handle more complicated problems. The detailed exposition can be found in [Klima & Retkiewicz-Wijitiwiak 2014].

## 5.1 THE CANONICAL PROBLEM

The algorithm presented here is applicable to a general dynamic (or static) stochastic optimisation problem with objective function given by a recursive forward-looking equation. The setup presented here is standard in economic textbooks. For example a detailed exposition can be found in [Ljungqvist & Sargent 2004] or [LeRoy *et al.* 1997].

Time is discrete, infinite and begins at  $t = 0$ . In each period  $t = 1, 2, \dots$  a realisation of stochastic event  $\xi_t$  is observed. A history of events up to time  $t$  is denoted by  $s_t$ . More formally, let  $(\Omega, \mathcal{F}, \mathbb{P})$  be a discrete probabilistic space with filtration  $\{\emptyset, \Omega\} = \mathcal{F}_0 \subset \mathcal{F}_1 \subset \dots \subset \mathcal{F}_t \subset \mathcal{F}_{t+1} \dots \subset \Omega$ . Each event at date  $t$  ( $\xi_t$ ) and every history up to time  $t$  ( $s_t$ ) is  $\mathcal{F}_t$ -measurable. Let  $\pi(s_t)$  denote the probability of history  $s_t$  up to time  $t$ . The conditional probability  $\pi(s_{t+1}|s_t)$  is the probability of an event  $\xi_{t+1}$  such that  $s_{t+1} = s_t \cap \xi_{t+1}$ .

In what follows it is assumed that variable with time index  $t$  is  $\mathcal{F}_t$ -measurable.

In  $t = 0$  period an agent determines vectors of control variables  $x(s_t) = (x^1(s_t), \dots, x^N(s_t))$  at all possible events  $s_t$  as a solution to her optimisation problem. The objective  $U_0$  (lifetime utility) function is recursively given by the following equation:

$$U_t(s_t) = F(x_{t-1}(s_{t-1}), x_t(s_t), z_{t-1}(s_{t-1}), z_t(s_t), E_t H^1(x_{t-1}, x_t, U_{t+1}, z_{t-1}, z_t, z_{t+1}), \dots, E_t H^J(\dots)), \quad (5.1)$$

with constraints satisfying:

$$G^i(x_{t-1}(s_{t-1}), x_t(s_t), z_{t-1}(s_{t-1}), z_t(s_t), E_t H^1(x_{t-1}, x_t, U_{t+1}, z_{t-1}, z_t, z_{t+1}), \dots, E_t H^J(\dots)) = 0, \\ x_{-1} \text{ given.} \quad (5.2)$$

where  $x_t(s_t)$  are decision variables and  $z_t(s_t)$  are exogenous variables and  $i = 1, \dots, I$  indexes constraints.

We shall denote expression  $E_t H^j(x_{t-1}, x_t, U_{t+1}, z_{t-1}, z_t, z_{t+1})$  compactly as  $E_t H_{t+1}^j$  with  $j = 1, \dots, J$ . We have:

$$E_t H_{t+1}^j = \sum_{s_{t+1} \subset s_t} \pi(s_{t+1}|s_t) H^j(x_{t-1}(s_{t-1}), x_t(s_t), U_{t+1}(s_{t+1}), z_{t-1}(s_{t-1}), z_t(s_t), z_{t+1}(s_{t+1})).$$

Let us now modify the problem by substituting  $q_t^j(s_t)$  for  $E_t H_{t+1}^j$  and adding constraints of the form  $q_t^j(s_t) = E_t H_{t+1}^j$ .

We shall also use  $F_t(s_t)$  and  $G_t^i(s_t)$  to denote expressions  $F(x_{t-1}(s_{t-1}), x_t(s_t), z_{t-1}(s_{t-1}), z_t(s_t), q_t^1(s_t), \dots, q_t^j(s_t))$  and  $G^i(x_{t-1}(s_{t-1}), x_t(s_t), z_{t-1}(s_{t-1}), z_t(s_t), q_t^1(s_t), \dots, q_t^j(s_t))$  respectively.

Then the agent's problem may be written as:

$$\begin{aligned}
 & \max_{(x_t)_{t=0}^{\infty}, (U_t)_{t=0}^{\infty}} U_0 \\
 & \text{s.t. :} \\
 & U_t(s_t) = F_t(s_t), \\
 & G_t^i(s_t) = 0, \\
 & q_t^j(s_t) = E_t H_{t+1}^j, \\
 & x_{-1} \text{ given.}
 \end{aligned} \tag{5.3}$$

## 5.2 FIRST ORDER CONDITIONS

After formulating the Lagrangian for the problem (5.3) one arrives at first order conditions for maximizing it with respect to  $U_t(s_t)$ ,  $x_t(s_t)$  and  $q_t^j(s_t)$ . After some transformations and setting  $\lambda_t(s_t) = 1$ <sup>1</sup>, first order conditions take the following form:

$$\lambda_{t+1}(s_{t+1}) = \sum_{j=1}^J \left( F_{t,4+j}(s_t) + \sum_{i=1}^I \mu_t^i(s_t) G_{t,4+j}^i(s_t) \right) H_{t+1,3}^j(s_{t+1}), \tag{5.4}$$

$$\begin{aligned}
 0 = & F_{t,2}(s_t) + \sum_{i=1}^I \mu_t^i(s_t) G_{t,2}^i(s_t) \\
 & + \sum_{j=1}^J \left( F_{t,4+j}(s_t) + \sum_{i=1}^I \mu_t^i(s_t) G_{t,4+j}^i(s_t) \right) H_{t+1,2}^j(s_{t+1}) \\
 & + E_t \lambda_{t+1} \left[ F_{t+1,1} + \sum_{i=1}^I \mu_{t+1}^i(s_{t+1}) G_{t+1,1}^i \right. \\
 & \left. + \sum_{j=1}^J \left( F_{t+1,4+j}(s_{t+1}) + \sum_{i=1}^I \mu_{t+1}^i(s_{t+1}) G_{t+1,4+j}^i(s_{t+1}) \right) H_{t+2,1}^j(s_{t+2}) \right],
 \end{aligned} \tag{5.5}$$

where e.g. 3 in  $H_{t+1,3}^j(s_{t+1})$  stands for a partial derivative of  $H_t^j(s_t)$  with respect to its third argument, i.e.  $U_{t+1}(s_{t+1})$  (we shall adopt such notation throughout this chapter).

There are  $N + 1$  first order conditions: one w.r.t. to  $U_t$  (5.4) and  $N$  w.r.t.  $x_t^n$  (5.5). There are also  $I$  conditions  $G_t^i = 0$ , equation  $F(x_{t-1}, x_t, z_{t-1}, z_t, q_t^1, \dots, q_t^J) = U_t$  and  $J$  equations defining  $q_t^j$ . The overall number of equations ( $N + I + J + 2$ ) equals the number of variables:  $N$  decision variables  $x_t^n$ , the variable  $U_t$ ,  $J$  variables  $q_t^j$ , the Lagrange multiplier  $\lambda_t$  and  $I$  Lagrange multipliers  $\mu_t^i$  (which gives  $N + I + J + 2$  variables).

FOCs are derived similarly for models formulated in a deterministic settings — based on the appropriately modified problem.

<sup>1</sup>This is equivalent to reinterpreting  $\lambda_{t+1}(s_{t+1})$  as  $\frac{\lambda_{t+1}(s_{t+1})}{\lambda_t(s_t)}$  in all equations.



### 5.3 HANDLING LAGS GREATER THAN ONE

When the lags greater than one appear in the model formulation, the problem is transformed into canonical form. For this purpose, for each  $y_{t-m}$  variable appearing in the  $m$ th lag,  $m-1$  artificial variables ( $y_t^{\text{lag}^1}, y_t^{\text{lag}^2}, \dots, y_t^{\text{lag}^{m-1}}$ ) and  $m-1$  additional equations are added:

$$\begin{aligned}y_t^{\text{lag}^1} &= y_{t-1}, \\y_t^{\text{lag}^2} &= y_{t-1}^{\text{lag}^1}, \\&\dots \\y_t^{\text{lag}^{m-1}} &= y_{t-1}^{\text{lag}^{m-2}}.\end{aligned}$$

If  $y$  is a control variable, these equations are added to the `constraints` block, each one accompanied by a Lagrange multiplier

Artificial variables are added to the list of control variables. In case of exogenous variables appearing in lags  $> 1$ , additional equations are added only to the `identities` block.

## 6 R CLASSES

The R-part of `gEcon` implementation is object-based. All the information characterizing a model (parameter values, steady state, solution, information about variables and stochastic structure) is stored in objects of the `gecon_model` class. The outputs of stochastic simulations of the model are, on the other hand, stored in a `gecon_simulation` class. Models are solved and analysed by invoking functions operating on the objects of `gecon_model` class or generic functions<sup>1</sup>. The information retrieved about the model variables, parameters, and shocks is stored in `gecon_var_info`, `gecon_par_info`, and `gecon_shock_info` classes, respectively.

### 6.1 CREATING `gecon_model` OBJECT

`.gcn` input files containing agent problems, identities, and market clearing conditions are processed by a shared library invoked from R level. As a result, an R file is created which comprises the `gecon_model` class constructor with functions and data to initialize slots. The command invoking the whole process of parsing an input file and constructing the `gecon_model` class object is (the `.gcn` extension is optional):

```
make_model("PATH_TO_FILE/NAME_OF_FILE.gcn")
```

The R file created by `gEcon` has exactly the same name as the input file followed by an `.model.R` extension. It can be later on loaded without parsing the `.gcn` file again, using the `load_model` function (the `.model.R` extension is optional):

```
load_model("PATH_TO_FILE/NAME_OF_FILE.model.R")
```

It is worth mentioning that the dynamic linked library may create new variables or substitute some of the user-defined variables. In particular, the variables defined in the `definitions` section are substituted for and no longer used (for details see chapter 3). `gEcon` may also create artificial variables to handle models with lags  $> 1$  or models with time aggregators more complicated than in the case of exponential discounting. For example, the  $y_t^{\text{lag}^1}$  variable described in section 5.3 will appear as the `y_lag_1`.

### 6.2 INTERNAL REPRESENTATION

All `gEcon` models are represented by the objects of the `gecon_model` class. The name of the class has been chosen to avoid errors caused by overwriting the class definition. If the class was named `model` and the user called one's model `model`, too, the model would load once but in the process, the class constructor would be overwritten by the instance of class.<sup>2</sup> Taking this into consideration, it has been decided to use `gecon_` prefixes in class definitions. Using names of objects beginning with `gecon_` is discouraged for the same reason.

All the model's elements are stored in `gecon_model` class slots, each of them containing objects of a specific class/type. Although slots of a `gecon_model` class object can be accessed using `@` followed by the slot's name

---

<sup>1</sup>Generic functions are functions that behave differently depending on class of arguments on which they are invoked. Usually they are used for performing standard operations on models like printing results or plotting. Generic functions make computations with `gEcon` intuitive for R users [Chambers 2010].

<sup>2</sup>Therefore further use of `gEcon` would not be possible until the workspace is cleared.

(e.g. `model_name@steady`), it is strongly recommended not to modify slots directly, i.e. without the use of `gEcon` functions.

The user may create a new model object without building it from a `.gcn` input file, by calling the constructor of the `gecon_model` class. Again, using this constructor directly is discouraged.

The so-called ‘setters’, i.e. the functions which allow to set the class slots to values specified by the user, use hash tables to check if the input variables’ names comply with the list of model variables. Whenever a ‘setter’ is used, relevant slots are updated. `gEcon` clears the values of slots that may no longer be in compliance with the updated parameters or settings. For instance, when a covariance matrix of shocks is passed to the object of `gecon_model` class, the steady state values and solution matrices are preserved but the model’s statistics are cleared. Any changes in free parameters’ values remove all the results from the model’s slots, forcing the user to recompute the model. However, steady-state values computed prior to the change which could affect them will be stored as new initial values of the variables.

During the construction of an object of `gecon_model` class, all the models are classified based on the information passed to the constructor. The model’s shocks, lead, and lagged values are examined which allows to classify the model as dynamic or static, and stochastic or deterministic.

`gEcon` neither allows to compute statistics of the deterministic models, nor to solve the perturbation in case of static ones. The information concerning the type of the model can be easily printed with the `show` or `print` functions.

### 6.3 FUNCTIONS OF `gecon_model` CLASS

One of `gEcon`’s greatest advantages is the possibility to solve models interactively, i.e. by invoking functions available for class `gecon_model` sequentially. This allows users to control subsequently obtained results and facilitates debugging of models. Nevertheless, all the functions used may still be invoked altogether as one R script.

The user can solve and analyse models using implemented in `gEcon`:

- calibration utilities (see chapters 1.4, 7),
- steady state and perturbation solvers (see chapters 1.4, 1.5, 7, 8),
- tools for IRFs and statistics computations (see chapters 1.6, 9),
- debugging utilities (see chapters 10),
- functions for retrieving computation results (see chapters 1, 10).

### 6.4 `gecon_simulation` CLASS

The `compute_irf`, `simulate_model`, and `random_path` functions create an object of `gecon_simulation` class (for details see section 9.3). This class was designed in order to store the information about the simulations’ settings and results. Standard generic functions such as — `show`, `print`, and `summary` — may be used with it. It is worth noting that the `get_simulation_results` function allows to retrieve the simulated series. Additionally, the `plot_simulation` function allows for simulations’ visualization in a convenient way.

### 6.5 INFORMATION ABOUT VARIABLES, PARAMETERS, AND SHOCKS

`gEcon` makes it easy for users to retrieve information about specified model elements by using commands ending with `_info` suffix: `var_info`, `par_info`, and `shock_info`. This option becomes very useful, when dealing with large-scale

models, for example it allows to easily identify the equations in which the variables/parameters of interest appear. The aforementioned functions return objects of classes: `gecon_var_info`, `gecon_par_info`, and `gecon_shock_info` respectively. These classes store the information in a structured way, and have the `print`, `show`, and `summary` methods defined, allowing to print information in an aesthetic manner.

## 7 DETERMINISTIC STEADY STATE & CALIBRATION

First order conditions, identities, and market clearing conditions determine the behaviour of agents in the model. If a long run equilibrium exists, one can find a set of variables' values that solves the system under the assumption that shocks are equal to zero and variables values do not change over time. This static equilibrium or the steady state can be a subject of separate analyses (e.g. comparative statics) but it is also a prerequisite of (log-)linearising the model and finding solution of the perturbation.

### 7.1 DETERMINISTIC STEADY STATE

All `gEcon` models can be written as a system of  $n$  equations of the form:

$$E_t F(y_{t-1}, y_t, y_{t+1}, \epsilon_t; \theta) = 0, \quad (7.1)$$

where  $y$  is a vector of  $n$  variables (consisting of control and exogenous variables:  $y_t = (x_t, z_t)$ ) and  $\theta$  is a vector of  $k$  parameters. In this setting a vector of deterministic steady-state values  $\bar{y}$  satisfies:

$$F(y^*, y^*, y^*, 0; \theta) = 0. \quad (7.2)$$

### 7.2 CALIBRATION OF PARAMETERS

It is a common practice to calibrate model parameters in a way that assures consistency of chosen variables' steady-state values with the values observed empirically (e.g. the technology parameter calibrated based on capital share in GDP). Such calibration can be done by `gEcon` automatically — the `gEcon` language allows the user to specify which parameters are calibrated parameters and set relevant variables' steady-state values in accordance with the real world data (these quantities are denoted as  $\gamma$ ). The system of equations (7.2) is modified for this purpose by adding  $m$  equations which describe the relationships between the chosen steady-state values where  $m$  parameters are treated as variables. Denote free parameters as  $\theta_{fixed}$  and calibrated parameters as  $\theta_{calibr}$ . The vector of variables' steady-state values  $y^*$  and the vector of calibrated parameters  $\theta_{calibr}$  satisfy a system of  $(n + m)$  equations:

$$\bar{F}(y^*, y^*, y^*, 0, \theta_{calibr}; \theta_{fixed}, \gamma) = 0. \quad (7.3)$$

The calibration equations are specified in a `.gcn` file. The initial values of calibrated parameters may be set in R by means of the `initval_calibr_par` function. Deterministic steady state is computed using the `steady_state` function. A logical argument `calibration` of the `steady_state` function specifies whether calibration equations should be taken into account or not. When it is set to `FALSE`, calibrated parameters, as set with the `initval_calibr_par` function, are treated as free ones and calibration equations declared in a `.gcn` file are ignored. Therefore the user has to be careful when using this option and specify reasonable values using the `initval_calibr_par` function.

## 7.3 IMPLEMENTED SOLVERS

The `steady_state` function calls numerical non-linear solvers from the `nleqslv` package. The `nleqslv` package implements two solvers based on Broyden's and Newton's methods. The effectiveness of these methods can be influenced by a choice of a global search strategy: quadratic or geometric line search, the Powell single dogleg method or the double dogleg method.<sup>1</sup> The default solver employed by `gEcon` is Newton's method with quadratic line search.<sup>2</sup>

The most important solver settings can be accessed and changed using the `options` argument of the `steady_state` function. A list of options may contain one or more elements — if some options are not specified, the default values are assumed. Options that may prove especially useful to users are: `global` which specifies the search strategy, `max_iter` which determines the maximal number of iterations carried out in search of the solution and `tol` which specifies tolerance for the solution. `gEcon` checks if solution indicated by the solver satisfies the model's equations. If the 1-norm of residuals is less than the specified tolerance, the solution is saved. Solver status is printed on the console and stored in the object of the `gecon_model` class.

## 7.4 HOW TO IMPROVE THE CHANCES OF FINDING SOLUTION?

Our experience shows that using symbolic reduction algorithm implemented in `gEcon` significantly improves chances of finding the steady state by reducing the problem dimension. You should not explicitly name Lagrange multipliers if not necessary (internally generated Lagrange multipliers are automatically selected for reduction) and always try to reduce as many variables as possible by listing candidates for reduction in the `tryreduce` block of the `.gcn` file (see section 3.4).

Although our experience indicates that most solvers manage to find the steady state of models, at least medium-size ones, based on the default initial values only,<sup>3</sup> good initial guesses of steady-state values always improve the chance of finding the solution. The initial values of variables and calibrated parameters are passed to the `gecon_model` class using the `initval_var` and `initval_calibr_par` functions respectively. When setting the initial values one has to remember about functions' domains — solver will not find a solution if it encounters an undefined expression in an initial iteration. E.g. the solver will not be able to compute the expression:  $\log(1 - a - b)$  when  $a + b > 1$  — setting the initial values of both variables  $a$  and  $b$  to 0.2 solves the problem.

## 7.5 TROUBLESHOOTING

In situation when `gEcon` fails to find the solution, the following warning message will appear:

```
> model <- steady_state(model)
Warning message:
In steady_state(model) :
  The steady state has not been found, 1-norm of residuals is: 582.637797660505.
It is more than requested precision.
Change initial values and check if the steady state can be found.
```

The `get_residuals` function allows to check which equations had the largest initial residuals and the largest residuals after the solver has stopped. For example, the following output indicates that the solver is converging but after the default number of iterations it is still too far from solution.

<sup>1</sup>For details see the package documentation [Hasselmann 2013].

<sup>2</sup>It uses Jacobian matrix automatically derived by `gEcon`, if Jacobian derivation was not turned off, see section 3.3.

<sup>3</sup>These are 0.9 for variables and 0.5 for parameters.

```
> get_residuals(model)
```

Initial residuals:

Eq. 1	Eq. 2	Eq. 3	Eq. 4	Eq. 5	Eq. 6
-0.887	-999.100	0.000	14.100	26.100	0.005
Eq. 7	Eq. 8	Eq. 9	Eq. 10	Eq. 11	Calibr Eq. 1
2.748	-34.658	0.878	5.182	-900.774	899.676

Equations with the largest initial residuals:

Eq. 2, Eq. 11, Calibr Eq. 1, Eq. 8, Eq. 5

Final residuals:

Eq. 1	Eq. 2	Eq. 3	Eq. 4	Eq. 5	Eq. 6
-0.167	0.000	0.000	582.638	378.930	0.000
Eq. 7	Eq. 8	Eq. 9	Eq. 10	Eq. 11	Calibr Eq. 1
0.041	-219.188	0.000	2.550	-397.172	233.009

Equations with the largest final residuals:

Eq. 4, Eq. 11, Eq. 5, Calibr Eq. 1, Eq. 8

The equations 4 and 11 may be displayed through a call to the `list_eq` function:

```
> list_eq(model, eq_idx = c(4, 11))
```

Eq. 4:  $-W[] + Z[] * (1 - \alpha) * K_d[]^\alpha * L_d[]^{-\alpha} = 0$

Eq. 11:  $-C[] - I[] + Y[] + K_s[-1] * r[] - r[] * K_d[] + L_s[] * W[] - L_d[] * W[] - \psi * K_s[-1] * (-\delta + K_s[-1]^{-1} * I[])^2 = 0$

The 1st calibrating equation can be viewed using the `list_calibr_eq` function:

```
> list_calibr_eq(model, c(1))
```

Calibr. Eq. 1:  $-0.36 * Y[ss] + r[ss] * K_d[ss] = 0$

As the  $Y$ ,  $K^d$  and  $r$  variables appear in all the 1st calibrating equation, their initial values may be suspected for causing troubles with convergence to the steady state. However,  $K^d$  appears in all equations and seems to prevent the model from converging. Indeed, in this a bit contrived example, its initial value was set deliberately to 1000, i.e. far from the true value. One can get more information about variables using the `var_info` function, see section 10.1.

When the norm of final residuals is greater than the norm of initial residuals, it may indicate one of several possible problems. It may suggest that variables' initial values are far from the solution. It may also hint that the model has been incorrectly formulated and does not allow for existence of equilibrium. Improper values of free parameters in an otherwise correct model can also cause this problem, e.g. discount factor greater than 1 or negative depreciation rate. Free parameters' values can be checked using the `get_par_values` function and set by the `set_free_par` function.

## 8 SOLVING THE MODEL IN LINEARISED FORM

`gEcon` solves dynamic equilibrium models using the first order perturbation method, which is most popular among researchers, especially when dealing with larger scale models. The perturbation method requires linearisation of the model around its steady state. Log-linearising models instead of only linearising them is a common practice among researchers, since variables after log-linearisation can be interpreted as percent relative deviations from their steady-state values.

### 8.1 LOG-LINEARISATION

Currently most models have to be log-linearised manually or written down using natural logarithms of variables in order to be log-linearised (the latter is required e.g. by Dynare). The first approach is quite tedious, while the latter makes interpretation of steady-state values difficult (one have to exponentiate obtained steady-state results manually as they appear as natural logarithms of the model's variables instead of their values). `gEcon` log-linearises equations automatically, right before solving the perturbation.

First order conditions and identities describing a model can be written as the following system:

$$\mathbb{E}_t F(y_{t-1}, y_t, y_{t+1}, \epsilon_t) = 0. \quad (8.1)$$

The steady state satisfies:

$$F(y^*, y^*, y^*, 0) = 0. \quad (8.2)$$

Differentiating (8.1), the model can be expanded around its steady state:

$$F_1|_{(y^*, y^*, y^*, 0)}(y_{t-1} - y^*) + F_2|_{(y^*, y^*, y^*, 0)}(y_t - y^*) + F_3|_{(y^*, y^*, y^*, 0)}(\mathbb{E}_t y_{t+1} - y^*) + F_4|_{(y^*, y^*, y^*, 0)}\epsilon_t = 0, \quad (8.3)$$

where  $F_n|_{(y^*, y^*, y^*, 0)}$  denotes the derivative of  $F$  with respect to the  $n$ th argument at the deterministic steady state. Let us define  $\tilde{y}^i$  as the measure of the  $i$ th variable's deviation from its steady-state value. In case of linearisation one has:

$$y^i(\tilde{y}) = y^{*i} + \tilde{y}^i, \quad (8.4)$$

while in case of the log-linearisation:

$$y^i(\tilde{y}) = y^{*i} e^{\tilde{y}^i}. \quad (8.5)$$

Linearising the model around its steady state in levels (where deviations are equal to zero), one obtains:

$$\left. \frac{\partial y}{\partial \tilde{y}} \right|_0 = I, \quad (8.6)$$

where  $I$  denotes identity matrix. Linearising it in logarithms, one arrives at:



$$\left. \frac{\partial y}{\partial \tilde{y}} \right|_0 = \begin{pmatrix} y^{*1} & 0 & \dots & 0 \\ 0 & y^{*2} & & 0 \\ \vdots & & \ddots & \vdots \\ 0 & 0 & \dots & y^{*n} \end{pmatrix}. \quad (8.7)$$

Let us denote this matrix by  $T$ . Using  $y^i(\tilde{y})$  enables us to rewrite (8.1) as:

$$E_t F(y(\tilde{y}_{t-1}), y(\tilde{y}_t), y(\tilde{y}_{t+1}), \epsilon_t) = 0. \quad (8.8)$$

Linearising (8.8) and using the chain rule we obtain:

$$F_1|_{(y^*, y^*, y^*, 0)} T \tilde{y}_{t-1} + F_2|_{(y^*, y^*, y^*, 0)} T \tilde{y}_t + F_3|_{(y^*, y^*, y^*, 0)} T E_t \tilde{y}_{t+1} + F_4|_{(y^*, y^*, y^*, 0)} \epsilon_t = 0. \quad (8.9)$$

The  $\tilde{F}_i = F_i|_{(y^*, y^*, y^*)} T$  matrices for  $i$  in  $1, 2, 3$  are further used in solving the perturbation. In case of each variable the user can decide whether it should be linearised or log-linearised — the  $T$  matrix diagonal's elements will be set accordingly either to 1 or relevant steady-state values.

Variables with a zero steady-state value are not log-linearised. A logical `loglin` argument of the `solve_pert` function specifies whether variables should be log-linearised. If it is set to `TRUE`, one can specify — using the `not_loglin_var` option — which variables should be omitted in this process, i.e. which ones are to be linearised only. `gEcon` does not log-linearise variables having zero steady-state values.

## 8.2 CANONICAL FORM OF THE MODEL AND SOLUTION

`gEcon` canonical form of the model in linearised form is:

$$A y_{t-1} + B y_t + C E_t y_{t+1} + D \epsilon_t = 0. \quad (8.10)$$

$A, B, C, D$  matrices depend both on parameters and steady-state values.  $y_t$  are (percentage) deviations of variables from the steady state in case of (log-)linearisation. Let  $y_t^{(s)}$  be state variables, i.e. those variables that appear in the model in lagged values (variables corresponding to non-zero rows in  $A$  matrix). Variables that are neither state variables nor exogenous shocks ( $\epsilon_t$ ) are called jumpers ( $y_t^{(j)}$ ). The solution of the model in terms of state variables  $y_t^{(s)}$  and exogenous shocks  $\epsilon_t$  looks as follows:

$$\begin{aligned} y_t^{(s)} &= P y_{t-1}^{(s)} + Q \epsilon_t, \\ y_t^{(j)} &= R y_{t-1}^{(j)} + S \epsilon_t. \end{aligned} \quad (8.11)$$

To verify whether the set of  $P, Q, R, S$  matrices solves the (8.10) problem, permute  $y$  and columns of matrices yielding  $\tilde{y}_t = \begin{pmatrix} y_t^{(s)} \\ y_t^{(j)} \end{pmatrix}$  and:

$$\tilde{A} \tilde{y}_{t-1} + \tilde{B} \tilde{y}_t + \tilde{C} E_t \tilde{y}_{t+1} + \tilde{D} \tilde{\epsilon}_t = 0. \quad (8.12)$$

Using  $\tilde{y}_t$  the (8.11) equations can be rewritten in a more compact way:

$$\tilde{y}_t = \underbrace{\begin{pmatrix} P & 0 \\ R & 0 \end{pmatrix}}_{R'} \tilde{y}_{t-1} + \underbrace{\begin{pmatrix} Q \\ S \end{pmatrix}}_{S'} \epsilon_t. \quad (8.13)$$

The solution should satisfy the (8.12) equation, so after using (8.13), the following condition is obtained:

$$(A + BR' + CR'R')\tilde{y}_{t-1} + (BS' + CR'S' + D)\epsilon_t + CS'E_t\epsilon_{t+1} = 0. \quad (8.14)$$

This condition can be satisfied for all the  $y$  and  $\epsilon$  values only if:

$$A + BR' + CR'R' = 0 \text{ (deterministic part condition),} \quad (8.15)$$

$$BS' + CR'S' + D = 0 \text{ (stochastic part condition).}$$

**gEcon** checks these conditions and displays a warning if they are not satisfied.<sup>1</sup> In order to specify the accuracy of this check, the `norm_tol` option of the `solve_pert` function can be used. It contends the maximum tolerable 1-norm of the residuals of the equations (8.15).

### 8.3 SOLUTION PROCEDURE

In order to obtain the solution, **gEcon** uses the **gensys** solver written by Christopher Sims [Sims 2002]. The canonical form accepted by this solver differs from the **gEcon**'s form described above. It is as follows:

$$\Gamma_0 g_t = \Gamma_1 g_{t-1} + C + \Psi \eta_t + \Pi \epsilon_t, \quad (8.16)$$

where the vector  $g_t$  consists of the model's variables sorted so that the first  $k$  variables are variables that appear in leads in any of the equations:

$$g_t = \begin{pmatrix} y_{1,t} \\ y_{2,t} \\ \vdots \\ y_{n,t} \\ E_t y_{1,t+1} \\ E_t y_{2,t+1} \\ \vdots \\ E_t y_{k,t+1} \end{pmatrix}, \quad (8.17)$$

the vector  $\eta_t$  denotes expectational errors:

$$\eta_t = \begin{pmatrix} \eta_{1,t} = y_{1,t} - E_{t-1} y_{1,t} \\ \eta_{2,t} = y_{2,t} - E_{t-1} y_{2,t} \\ \vdots \\ \eta_{k,t} = y_{k,t} - E_{t-1} y_{k,t} \end{pmatrix},$$

$\epsilon_t$  is a vector of stochastic shocks at time  $t$  with dimension  $s$  equal to the number of shocks,  $\Gamma_0$  and  $\Gamma_1$  are matrices with dimensions  $(n+k) \times (n+k)$  and  $\Psi$  and  $\Pi$  have dimensions of  $(n+k) \times (k)$  and  $(n+k) \times s$ , respectively.  $C$  denotes a constant term. The solver uses qz decomposition (based on Lapack implementation) with `qzdiv` and `qzswitch` routines to order decomposition results, dividing the system into stable and non-stable parts. After solving the each part, the solution is written in the following form:

<sup>1</sup>This may occur when the model is incorrectly specified or due to numerical roundoff errors. In the latter case, the user should consider log-linearising variables with large steady-state values or changing model's parametrisation.

$$g_t = \Theta_1 g_{t-1} + \Theta_c + \Theta_0 \epsilon_t. \tag{8.18}$$

See [Sims 2002] for the detailed description of the procedure.

The transformation of gEcon’s canonical form into Sims’ form requires sorting matrices’ columns so that they could correspond to the order of variables in the  $g$  vector and adding equations for expectational errors. In matrix notation, using the naming convention applied in the (8.10) and (8.17) definitions, the transformation can be written as:

$$\underbrace{\begin{pmatrix} B & C \\ -I & 0 \end{pmatrix}}_{\Gamma_0} g_t = \underbrace{\begin{pmatrix} A & 0 \\ 0 & I \end{pmatrix}}_{\Gamma_1} g_{t-1} + C + \underbrace{\begin{pmatrix} 0 \\ I \end{pmatrix}}_{\Psi} \eta_t + \underbrace{\begin{pmatrix} D \\ 0 \end{pmatrix}}_{\Pi} \epsilon_t. \tag{8.19}$$

The gensys output is transformed into gEcon solution’s form by picking indices of non-zero columns in  $\Theta_1$  and then adjusting it to the similar form as (8.13).

The solution can be found only if the number of the non-predetermined variables is equal to the number of eigenvalues outside the unit circle ([Blanchard O. J. 1980]). If the number of eigenvalues greater than 1 exceeds (is less than) the number of non-predetermined variables, there is no solution (an infinite number of solutions). The gEcon check\_bk function allows to print the eigenvalues and compare them with the number of non-predetermined variables.

## 8.4 TROUBLESHOOTING

Consider a case of a simple RBC model whose steady state has been found but problems with the perturbation solution occurred. The check\_bk command shows that there are more forward looking variables than eigenvalues larger than 1:

```
> check_bk(model)
```

Eigenvalues of system:

	Mod	Re	Im
[1,]	9.500000e-01	9.500000e-01	0.000000e+00
[2,]	9.658471e-01	9.658471e-01	-1.555702e-18
[3,]	1.010101e+00	1.010101e+00	0.000000e+00
[4,]	1.045819e+00	1.045819e+00	-1.470342e-17
[5,]	3.087408e+14	3.087408e+14	0.000000e+00
[6,]	4.701462e+16	4.696996e+16	2.048699e+15
[7,]	1.061755e+17	-1.061755e+17	0.000000e+00

The model has 6 forward looking variables and 5 eigenvalues larger than 1 in modulus. BK conditions have NOT been SATISFIED.

Such an output indicates that either timing convention, parametrisation, or the model formulation is wrong. The timing of variables in all equations in which they appear can be easily checked by using the var\_info function. In our example, the information generated by this function is as follows:

```
> var_info(model, all = T)
```

Incidence info:

Equation	1	C	I	K_d	K_s	L_d	L_s	PI	U	W	Y	Z	pi	r
	1	.	.	t	t-1	.	.	.	.	.	.	.	.	.

Equation	2	.	.	.	.	t	t	.	.	.	.	.	.
Equation	3	.	.	.	.	.	.	t	.	.	.	.	t
Equation	4	.	.	t	.	t	.	.	.	t	.	t	.
Equation	5	.	.	t	.	t	.	.	.	.	t	t	.
Equation	6	.	.	.	.	.	.	.	.	.	.	t, t+1	.
Equation	7	.	.	t	.	t	.	.	.	.	.	t	.
Equation	8	t	.	.	.	.	.	t	.	.	t	.	.
Equation	9	t, t+1	t, t+1	.	t-1, t	.	t, t+1	.	.	.	.	.	t+1
Equation	10	.	t	.	t-1, t	.	.	.	.	.	.	.	.
Equation	11	t	.	.	.	.	t	.	t, t+1	.	.	.	.
Equation	12	.	.	t	.	t	.	.	.	t	t	.	t
Equation	13	t	t	.	t-1	.	t	.	.	t	.	.	t

It can be inferred from this output that the following variables:  $C$  (consumption),  $r$  (interest rate),  $U$  (aggregate utility),  $Z$  (technology level),  $L_s$  (labour supply), and  $I$  (investments) appear in leads. While in case of variables  $C$ ,  $r$ ,  $U$ ,  $L_s$  and  $I$  such a timing convention is accepted in RBC models,  $Z$  — technology level — should appear only in lagged and current values. After changing the timing convention, the model will be solved without trouble.

## 9 MODEL STATISTICS & SIMULATION

Model solution, i.e. the recursive equilibrium laws of motion (8.11) can be used to examine model implications. `gEcon` offers the computation of statistics most commonly found in literature, using spectral or simulation methods. In addition, `gEcon` allows users to easily determine the Impulse Response Functions and simulate the model.

### 9.1 SPECIFICATION OF SHOCK DISTRIBUTION

Stochastic innovations in `gEcon` models are assumed to follow a multivariate normal distribution with zero mean. By default, the covariance matrix of shocks is assumed to be an identity matrix, i.e. shocks are assumed to be uncorrelated with one another, with variance of each equal to 1. The entire covariance matrix as well as its individual elements can be set or changed by one of two functions: `set_shock_cov_mat` and `set_shock_distr_par`.

The entire covariance matrix can be passed to a `gecon_model` object using the `set_shock_cov_mat` function. It is assumed that the order of rows and columns in the supplied matrix is consistent with the order of shocks stored in an object of the `gecon_model` class. The order of shocks in the supplied matrix can be altered using the `shock_order` argument. As an example, the following command has to be executed to set the covariance matrix for a model with three shocks: `epsilon_1`, `epsilon_2`, and `epsilon_3`:

```
model <- set_shock_cov_mat(model,
                           cov_matrix = matrix(c(0.01, 0.008, 0.009,
                                                  0.008, 0.04, 0.036,
                                                  0.009, 0.036, 0.09), 3, 3),
                           shock_order = c('epsilon_1',
                                             'epsilon_2',
                                             'epsilon_3'))
```

The `set_shock_distr_par` function gives an alternative method of setting and modifying the covariance matrix modification. It accepts single entries, updating a current covariance matrix in a coherent way. Distribution parameters can be specified as standard deviations (`sd`), variances (`var`), covariances (`cov`) or correlations (`cor`). Correlations between shocks are preserved even if the user subsequently modifies variance or standard deviation of any shock.

The naming convention for parameters accepted by this function is as follows:

```
"sd( SHOCK_NAME )"
"var( SHOCK_NAME )"
"cov( SHOCK_NAME_1, SHOCK_NAME_2 )"
"cor( SHOCK_NAME_1, SHOCK_NAME_2 )"

```

The following command:

```
model <- set_shock_distr_par(model,
  distr_par = list("sd(epsilon_1)" = 0.1,
    "var(epsilon_2)" = 0.04,
    "sd(epsilon_3)" = 0.3,
    "cor(epsilon_1, epsilon_2)" = 0.4,
    "cov(epsilon_1, epsilon_3)" = 0.009,
    "cor(epsilon_3, epsilon_2)" = 0.6))
```

should assign the same parameters to the covariance matrix of model shocks as the `set_shock_cov_mat` command above.

**Note:** There are two issues which the user should be careful about while using the `set_shock_distr_par` function. First, in contrast to other parameters, shock distribution parameters require quotation marks to be assigned properly. If quotation marks are omitted, R parser treats elements of the `distr_par` list or vector as functions and attempts to evaluate them, producing errors. Second, parameters passed to the `distr_par` argument should not be specified twice. The following code snippets present commands leading to syntax errors discussed above:

```
# missing quotation marks: ERROR
model <- set_shock_distr_par(model,
  distr_par = list(cor(epsilon_1, epsilon_2) = 0.3))

# the same parameter specified twice: ERROR
model <- set_shock_distr_par(model,
  distr_par = list("cor(epsilon_1, epsilon_2)" = 0,
    "cor(epsilon_2, epsilon_1)" = 0.2))
```

If variance or standard deviation of any shock is set to zero using any of two functions discussed in this section, this shock is not taken into account when the model is simulated.

## 9.2 COMPUTATION OF CORRELATIONS

In order to compute the statistics of model variables in `gEcon`, such as variances, correlations, autocorrelations, and variance decomposition the `compute_model_stats` function should be used.

### 9.2.1 SPECTRAL ANALYSIS

If the `sim` option is set to `FALSE`, then frequency-domain techniques will be applied to compute variables' statistics. As far as the computational approach is concerned, `gEcon` uses mainly the framework proposed by Uhlig [Uhlig 1995].

In chapter 8 state variables were defined as  $y_t^{(s)}$  and jumpers, i.e. variables that are neither state variables nor exogenous shocks ( $\epsilon$ ) as  $y_t^{(j)}$ . Using this notation the solution of the model in terms of state variables  $y_t^{(s)}$  and exogenous shocks  $\epsilon$  was formulated as the system of  $P$ ,  $Q$ ,  $R$ ,  $S$  matrices such that:

$$y_t^{(s)} = P y_{t-1}^{(s)} + Q \epsilon_t,$$

$$y_t^{(j)} = R y_{t-1}^{(s)} + S \epsilon_t.$$

The total number of variables  $y_t$  is assumed to be equal to  $n$  and  $E(y_t) = \mu$  is the unconditional mean of the vector. Following Hamilton (see [Hamilton 1994], chapter 10), for a covariance-stationary  $n$ -dimensional vector process  $y_t$  the  $j$ th autocovariance matrix is defined to be the following  $(n \times n)$  matrix:

$$\Gamma_j = E[(y_t - \mu)(y_{t-j} - \mu)^T]. \quad (9.1)$$

For the process  $y_t$  with an absolute summable sequence of autocovariance matrices, the matrix-valued autocovariance-generating function  $G_Y(z)$  is defined as:

$$G_Y(z) \equiv \sum_{j=-\infty}^{\infty} \Gamma_j z^j, \quad (9.2)$$

where  $z$  is a complex scalar.

The function  $G_Y(z)$  associates  $(n \times n)$  matrix of complex numbers with the complex scalar  $z$ . If it is divided by  $2\pi$  and evaluated at  $z = e^{-i\omega}$ , where  $\omega$  is a real scalar and  $i = \sqrt{-1}$ , the result is the *population spectrum* of the vector  $y$ :

$$f_Y(\omega) = (2\pi)^{-1} G_Y(e^{-i\omega}) = (2\pi)^{-1} \sum_{j=-\infty}^{\infty} \Gamma_j e^{-i\omega j}. \quad (9.3)$$

When any element of  $f_Y(\omega)$  defined by (9.3) the equation is multiplied by  $e^{-i\omega j}$  and the resulting function of  $\omega$  is integrated from  $-\pi$  to  $\pi$ , the result is the corresponding element of the  $j$ th autocovariance matrix of  $y$ :

$$\int_{-\pi}^{\pi} f_Y(\omega) e^{i\omega j} d\omega = \Gamma_j. \quad (9.4)$$

The area under the population spectrum is the unconditional covariance matrix of  $y$ . So, knowing the value of the spectral density for the vector of model's variables  $y$  for all  $\omega$  in a real scalar  $[0, \pi]$ , the value of the  $j$ th autocovariance matrix for  $y$  can be calculated.

If we combine the matrices  $P$  and  $R$  into  $P' = \begin{pmatrix} P \\ R \end{pmatrix}$  and  $Q$  and  $S$  into  $Q' = \begin{pmatrix} Q \\ S \end{pmatrix}$ , then the matrix-valued spectral density for the entire vector of variables  $y_t$  is given by:

$$f(\omega) = \frac{1}{2\pi} (I_m - P' e^{-i\omega})^{-1} Q' N Q'^T ((I_m - P'^T e^{i\omega})^{-1}), \quad (9.5)$$

where  $I_m$  is the identity matrix of dimension  $m$  denoting the number of state variables and  $N$  is a covariance matrix of shocks existing in the model. In order to approximate the spectrum, the grid of points is constructed (the grid's density can be controlled using `ngrid` option — the experience of the authors indicates that it should be at least 256 so that correlations do not diverge significantly from the simulation results for ordinary RBC models).<sup>1</sup>

Most statistics in the DSGE/RBC literature are computed for HP-filtered data. `gEcon` offers this functionality, too.

The HP-filter removes the trend  $\tau_t$  from the data given by  $y_t$  by solving:

$$\min_{\tau_t} \sum_{t=1}^T ((y_t - \tau_t)^2 + \lambda((\tau_{t+1} - \tau_t) - (\tau_t - \tau_{t-1}))^2), \quad (9.6)$$

<sup>1</sup>For details of estimating the population spectrum see [Hamilton 1994], pp. 276-278.

where  $\lambda$  is a HP-filter parameter determining the smoothness of the trend component. The transfer function for the solution, i.e. a linear lag polynomial  $r_t = y_t - \tau_t = h(L)x_t$ , is:

$$\tilde{h}(\omega) = \frac{4\lambda(1 - \cos(\omega))^2}{1 + 4\lambda(1 - \cos(\lambda))^2}. \quad (9.7)$$

We obtain the matrix spectral density of the HP-filtered vector of the form:

$$g_{HP}(\omega) = \tilde{h}(\omega)g(\omega). \quad (9.8)$$

Taking advantage of (9.3) and (9.4), we derive autocorrelations of  $r_t$  by means of an inverse Fourier transformation:

$$\int_{-\pi}^{\pi} g_{HP}(\omega)e^{i\omega k} d\omega = \mathbb{E}[r_t r_{t-k}^T]. \quad (9.9)$$

Subsequently, this is used to derive a covariance matrix and — after relevant transformations — variances, standard deviations of the model's variables and correlations, including correlations with the reference variable (e.g. GDP) in leads and lags.

## 9.2.2 SIMULATIONS

As mentioned above, models may be analysed in **gEcon** based on the Monte Carlo simulations.

Depending on the number of simulation runs which are to be executed (with the default of 100 000), random shock vectors for multivariate normal distribution are generated. Every simulation run proceeds according to the algorithm:

1. First, the Cholesky decomposition (factorization) of the covariance matrix of model's shocks  $\Sigma$  is computed, so as to obtain a matrix  $A$  for which there is:  $AA^T = \Sigma$ .
2. Second, a vector  $Z$  consisting of  $n$  independent random variables (model's shocks) with standard normal distribution is generated.
3. Assuming a mean vector equal to 0, a random shock vector  $X$  is equal to:  $X = AZ$ .
4. Using the matrices containing the variables' equilibrium laws of motion, i.e. the impact of lagged state variables (matrices  $P$  and  $Q$ ) and shocks (matrices  $R$  and  $S$ ) on all the variables in the model, consecutive values of the variable series are computed based on random shock vectors.

In this way the series for all the model's variables are simulated. As mentioned above, **gEcon** allows to filter the series using the HP-filter.

Finally, based on the simulated and optionally HP-filtered series, the covariance matrix of the model's variables and autocorrelations are computed.

Please note that MC simulations for large-scale models may take significant amount of time.

## 9.2.3 DECOMPOSITION OF VARIANCE

In order to obtain the decomposition of variance a three-step procedure is carried out:

- the total variance of each model variable is computed,
- the amount of variance each shock accounts for is determined,



- the share of variance caused by each shock relative to the total variance is calculated.

The amount of variance each shock accounts for is computed analogously to the total variance, i.e. using (9.5) for spectral density computation, with one exception.  $N_i$  equal to:

$$N_i = (Ae_i)(Ae_i)' \quad (9.10)$$

is used for the  $i$ th shock instead of  $N$  (where  $N = AA'$  and  $e_i$  is a column vector with 1 on the  $i$ th place and zeros elsewhere).

### 9.3 SIMULATING THE MODEL

`gEcon` allows users to perform model simulations in three different ways:

- computation of standard impulse response functions for all model shocks,
- simulation using random path of shocks drawn from distribution with a given covariance matrix,
- simulation using a user-defined path of shocks.

It should be noted that all the simulations available in `gEcon` are performed under the assumption that agents in the model do not know shocks' realisations in advance.

The function `compute_irf` computes the IRFs based on uncorrelated shocks when the option `cholesky` is set to `FALSE`. The IRFs based on correlated shocks are computed when this option is set to `TRUE`, i.e. when the Cholesky decomposition of a covariance matrix of the model's shocks is used.

The command `random_path` simulates the behaviour of the economy. It draws a path of shocks based on their covariance matrix and computes the implied dynamics of chosen variables.

The user may also specify her own path of shocks and verify its impact on the economy using the function `simulate_model`. E.g. the IRFs for negative shocks can be generated in this way.

The functions `random_path` and `compute_irf` create shock paths which are passed to the `simulate_model` function — the main simulation engine. Based on the state-space representation (the matrices  $P$ ,  $Q$ ,  $R$ , and  $S$ ) the simulation is performed for all state variables and specified non-state variables.

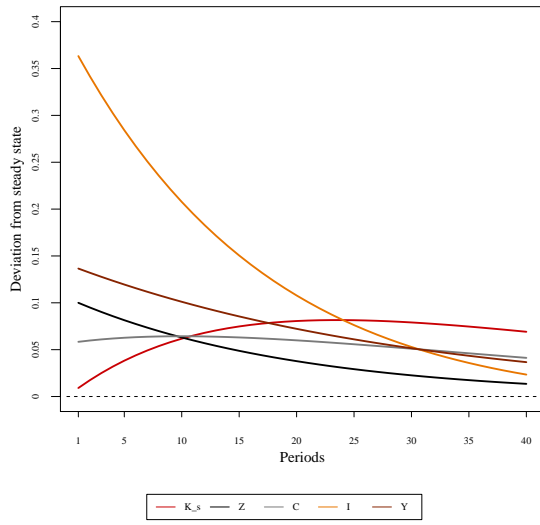
Simulation results are returned in an object of class `gecon_simulation`. The user may see the simulation results after calling the `summary` method and retrieve them by using the `get_simulation_results` function.

In the following example the user-defined shocks have been set with the command:

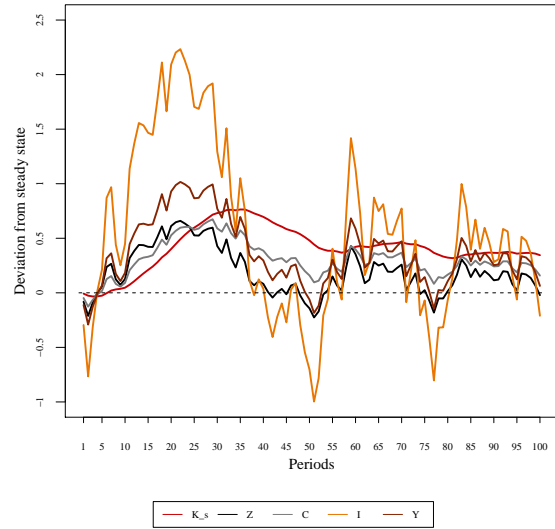
```
rbc_ic_sim <- simulate_model(rbc_ic, variables = c('K_s', 'C', 'Z', 'I', 'Y'),
                           shocks = c('epsilon_Z'),
                           shock_path = matrix(c(-0.05, 0, 0, -0.05), nrow = 1, ncol = 4))
```

In the analysed scenario two negative shocks affect productivity in the first and fourth period.

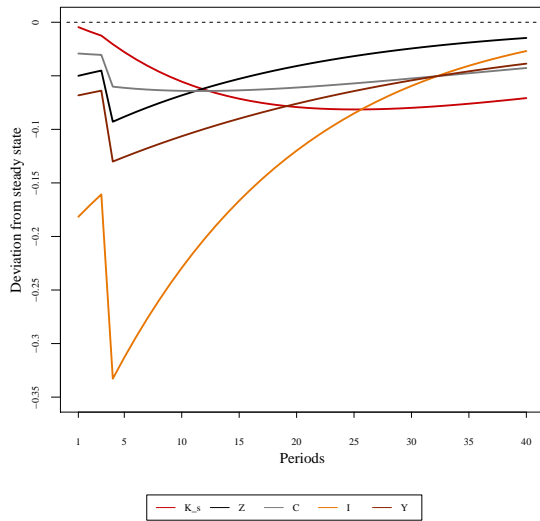
Simulation results stored in an object of `gecon_simulation` class can be plotted by using the `plot_simulation` function taking an object of this class as an argument. Sample plots for the model from chapter 1 are presented below.



**Figure 9.1:** Impulse response function for  $\epsilon^Z$



**Figure 9.2:** Random path for 100 periods



**Figure 9.3:** Simulation with the user defined shocks

## 10 WORKING WITH MODELS FROM R

`gEcon` has been designed with a goal to simplify the process of creating and solving DSGE & CGE models and to make it interactive, so that models can be analysed and debugged more easily. This is reflected both in the language and the R interface, which provides users with functions that allow to easily extract model characteristics, check solution status and help with debugging.

### 10.1 INFORMATION ABOUT PARAMETERS, VARIABLES & SHOCKS

Parameters, variables, and shocks in a model can be listed by the `get_par_names`, `get_var_names`, and `get_shock_names` functions, which return vectors of character strings. Using the `get_par_names` logical arguments `free_par` and `calibr_par` one can select free or calibrated parameters only. By default all parameters are returned.

In our `rbc_ic` example from chapter 1 these functions return:

```
> get_par_names(rbc_ic, free_par = TRUE, calibr_par = FALSE)
[1] "beta" "delta" "eta" "mu" "phi" "psi"
> get_par_names(rbc_ic, free_par = FALSE, calibr_par = TRUE)
[1] "alpha"
> get_var_names(rbc_ic)
[1] "r" "C" "I" "K_s" "L_s" "U" "W" "Y" "Z"
> get_shock_names(rbc_ic)
[1] "epsilon_Z"
```

`gEcon` provides users with three functions: `par_info`, `var_info` and `shock_info`, which collect information about (selected) model parameters, variables and shocks and return objects of classes `gecon_par_info`, `gecon_var_info`, and `gecon_shock_info` respectively. If the return value of these functions is not assigned to a variable, it is printed on the R console. They can be used for both model analysis as well as diagnosing problems. In order to select parameters, variables and shocks of interest use these functions' arguments `par_names`, `var_names`, and `shock_names` respectively.

An example using these functions is presented below:

```
> par_info(rbc_ic, parameters = c("alpha", "eta", "psi"))
Incidence info:
```

	alpha	eta	psi
Equation 1	X	.	.
Equation 2	X	.	.
Equation 3	X	.	.
Equation 5	.	X	X
Equation 6	.	X	.
Equation 8	.	X	.
Equation 9	.	.	X

Parameter info:

	.gcn file value	Current value	Parameter type
alpha	.	0.4	Calibrated
eta	2	2	Free
psi	0.8	0.8	Free

```
> var_info(rbc_ic, variables = c("Y", "C", "I"))
```

Incidence info:

		Y	C	I
Equation	3	t	.	.
Equation	5	.	t, t+1	t, t+1
Equation	6	.	t	.
Equation	7	.	.	t
Equation	8	.	t	.
Equation	9	t	t	t
Calibr. Eq.	1	ss	.	.

Steady-state values:

	Steady state
Y	1.3393
C	0.9578
I	0.3816

Variable info:

	Is a state variable?	Is log-linearised?
Y		Y
C		Y
I		Y

Recursive laws of motion for the variables

State variables impact:

	K <sub>s</sub> [-1]	Z[-1]
Y	0.5150	0.5269
C	-0.2073	3.1849
I	0.3092	1.2842

Shocks impact:

	epsilon_Z
Y	0.5547

```
C    3.3526
I    1.3518
```

-----

Basic statistics:

	Steady-state value	Std. dev.	Variance	Loglin
Y	1.3393	0.1762	0.031	Y
C	0.9578	0.0744	0.0055	Y
I	0.3816	0.4373	0.1913	Y

Correlations:

	r	C	I	K_s	L_s	U	W	Y	Z
Y	0.9760	0.9791	0.9962	0.3119	0.9895	0.9909	0.9939	1.0000	0.9977
C	0.9113	1.0000	0.9577	0.4987	0.9393	0.9976	0.9956	0.9791	0.9629
I	0.9912	0.9577	1.0000	0.2282	0.9983	0.9755	0.9805	0.9962	0.9998

```
> shock_info(rbc_ic, all = TRUE)
Incidence info:
```

```
      epsilon_Z
Eq. 4      X
```

-----

Covariance matrix of shocks:

```
      epsilon_Z
epsilon_Z      0.01
```

An application of the `var_info` function to debugging first order perturbation is presented in section 8.4.

## 10.2 MODELS WRITTEN USING gEcon TEMPLATE MECHANISM

The `gEcon` template mechanism allows to create models consisting of hundreds or even thousands of variables without much effort (see chapter 4). However, calibration and analysis of such models may get tedious. To facilitate these processes, two types of functions were added to the `gEcon`'s R interface.

The `get_index_sets` function allows to retrieve a list of index sets used in a model. For instance, the call to this function for the example model presented in chapter 4 (named 'pure\_exchange'), i.e.:

```
get_index_sets(pure_exchange)
```

will print the following list:

```
$agents
[1] "A" "B"

$goods
[1] "1" "2" "3"
```

Each of the list elements contains vector of the indices names in a given set.

The `get_var_names_by_index`, `get_par_names_by_index`, and `get_shock_names_by_index` functions allow to retrieve names of variables, parameters, and shocks with a given index. The following syntax could be used in the example model from chapter 4 in order to retrieve the names of variables related to the agent *A*:

```
get_var_names_by_index(pure_exchange, index_names = c('A'))
```

The output will be as follows:

```
[1] "e__A__1"      "e__A__2"      "e__A__3"      "lambda__AGENTS_1__A"      "C__A__1"
[6] "C__A__2"      "C__A__3"      "U__A"
```

### 10.3 MODEL EQUATIONS

As described in section 3.3.2, the model equations derived by gEcon can be written to a logfile and L<sup>A</sup>T<sub>E</sub>X documentation. For debugging purposes it can also be useful to list them from the R interface level. To this end functions `list_eq` and `list_calibr_eq` are provided. Some examples of their use can be found in section 7.5.

### 10.4 ACCESSING MODEL RESULTS

The results of computations performed in gEcon can be further analysed and presented by using specially designed R functions. Contrary to other DSGE packages, which print the outcomes, but internally store them in complex and difficult-to-access structures, gEcon implements a set of functions allowing to retrieve the computed results in a user-friendly way.

The `get_model_info` returns a character vector containing the input file name, the input file path, and the date of model creation.

The `get_par_values` function prints and returns the vector of parameters. A call to this function for the example model presented in chapter 1 (called `rbc_ic`), i.e.:

```
get_par_values(rbc_ic)
```

will print the following output:

Model parameters:

```
      Value
alpha 0.400
beta  0.990
delta 0.025
eta   2.000
mu    0.300
phi   0.950
psi   0.800
```

It is worth mentioning that one can choose parameters (e.g. calibrated parameters only) whose values are to be returned with this function. In our example the call:

```
get_par_values(rbc_ic, parameters = c('alpha'))
```

will only print the value of the selected calibrated  $\alpha$  parameter. Most `gEcon` “getters” have an option allowing to specify the set of variables (parameters) of interest.

The `get_ss_values` function prints and returns the vector of steady-state values. Going on with our example `rbc_ic`, the call:

```
get_ss_values(rbc_ic)
```

will print:

Steady-state values:

	Steady-state value
<code>r</code>	0.0351
<code>C</code>	0.9578
<code>I</code>	0.3816
<code>K_s</code>	15.2627
<code>L_s</code>	0.2645
<code>U</code>	-125.6048
<code>W</code>	3.0384
<code>Y</code>	1.3393
<code>Z</code>	1.0000

The presented results may be assigned to any R variable. For example, they could be later used for comparison with the results of model with different parametrisation (comparative statics).

The `get_pert_solution` function prints and returns a list of four matrices containing variables’ recursive laws of motion. The output for the example from chapter 1 is:

Matrix P:

	<code>K_s[-1]</code>	<code>Z[-1]</code>
<code>K_s[]</code>	0.9698	0.0796
<code>Z[]</code>	0.0000	0.9500

Matrix Q:

	<code>epsilon_Z</code>
<code>K_s</code>	0.0838
<code>Z</code>	1.0000

Matrix R:

	<code>K_s[-1]</code>	<code>Z[-1]</code>
<code>r[]</code>	-0.0242	0.0451
<code>C[]</code>	0.5150	0.5269
<code>I[]</code>	-0.2073	3.1849
<code>L_s[]</code>	-0.1513	0.5570
<code>U[]</code>	0.0483	0.0670
<code>W[]</code>	0.4605	0.7272
<code>Y[]</code>	0.3092	1.2842

Matrix S:

```

      epsilon_Z
r      0.0474
C      0.5547
I      3.3526
L_s    0.5863
U      0.0705
W      0.7655
Y      1.3518

```

Again, the returned list can be assigned to a variable for future use. Both `get_pert_solution` and `get_ss_values` functions have option `silent`, which suppresses console output when set to `TRUE`.

The solution status can be verified by using the `ss_solved` and `re_solved` functions. They return `TRUE` if the steady state and perturbation solution, respectively, have been found and `FALSE` otherwise.

The `get_shock_cov_mat` returns the covariance matrix of model shocks.

The `get_model_stats` function prints and returns the statistics of the model. The user may choose statistics which to be returned. This function should be called after a call to `compute_model_stats`.

The following commands in our example:

```

rbc_ic <- compute_model_stats(model = rbc_ic, n_leadlags = 6)
get_model_stats(rbc_ic)

```

produce:

Basic statistics:

	Steady-state value	Std. dev.	Variance	Loglin
r	0.0351	0.0063	0.0000	N
C	0.9578	0.0744	0.0055	Y
I	0.3816	0.4373	0.1913	Y
K_s	15.2627	0.0390	0.0015	Y
L_s	0.2645	0.0769	0.0059	Y
U	-125.6048	0.0093	0.0001	Y
W	3.0384	0.1008	0.0102	Y
Y	1.3393	0.1762	0.0310	Y
Z	1.0000	0.1303	0.0170	Y

Correlation matrix:

	r	C	I	K_s	L_s	U	W	Y	Z
r	1	0.911	0.991	0.098	0.997	0.938	0.946	0.976	0.989
C		1	0.958	0.499	0.939	0.998	0.996	0.979	0.963
I			1	0.228	0.998	0.975	0.981	0.996	1.000
K_s				1	0.171	0.437	0.415	0.312	0.246
L_s					1	0.961	0.967	0.989	0.997
U						1	1	0.991	0.979
W							1	0.994	0.984
Y								1	0.998
Z									1.000



Autocorrelations:

	Lag 1	Lag 2	Lag 3	Lag 4	Lag 5	Lag 6
r	0.711	0.467	0.267	0.105	0.000	-0.115
C	0.745	0.522	0.331	0.170	0.039	-0.064
I	0.712	0.470	0.269	0.108	-0.018	-0.113
K_s	0.960	0.863	0.729	0.574	0.411	0.249
L_s	0.711	0.467	0.266	0.105	-0.021	-0.115
U	0.734	0.504	0.310	0.149	0.020	-0.081
W	0.731	0.499	0.303	0.143	0.014	-0.086
Y	0.718	0.479	0.280	0.119	-0.008	-0.104
Z	0.713	0.471	0.271	0.110	-0.016	-0.111

Variance decomposition:

	epsilon_Z
r	1
C	1
I	1
K_s	1
L_s	1
U	1
W	1
Y	1
Z	1

It is a common practice to relate variables' standard deviations to a chosen reference variable (GDP) and to compute correlations with its leads and lags. This can be achieved by setting the `ref_var` argument of the `compute_model_stats` function to the name of the reference variable. In our example the call:

```
rbc_ic <- compute_model_stats(model = rbc_ic, ref_var = 'Y', n_leadlags = 5)
get_model_stats(rbc_ic, basic_stats = F, corr = T, autocorr = F, var_dec = F)
```

will produce:

Correlation matrix:

	r	C	I	K_s	L_s	U	W	Y	Z
r	1	0.911	0.991	0.098	0.997	0.938	0.946	0.976	0.989
C		1	0.958	0.499	0.939	0.998	0.996	0.979	0.963
I			1	0.228	0.998	0.975	0.981	0.996	1.000
K_s				1	0.171	0.437	0.415	0.312	0.246
L_s					1	0.961	0.967	0.989	0.997
U						1	1	0.991	0.979
W							1	0.994	0.984
Y								1	0.998
Z									1.000

Cross correlations with the reference variable (Y):

Std. dev. rel. to Y	Y[-5]	Y[-4]	Y[-3]	Y[-2]	Y[-1]	Y[]	Y[1]	Y[2]	Y[3]	Y[4]	Y[5]
---------------------	-------	-------	-------	-------	-------	-----	------	------	------	------	------

r[]	0.036	0.102	0.222	0.368	0.542	0.745	0.976	0.638	0.363	0.143	-0.026	-0.151
C[]	0.422	-0.111	0.017	0.186	0.399	0.662	0.979	0.762	0.567	0.396	0.249	0.126
I[]	2.482	0.036	0.161	0.317	0.507	0.733	0.996	0.690	0.435	0.227	0.062	-0.065
K_s[]	0.221	-0.483	-0.426	-0.326	-0.176	0.034	0.312	0.498	0.607	0.656	0.657	0.622
L_s[]	0.436	0.065	0.188	0.340	0.523	0.740	0.989	0.669	0.404	0.191	0.023	-0.103
U[]	0.053	-0.076	0.052	0.219	0.428	0.685	0.991	0.750	0.539	0.358	0.206	0.081
W[]	0.572	-0.064	0.064	0.230	0.438	0.692	0.994	0.746	0.529	0.344	0.190	0.065
Y[]	1.000	-0.008	0.119	0.280	0.479	0.718	1.000	0.718	0.479	0.280	0.119	-0.008
Z[]	0.740	0.027	0.152	0.309	0.501	0.730	0.998	0.697	0.445	0.239	0.074	-0.053

## 10.5 DOCUMENTING RESULTS IN L<sup>A</sup>T<sub>E</sub>X

All functions described in the previous section (`get_par_values`, `get_ss_values`, `get_pert_solution`, `get_model_stats`) have a logical argument `to_tex`. If it is set to `TRUE`, results are written to a L<sup>A</sup>T<sub>E</sub>X file `model_name.results.tex`. If this file does not exist (L<sup>A</sup>T<sub>E</sub>X model output has not been turned on, see 3.3.2) it will be created on the first call to any of the aforementioned functions (with `to_tex = TRUE` argument).

Plots created by a call to `plot_simulation` function (see 9.3) can be stored on disk (as encapsulated Postscript files) after setting the `to_eps` argument to `TRUE`.

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