

...

Assessing Structural VAR's

by

Lawrence J. Christiano, Martin Eichenbaum and Robert Vigfusson

Minneapolis, August 2005

Background

- In Principle, Impulse Response Functions from SVARs are useful as a guide to constructing and evaluating Dynamic Stochastic General Equilibrium (DSGE) models.
- To be useful in practice, estimators of response functions must have good sampling properties.

What We Do

- Investigate the Sampling Properties of SVARs, When Data are Generated by Estimated DSGE Models.
 - Bias Properties of Impulse Response Function Estimators
 - * Bias: Mean of Estimator Minus True Value of Object Being Estimated
 - Accuracy of Standard Estimators of Sampling Uncertainty
 - Is Inference Sharp?
 - * How Large is Sampling Uncertainty?

What We Do ...

- Throughout, We Assume The Identification Assumptions Motivated by Economic Theory Are Correct
 - Example: ‘Only Shock Driving Labor Productivity in Long Run is Technology Shock’
- In Practice, Implementing VARs Involves Auxiliary Assumptions (Cooley-Dwyer)
 - Example: Lag Length Specification of VARs
 - Failure of Auxilliary Assumptions May Induce Distortions

What We Do ...

- We Look at Two Classes of Identifying Restrictions
- Long-run identification
 - Exploit implications that some models have for long-run effects of shocks
- Short-run identification
 - Exploit model assumptions about the timing of decisions relative to the arrival of information.

Key Findings

- With Short Run Restrictions, SVARs Work *Remarkably* Well
 - Inference Sharp (Sampling Uncertainty Small), Essentially No Bias.
- With Long Run Restrictions,
 - For Model Parameterizations that Fit the Data Well, SVARs Work Well
 - * Inference is correct but not necessarily sharp.
 - * Sharpness is example specific.
 - Examples Can Be Found In Which There is Noticeable Bias
 - * But, Analyst Who Looks at Standard Errors Would Not Be Misled

Outline of Talk

- Analyze Performance of SVARs Identified with Long Run Restrictions
 - Reconcile Our Findings for Long-Run Identification with CKM
- Analyze Performance of SVARs Identified with Short Run Restrictions
- We Focus on the Question:
 - How do hours worked respond to a technology shock?

A Conventional RBC Model

- Preferences:

$$E_0 \sum_{t=0}^{\infty} (\beta (1 + \gamma))^t [\log c_t + \psi \log (1 - l_t)].$$

- Constraints:

$$c_t + (1 + \tau_x) [(1 + \gamma) k_{t+1} - (1 - \delta) k_t] \leq (1 - \tau_{lt}) w_t l_t + r_t k_t + T_t.$$

$$c_t + (1 + \gamma) k_{t+1} - (1 - \delta) k_t \leq k_t^\theta (z_t l_t)^{1-\theta}.$$

- Shocks:

$$\Delta \log z_t = \mu_Z + \sigma_z \varepsilon_t^z$$

$$\tau_{lt+1} = (1 - \rho_l) \bar{\tau}_l + \rho_l \tau_{lt} + \sigma_l \varepsilon_{t+1}^l$$

- Information: Time t Decisions Made After Realization of All Time t Shocks

Long-Run Properties of Our RBC Model

- ε_t^z is only shock that has a permanent impact on output and labor productivity

$$a_t \equiv y_t/l_t.$$

- *Exclusion property:*

$$\lim_{j \rightarrow \infty} [E_t a_{t+j} - E_{t-1} a_{t+j}] = f(\varepsilon_t^z \text{ only}),$$

- *Sign property:*

f is an increasing function.

Parameterizing the Model

- Parameters:
 - Exogenous Shock Processes: We Estimate These
 - Other Parameters: Same as CKM

β	θ	δ	ψ	γ	$\bar{\tau}_x$	$\bar{\tau}_l$	μ_z
$0.98^{1/4}$	$\frac{1}{3}$	$1 - (1 - .06)^{1/4}$	2.5	$1.01^{1/4} - 1$	0.3	0.243	$1.02^{1/4} - 1$

- Baseline Specifications of Exogenous Shocks Processes:
 - Our Baseline Specification
 - Chari-Kehoe-McGrattan (July, 2005) Baseline Specification

Our Baseline Model (*KP Specification*):

- Technology shock process corresponds to Prescott (1986):

$$\Delta \log z_t = \mu_Z + 0.011738 \times \varepsilon_t^z.$$

- Law of motion for Preference Shock, $\tau_{l,t}$:

$$\tau_{l,t} = 1 - \left(\frac{c_t}{y_t} \right) \left(\frac{l_t}{1 - l_t} \right) \left(\frac{\psi}{1 - \theta} \right) \text{ (Household and Firm Labor Func)}$$

$$\tau_{l,t} = \bar{\tau}_l + 0.9934 \times \tau_{l,t-1} + .0062 \times \varepsilon_t^l.$$

- Estimation Results Robust to Maximum Likelihood Estimation -
 - Output Growth and Hours Data
 - Output Growth, Investment Growth and Hours Data (here, τ_{xt} is stochastic)

CKM Baseline Model

- Exogenous Shocks: also estimated via maximum likelihood

$$\begin{aligned}\Delta \log z_t &= 0.00516 + 0.0131 \times \varepsilon_t^z \\ \tau_{lt} &= \bar{\tau}_l + 0.952\tau_{l,t-1} + 0.0136 \times \varepsilon_t^l.\end{aligned}$$

- Note: the shock variances (particularly τ_{lt}) are very large compared with KP
- We Will Investigate Why this is so, Later

Estimating Effects of a Positive Technology Shock

- Vector Autoregression:

$$Y_{t+1} = B_1 Y_{t-1} + \dots + B_p Y_{t-p} + u_{t+1}, \quad E u_t u_t' = V,$$

$$u_t = C \varepsilon_t, \quad E \varepsilon_t \varepsilon_t' = I, \quad C C' = V$$

$$Y_t = \begin{pmatrix} \Delta \log a_t \\ \log l_t \end{pmatrix}, \quad \varepsilon_t = \begin{pmatrix} \varepsilon_t^z \\ \varepsilon_{2t} \end{pmatrix}, \quad a_t = \frac{Y_t}{l_t}$$

Estimating Effects of a Positive Technology Shock

- Vector Autoregression:

$$Y_{t+1} = B_1 Y_{t-1} + \dots + B_p Y_{t-p} + u_{t+1}, \quad E u_t u_t' = V,$$

$$u_t = C \varepsilon_t, \quad E \varepsilon_t \varepsilon_t' = I, \quad C C' = V$$

$$Y_t = \begin{pmatrix} \Delta \log a_t \\ \log l_t \end{pmatrix}, \quad \varepsilon_t = \begin{pmatrix} \varepsilon_t^z \\ \varepsilon_{2t} \end{pmatrix}, \quad a_t = \frac{Y_t}{l_t}$$

- Impulse Response Function to Positive Technology Shock (ε_t^z):

$$Y_t - E_{t-1} Y_t = C_1 \varepsilon_t^z, \quad E_t Y_{t+1} - E_{t-1} Y_{t+1} = B_1 C_1 \varepsilon_t^z$$

- Need

$$B_1, \dots, B_p, C_1.$$

Identification Problem

- From Applying OLS To Both Equations in VAR, We ‘Know’:

$$B_1, \dots, B_p, V$$

- Problem, Need first Column of C , C_1
- Following Restrictions Not Enough:

$$CC' = V$$

- Identification Problem:

Not Enough Restrictions to Pin Down C_1

- Need More Restrictions

Identification Problem ...

- Impulse Response to Positive Technology Shock (ε_t^z):

$$\lim_{j \rightarrow \infty} [E_t a_{t+j} - E_{t-1} a_{t+j}] = (1 \ 0) [I - (B_1 + \dots + B_p)]^{-1} C \begin{pmatrix} \varepsilon_t^z \\ \varepsilon_{2t} \end{pmatrix},$$

- Exclusion Property of RBC Model Motivates the Restriction:

$$D \equiv [I - (B_1 + \dots + B_p)]^{-1} C = \begin{bmatrix} x & 0 \\ \text{number} & \text{number} \end{bmatrix}$$

- Sign Property of RBC Model Motivates the Restriction, $x \geq 0$.

$$DD' = [I - (B_1 + \dots + B_p)]^{-1} V [I - (B_1 + \dots + B_p)']^{-1}$$

- Exclusion/Sign Properties Uniquely Pin Down First Column of D , D_1 , Then,

$$C_1 = [I - (B_1 + \dots + B_p)] D_1 = f_{LR}(V, B_1 + \dots + B_p)$$

The Importance of Frequency Zero

- Note:

$$DD' = [I - (B_1 + \dots + B_p)]^{-1} V [I - (B_1 + \dots + B_p)']^{-1} = S_0$$

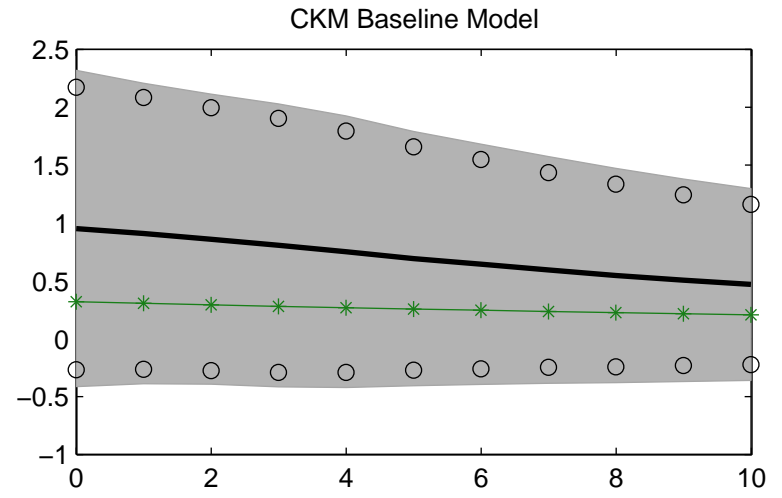
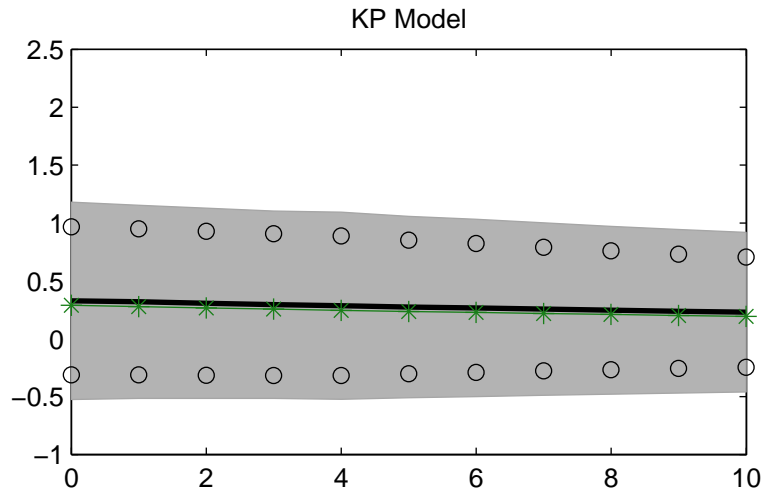
- S_0 Is VAR-based Parametric Estimator of the Zero-Frequency Spectral Density Matrix of Data
- An Alternative Way to Compute D_1 (and, hence, C_1) Is to Use a Different Estimator of S_0

$$S_0 = \sum_{k=-r}^r \left|1 - \frac{k}{r}\right| \hat{C}(k), \quad \hat{C}(k) = \frac{1}{T} \sum_{t=k}^T EY_t Y_{t-k}'$$

- Modified SVAR Procedure Similar to Extending Lag Length, But Non-Parametric

Response of Hours to A Technology Shock

Long-Run Identification Assumption



Diagnosing the Results

- What is Going on in Examples Where There is Some Bias?
 - The Difficulty of Estimating the Sum of VAR Coefficients.
- Corroborating Our Answer: Results with Modified Long-run SVAR Procedure
- Reconciling with CKM

Sims' Approximation Theorem

- Suppose that the True VAR Has the Following Representation:

$$Y_t = B(L)Y_{t-1} + u_t, u_t \perp Y_{t-s}, s > 0.$$

- Econometrician Estimates Finite-Parameter Approximation to $B(L)$:

$$Y_t = \hat{B}_1 Y_{t-1} + \hat{B}_2 Y_{t-2} + \dots + \hat{B}_p Y_{t-p} + u_t, Eu_t u_t' = \hat{V}$$

$$\hat{C} = [\hat{C}_1 : \hat{C}_2], \varepsilon_t = \begin{pmatrix} \varepsilon_t^z \\ \varepsilon_{2t} \end{pmatrix}, \hat{C}_1 = f_{LR}(\hat{V}, \hat{B}_1 + \dots + \hat{B}_p)$$

- Concern: $\hat{B}(L)$ May Have Too Few Lags (p too small)
- How Does Specification Error Affect Inference About Impulse Responses?

Sims' Approximation Theorem ...

- In Population, \hat{B} , \hat{V} Chosen to Solve (Sims, 1972)

$$\hat{V} = \min_{\hat{B}} \frac{1}{2\pi} \int_{-\pi}^{\pi} \left[B(e^{-i\omega}) - \hat{B}(e^{-i\omega}) \right] S_Y(e^{-i\omega}) \left[B(e^{i\omega})' - \hat{B}(e^{i\omega})' \right] d\omega + V$$

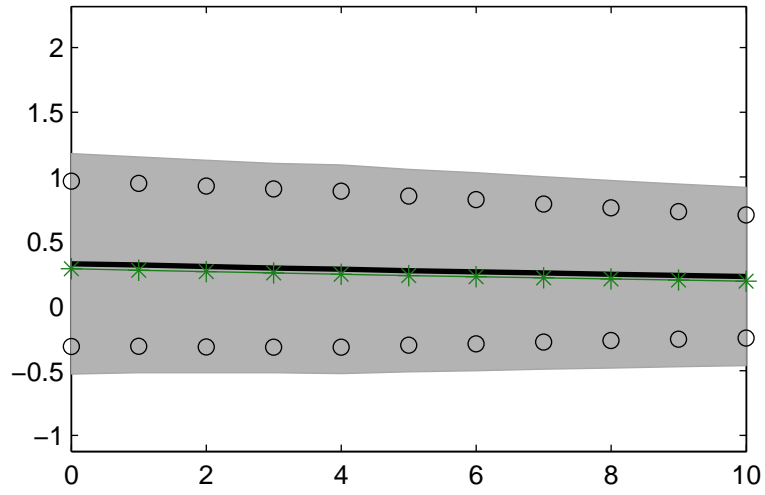
- With No Specification Error, $\hat{B}(L) = B(L)$, $\hat{V} = V$
- With Short Lags,
 - \hat{V} Accurate
 - $\hat{B}_1 + \dots + \hat{B}_p$ Accurate Only By Chance (i.e., if $S_Y(e^{-i \times 0})$ large)
 - No Reason to Expect \hat{S}_0 to be Accurate

Modified Long-run SVAR Procedure

- Replace \hat{S}_0 Implicit in Standard SVAR Procedure, with Non-parametric Estimator of S_0

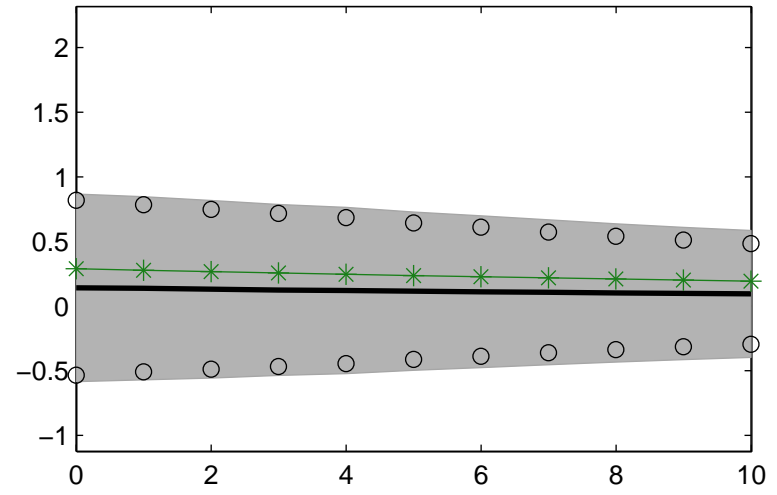
The Importance of Frequency Zero

Standard Method

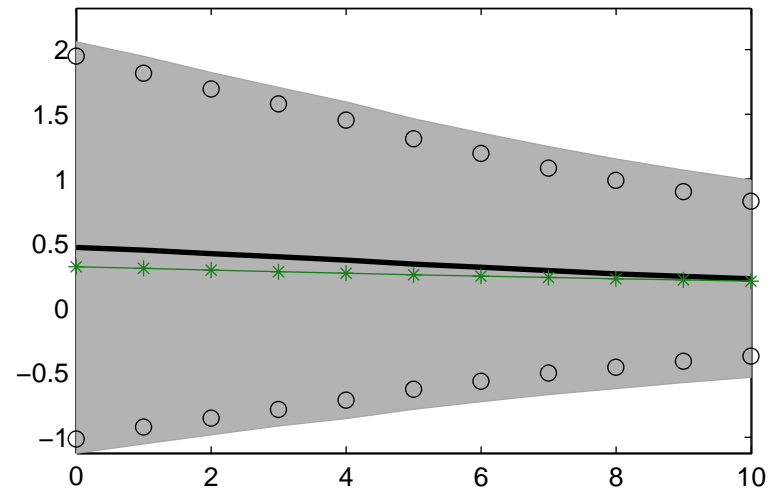
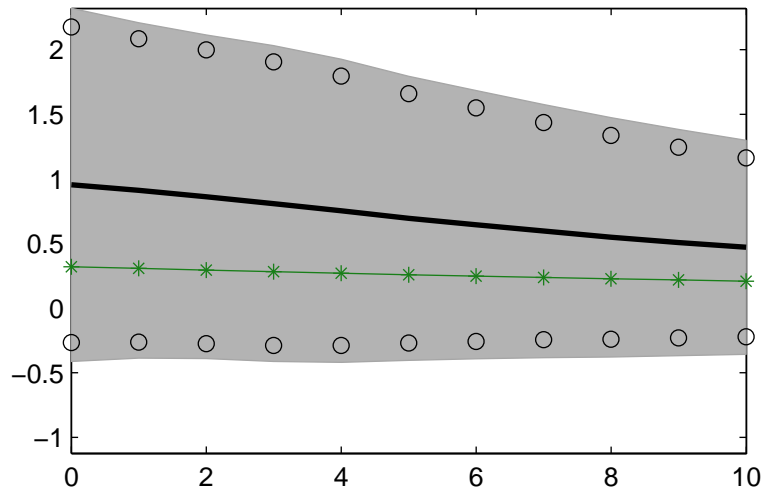


Bartlett Window

KP Model



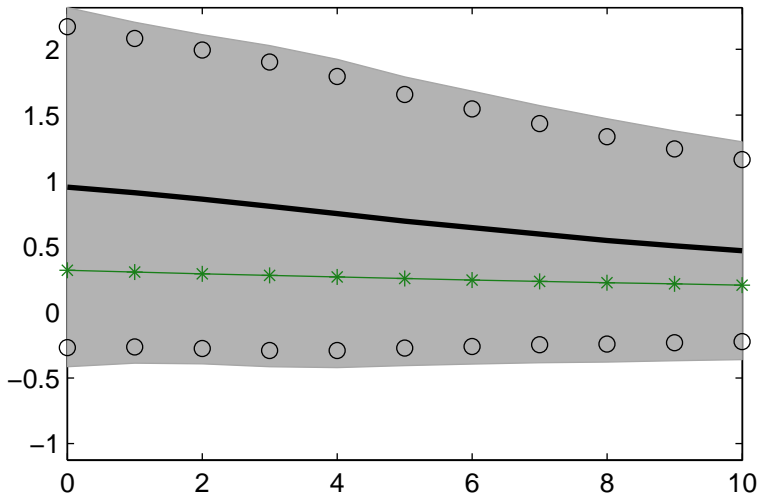
CKM Baseline Model



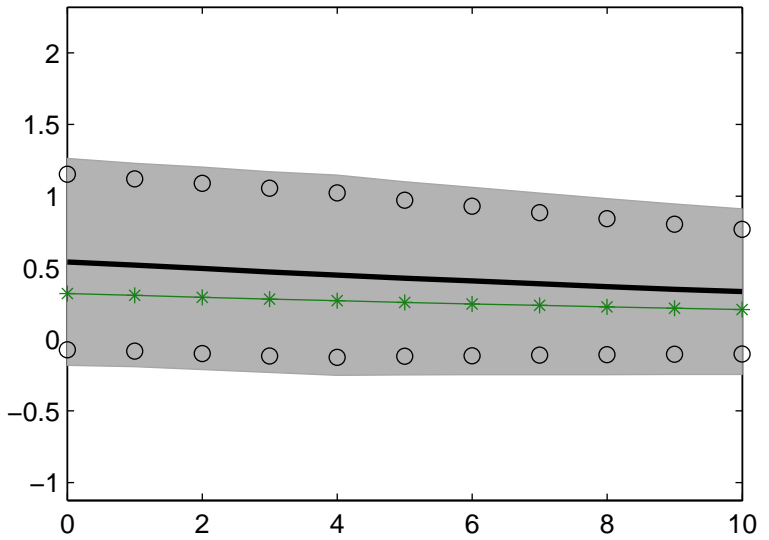
The Importance of Power at Low Frequencies

- Standard Conjecture
 - Long- run Identification Most Likely to be Distorted If Non-Technology Shocks Highly Persistent

- Conjecture is Incorrect
 - Sims' Formula Draws Attention to Possibility that Persistence *Helps*.



CKM Baseline Model except $\rho_1 = 0.995$ with λ



Reconciling with CKM

- CKM Conclude Long-run SVARs Not Fruitful for Building DSGE Models.
- We Disagree: Three Reasons

Reconciling with CKM

- CKM Conclude Long-run SVARs Not Fruitful for Building DSGE Models.
- We Disagree: Three Reasons
 - CKM emphasize examples in which econometrician over-differences per capita hours worked (DSVAR).
 - * Not a Fundamental Problem for SVARs
 - * Don't Over - Difference (see CEV (2003a,b)).

Reconciling with CKM

- CKM Conclude Long-run SVARs Not Fruitful for Building DSGE Models.
- We Disagree: Three Reasons
 - CKM emphasize examples in which econometrician over-differences per capita hours worked (DSVAR).
 - * Not a Fundamental Problem for SVARs
 - * Don't Over - Difference (see CEV (2003a,b)).
 - CKM Adopt a Different Measure of Distortions in SVARs
 - * Their Metric Is Not Informative About Performance of VARs in Practice

Reconciling with CKM

- CKM Conclude Long-run SVARs Not Fruitful for Building DSGE Models.
- We Disagree: Three Reasons
 - CKM emphasize examples in which econometrician over-differences per capita hours worked (DSVAR).
 - * Not a Fundamental Problem for SVARs
 - * Don't Over - Difference (see CEV (2003a,b)).
 - CKM Adopt a Different Measure of Distortions in SVARs
 - * Their Metric Is Not Informative About Performance of VARs in Practice
 - The Data *Overwhelmingly* Reject CKM's Parameterization

Measuring Distortion in SVARs

- Our Measure:

Compare True Model Impulse with Mean of Corresponding Estimator

- Measure Emphasized Most in CKM:

Compare True Model Impulse with What 4-lag SVAR with Infinite Data Would Find

Measuring Distortion in SVARs ...

- For Our Purposes 4-Lag SVAR Plims are Uninteresting.
 - In Practice, We Do Not Have An Infinite Amount of Data
 - And, if We Did Have Infinite Data We'd Use More than 4 Lags
 - * In this Case, there are *No* Large Sample Distortions

Measuring Distortion in SVARs ...

- For Our Purposes 4-Lag SVAR Plims are Uninteresting.
 - In Practice, We Do Not Have An Infinite Amount of Data
 - And, if We Did Have Infinite Data We'd Use More than 4 Lags
 - * In this Case, there are *No* Large Sample Distortions
- For SVARs to be Useful in Practice
 - Need to Work Well in Samples Like Actual Data.
 - Want to Know About Bias, Characterization of Sampling Uncertainty, Precision.

CKM Baseline Model is Rejected by the Data

- CKM estimate their model using MLE with Measurement Error.
 - Let

$$Y_t = (\Delta \log y_t, \log l_t, \Delta \log i_t, \Delta \log G_t)',$$

- Observer Equation:

$$Y_t = X_t + u_t, \quad E u_t u_t' = R,$$

R is a diagonal matrix,

u_t : 4×1 vector of iid measurement error,

X_t : model implications for Y_t

CKM Baseline Model is Rejected by the Data ...

- CKM Allow for Four Shocks

$$(\tau_{l,t}, z_t, \tau_{xt}, g_t)$$

.

$$G_t = g_t z_t$$

- CKM fix the elements on the diagonal of R to equal $1/100 \times \text{Var}(Y_t)$

CKM Baseline Model is Rejected by the Data ...

- CKM Allow for Four Shocks

$$(\tau_{l,t}, z_t, \tau_{xt}, g_t)$$

.

$$G_t = g_t z_t$$

- CKM fix the elements on the diagonal of R to equal $1/100 \times Var(Y_t)$
- For Purposes of Estimating the Baseline Model, Assume:

$$g_t = \bar{g}, \tau_{xt} = \tau_x.$$

- So,

$$\Delta \log G_t = \Delta \log z_t + \text{small measurement error}_t .$$

CKM Baseline Model is Rejected by the Data ...

- Overwhelming Evidence Against CKM Baseline Model

		Likelihood Ratio Statistic
	Likelihood Value	(degrees of freedom)
Estimated model	-328	
Freeing Measurement Error on $g = z$	2159	4974 (1)
Freeing All Four Measurement Errors	2804	6264 (4)

CKM Baseline Model is Rejected by the Data ...

- Overwhelming Evidence Against CKM Baseline Model

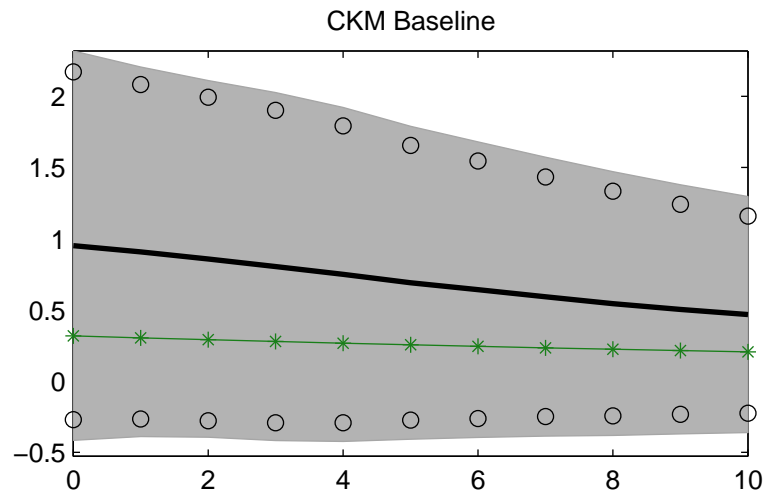
		Likelihood Ratio Statistic
	Likelihood Value	(degrees of freedom)
Estimated model	-328	
Freeing Measurement Error on $g = z$	2159	4974 (1)
Freeing All Four Measurement Errors	2804	6264 (4)

- Evidence of Bias in Estimated CKM Model Reflects CKM Choice of Measurement Error

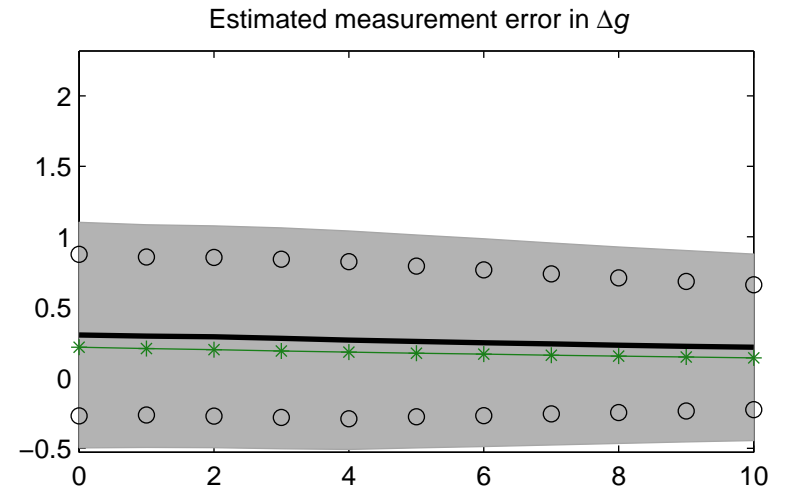
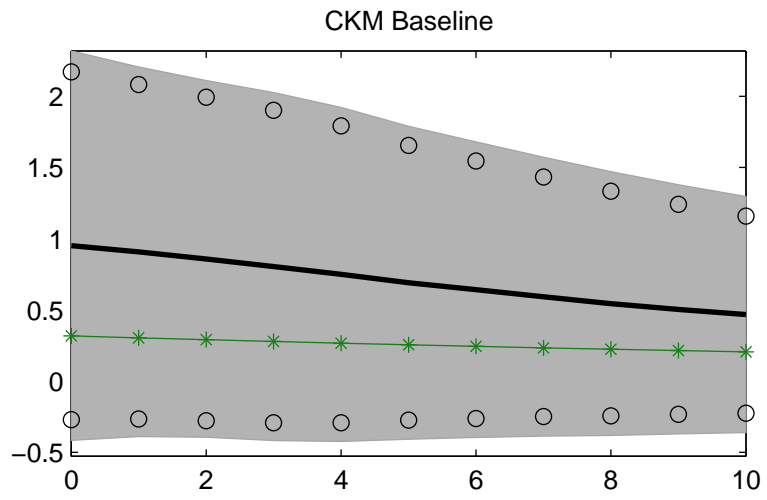
– Free Up Measurement error on $g = z$

* Produces Model With Good Bias Properties: Similar to KP Benchmark Model

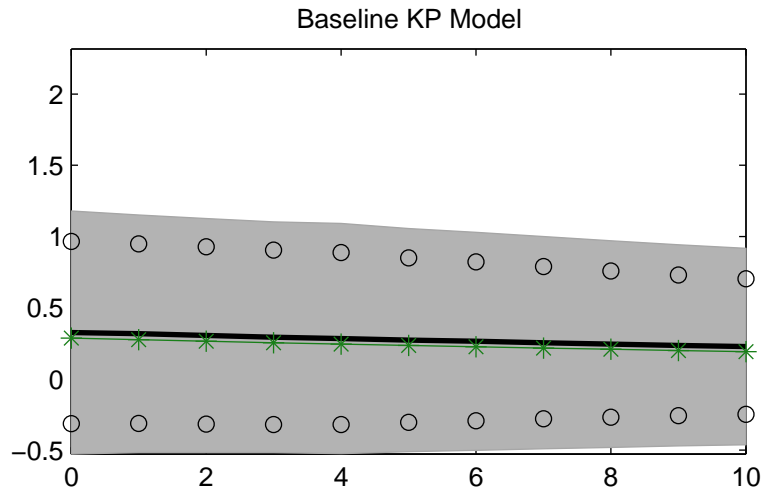
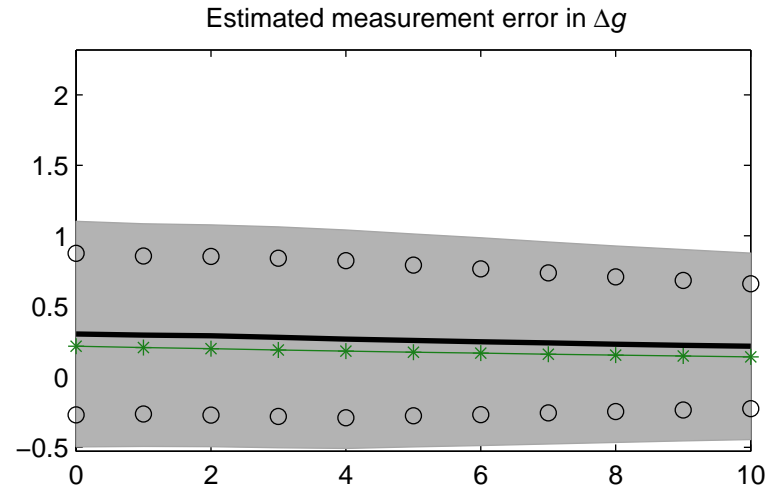
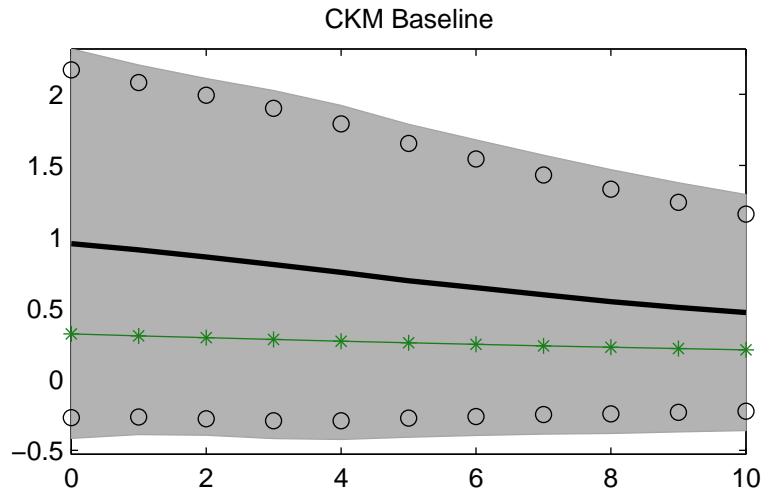
The Role of Δg



The Role of Δg



The Role of Δg



Alternate CKM Model With Government Spending Also Rejected

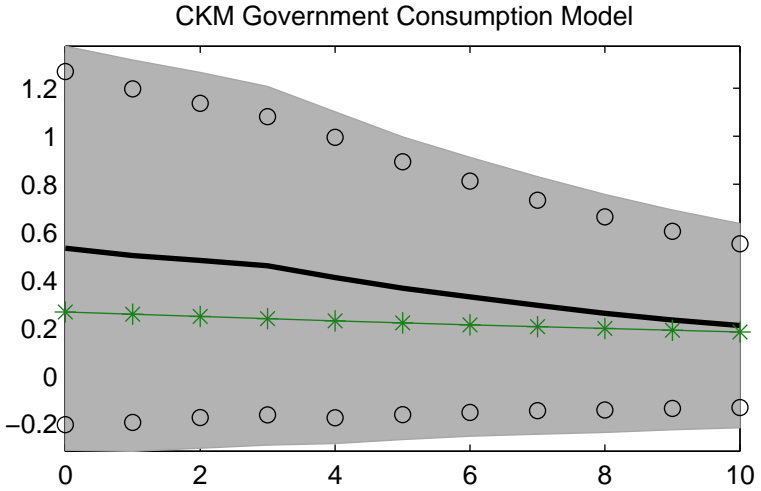
- CKM Model With G_t :

$$G_t = g_t z_t$$

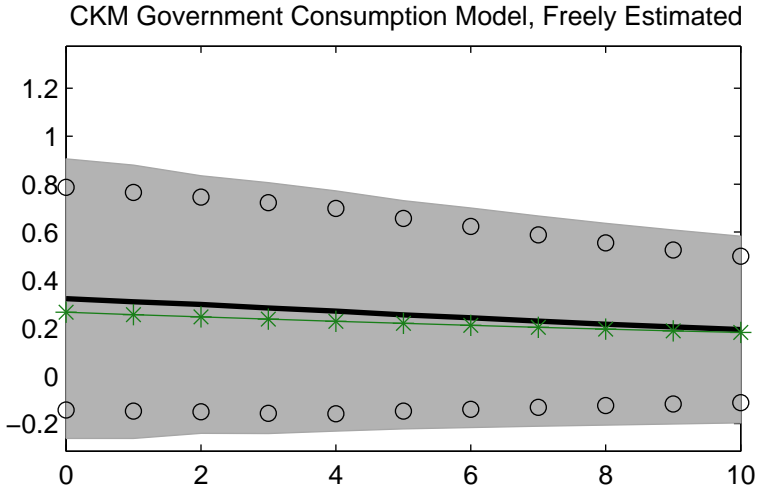
g_t First Order Autoregression

- Model Estimated Holding Measurement Error Fixed As Before.
 - Resulting Model Implies Noticeable Bias in SVARs
 - But, Sampling Uncertainty is Big and Econometrician Would Know it
 - When Restriction on Measurement Error is Dropped Resulting Model Implies Bias in SVARs Small

The Role of Government Spending



LLF = 2695.46



LLF = 2842.96

Likelihood Ratio Statistic: 295 with 4 degrees of freedom

CKM Assertion that SVARs Perform Poorly 'Large' Range of Parameter Values

- Problem With CKM Assertion
 - Allegation Applies only to Parameter Values that are Extremely Unlikely
 - Even in the Extremely Unlikely Region, Econometrician Who Looks at Standard Errors is Innoculated from Error

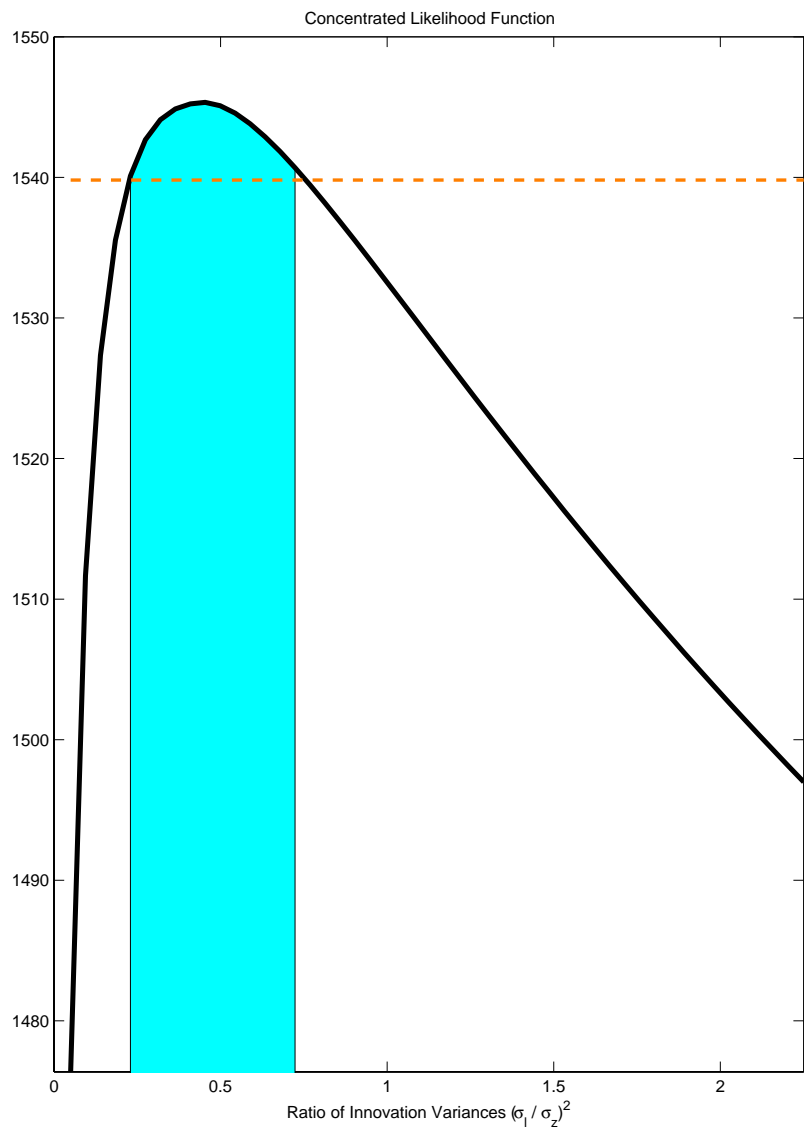
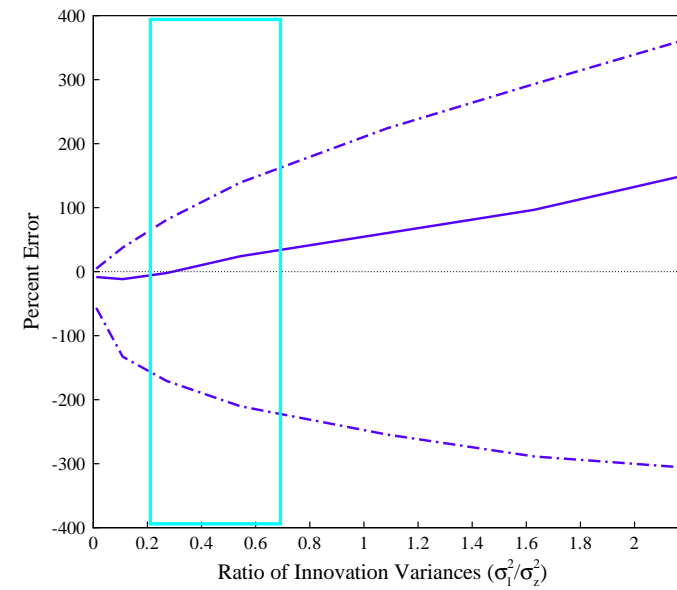


FIGURE A6

Combined Error in the Mean Impact Coefficient (solid line) and the Mean of 95% Bootstrapped Confidence Bands (dashed lines) Averaged Across 1,000 Applications of the Four-Lag LSVAR Procedure with $\rho = .99$ to Model Simulations of Length 180, Varying the Ratio of Innovation Variances



NOTE: The combined error is defined to be the percent error in the small sample SVAR response of hours to technology on impact relative to the model's theoretical response. This error combines the specification error and the small sample bias.

A Summing Up So Far

- With Long Run Restrictions,
 - For RBC Models that Fit the Data Well, Structural VARs Work Well
 - Examples Can Be Found With Some Bias
 - * Reflects Difficulty of Estimating Sum of VAR Coefficients
 - * Bias is Small Relative to Sampling Uncertainty
 - * Econometrician Would Correctly Assess Sampling Uncertainty
- Golden Rule: Pay Attention to Standard Errors!

Turning to *SVARS* with Short Run Identifying Restrictions

- Bulk of SVAR Literature Concerned with Short-Run Identification

Turning to SVARS with Short Run Identifying Restrictions

- Bulk of SVAR Literature Concerned with Short-Run Identification
- Substantive Economic Issues Hinge on Accuracy of SVARs with Short-run Identification

Turning to SVARS with Short Run Identifying Restrictions

- Bulk of SVAR Literature Concerned with Short-Run Identification
- Substantive Economic Issues Hinge on Accuracy of SVARs with Short-run Identification
- Ed Green's Review of Mike Woodford's Recent Book on Monetary Economics
 - Recent Monetary DSGE Models Deviate from Original Rational Expectations Models (Lucas-Prescott, Lucas, Kydland-Prescott, Long-Plosser, and Lucas-Stokey) By Incorporating Various Frictions.

Turning to SVARS with Short Run Identifying Restrictions

- Bulk of SVAR Literature Concerned with Short-Run Identification
- Substantive Economic Issues Hinge on Accuracy of SVARs with Short-run Identification
- Ed Green's Review of Mike Woodford's Recent Book on Monetary Economics
 - Recent Monetary DSGE Models Deviate from Original Rational Expectations Models (Lucas-Prescott, Lucas, Kydland-Prescott, Long-Plosser, and Lucas-Stokey) By Incorporating Various Frictions.
 - Motivated by Analysis of SVARs with Short-run Identification.

SVARS with Short Run Identifying Restrictions

- Adapt our Conventional RBC Model, to Study VARs Identified with Short-run Restrictions
 - Results Based on Short-run Restrictions Allow Us to Diagnose Results Based on Long-run Restrictions
- *Recursive version of the RBC Model*
 - First, τ_{lt} is observed
 - Second, labor decision is made.
 - Third, other shocks are realized.
 - Then, everything else happens.

The Recursive Version of the RBC Model

- Key Short Run Restrictions:

$$\log l_t = f(\varepsilon_{l,t}, \text{lagged shocks})$$

$$\Delta \log \frac{Y_t}{l_t} = g(\varepsilon_t^z, \varepsilon_{l,t}, \text{lagged shocks}),$$

- Recover ε_t^z :
 - Regress $\Delta \log \frac{Y_t}{l_t}$ on $\log l_t$
 - Residual is measure of ε_t^z .
- This Procedure is Mapped into an SVAR identified with a *Choleski* decomposition of \hat{V} .

The Recursive Version of the RBC Model ...

- The Estimated VAR:

$$Y_t = B_1 Y_{t-1} + B_2 Y_{t-2} + \dots + B_p Y_{t-p} + u_t, \quad E u_t u_t' = V$$

$$u_t = C \varepsilon_t, \quad C C' = V.$$

$$C = [C_1 : C_2], \quad \varepsilon_t = \begin{pmatrix} \varepsilon_t^z \\ \varepsilon_{2t} \end{pmatrix}$$

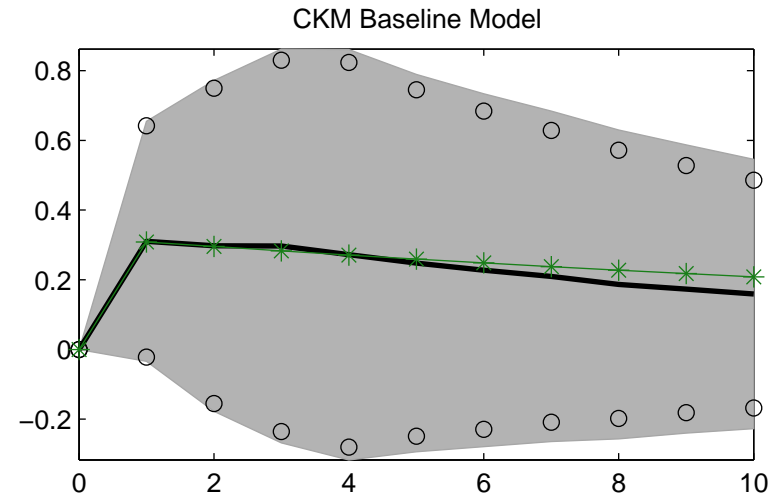
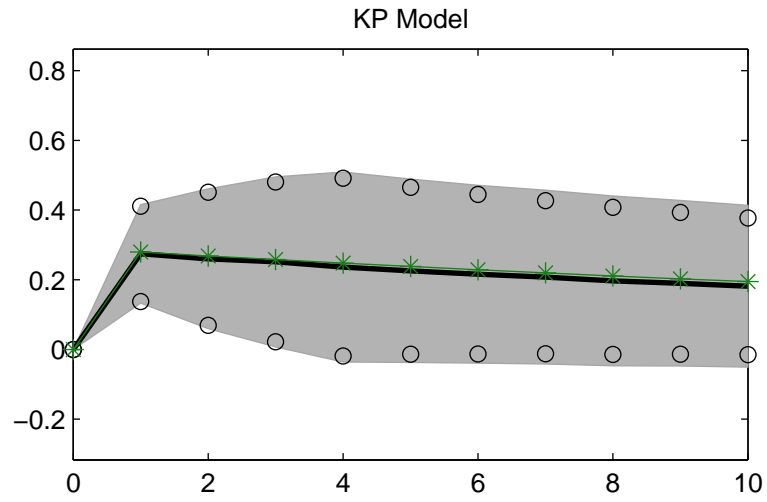
- Impulse Response Response Functions Require: B_1, \dots, B_p, C_1
- Short-run Restrictions Uniquely Pin Down C_1 :

$$C_1 = f_{SR}(\hat{V})$$

- Note: Sum of VAR Coefficients Not Needed

Response of Hours to A Technology Shock

Short-Run Identification Assumption



SVARs with Short Run Restrictions

- Perform remarkably well
 - Inference is Sharp and Correct

Short Run Versus Long Run Restrictions

- Recursive Results Helpful For Diagnosing Results with Long-run Identification
- Corroborates Theme: When there is Bias with Long-run Identification, It is Because of Difficulties with Estimating Sum of VAR Coefficients

– Long-run Identification:

$$C_1 = f_{LR} \left(\hat{V}, \hat{B}_1 + \dots + \hat{B}_p \right)$$

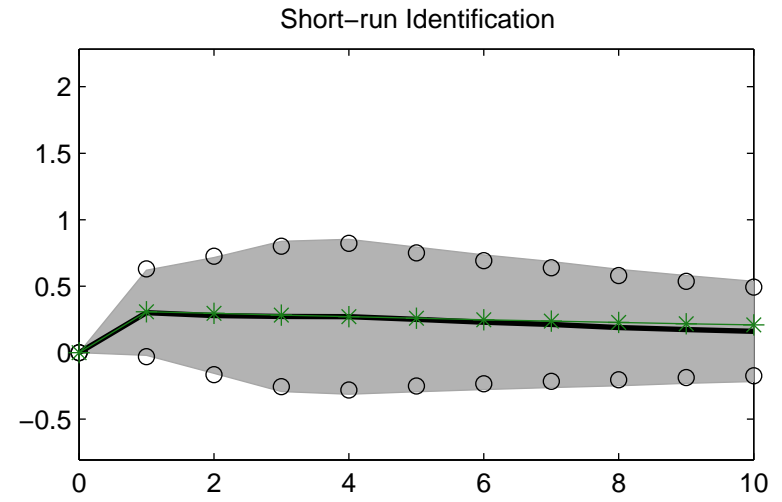
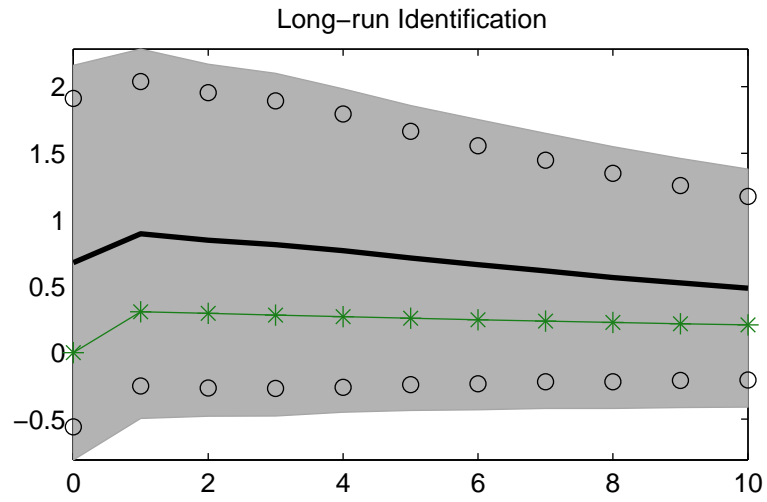
– Short-run Identification:

$$C_1 = f_{SR} \left(\hat{V} \right)$$

- Recursive Version of CKM Model Rationalizes Both Short and Long-run Identification

The Importance of Frequency Zero: Another View

Analysis of Recursive Version of Baseline CKM Model

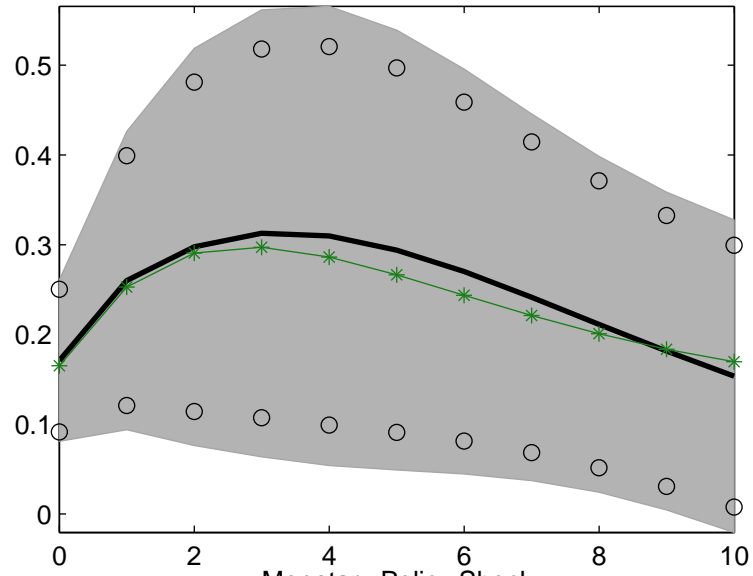


VARs and Models with Nominal Frictions

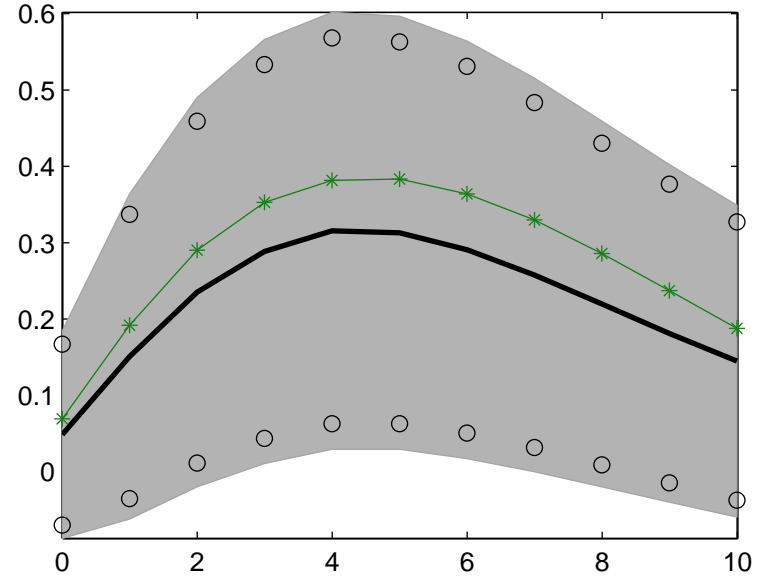
- Data Generating Mechanism: an estimated DSGE model embodying nominal wage and price frictions as well as real and monetary shocks ACEL (2004)
- Three shocks
 - Neutral shock to technology,
 - Shock to capital-embodied technology
 - Shock to monetary policy.
- Each shock accounts for about 1/3 of cyclical output variance in the model

Analysis of VARS using the ACEL model as DGP

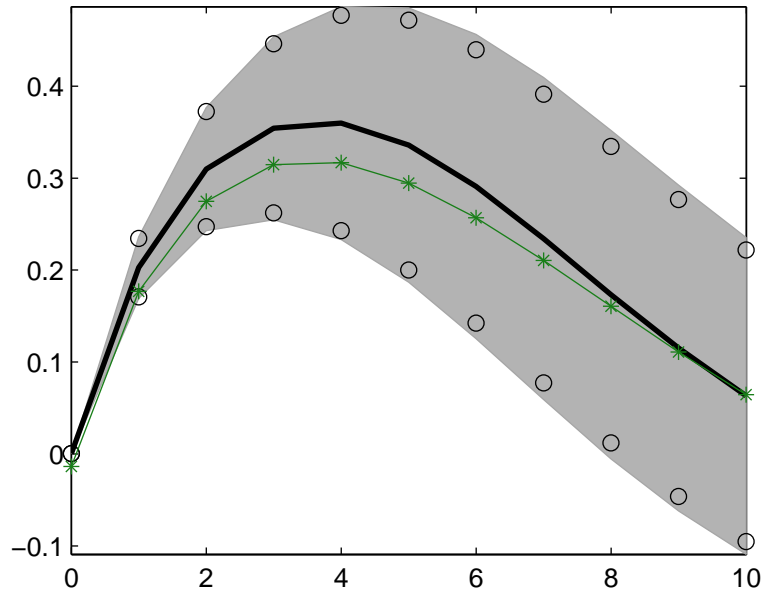
Neutral Technology Shock



Investment-Specific Technology Shock



Monetary Policy Shock



Continuing Work with Models with Nominal Frictions

- ACEL (2004) Assesses Bias Properties in VARs with Many More Variables
 - Requires Expanding Number of Shocks
 - Results So Far are Mixed
 - * Could Be an Artifact of How We Introduced Extra Shocks
 - * We are Currently Studying This Issue.

Conclusion

- We studied the properties of SVARs.
 - With short run restrictions, SVARs perform remarkably well in All Examples Considered
 - * VAR Coefficients Reasonably Accurately Estimated With 4 Lags (Despite Presence of Capital)
 - With long run restrictions, SVARs also perform well for Data Generating Mechanisms that Fit the Data Well
 - * Bias is Small & Sampling Uncertainty Characterized Accurately

Conclusion ...

- There do exist cases when long run SVARs Exhibit Some Bias,
 - When there is Bias, Reflects Difficulty of Estimating Sum of VAR Coefficients Accurately

 - However,
 - * Cases are Based on Models that are Overwhelmingly Rejected by the US Data

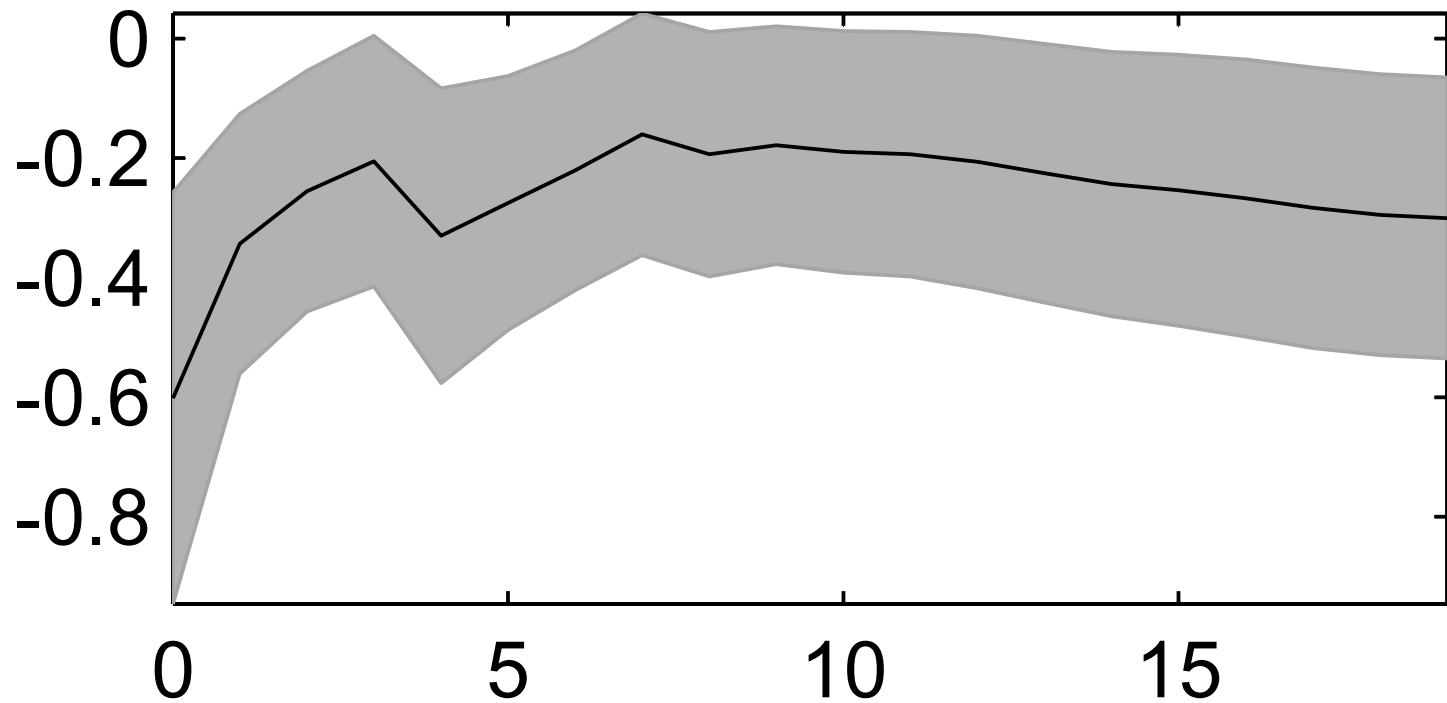
 - * In Any Event, Econometrician Would See Large Standard Errors and Discount the Evidence

- Rule for Staying Out of Trouble With Long-Run SVARs: Pay Attention to Standard Errors

Conclusion ...

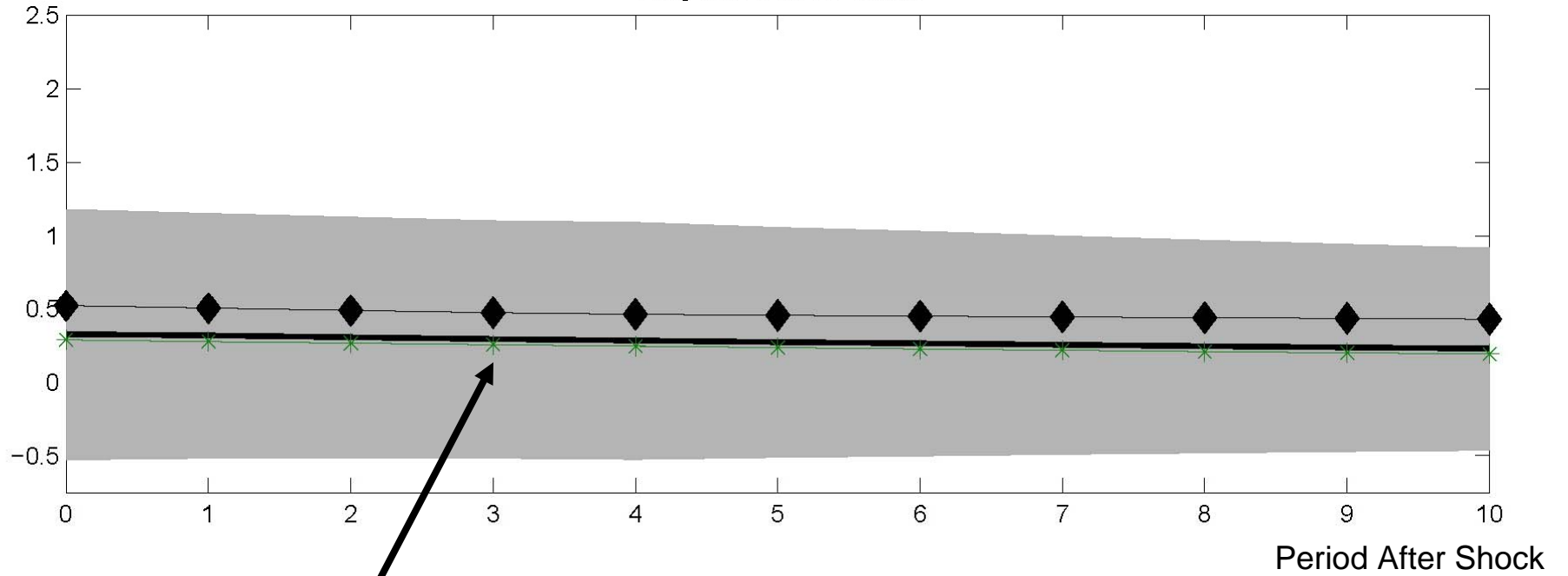
- In The RBC Examples Shown With Long-run Restrictions:
 - Sampling Uncertainty High
- High Sampling Uncertainty Does Not Always Occur
 - Ex #1: ACEL Simulations
 - Ex #2: In ACEL Estimated SVAR, Inflation Responds Strongly to Neutral Technology Shock
 - * Simulations (Cautiously) Suggest We Should Trust Standard Errors from SVARs with Long-Run Restrictions
 - * Result Casts a Cloud Over Models with Price Frictions

Inflation



Percent Response of Hours Worked

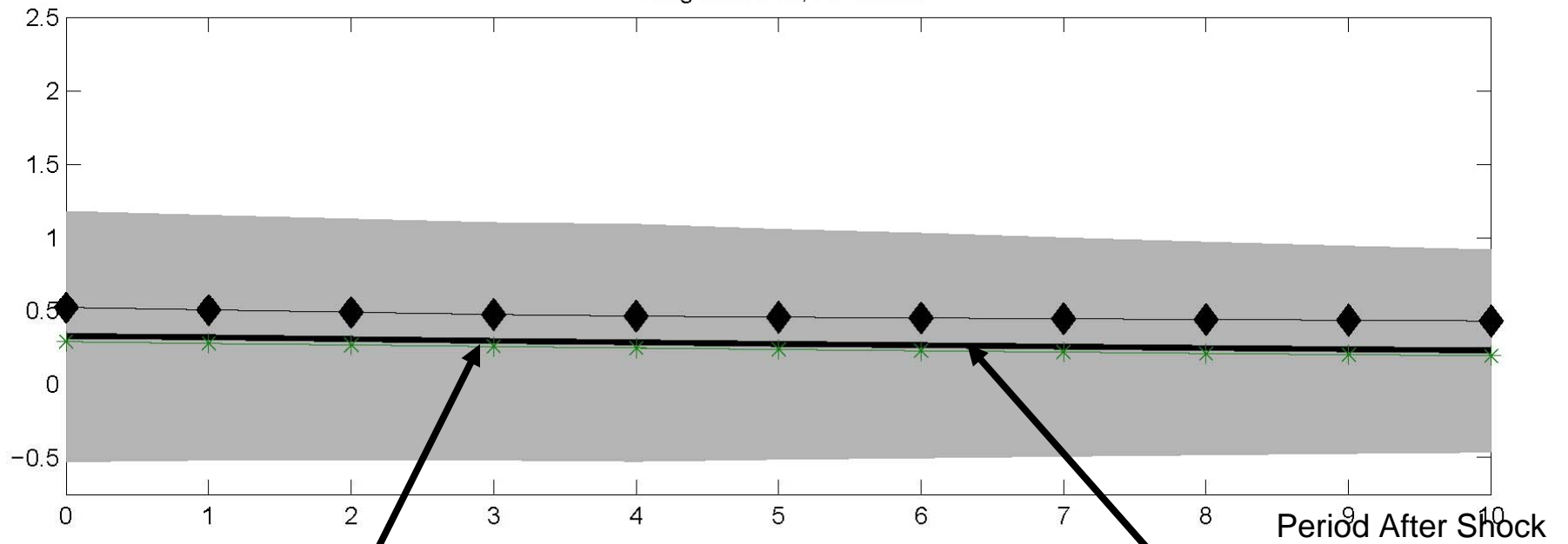
Long Run VAR, KP Model



True Response
Economic Model

Percent Response of Hours Worked

Long Run VAR, KP Model

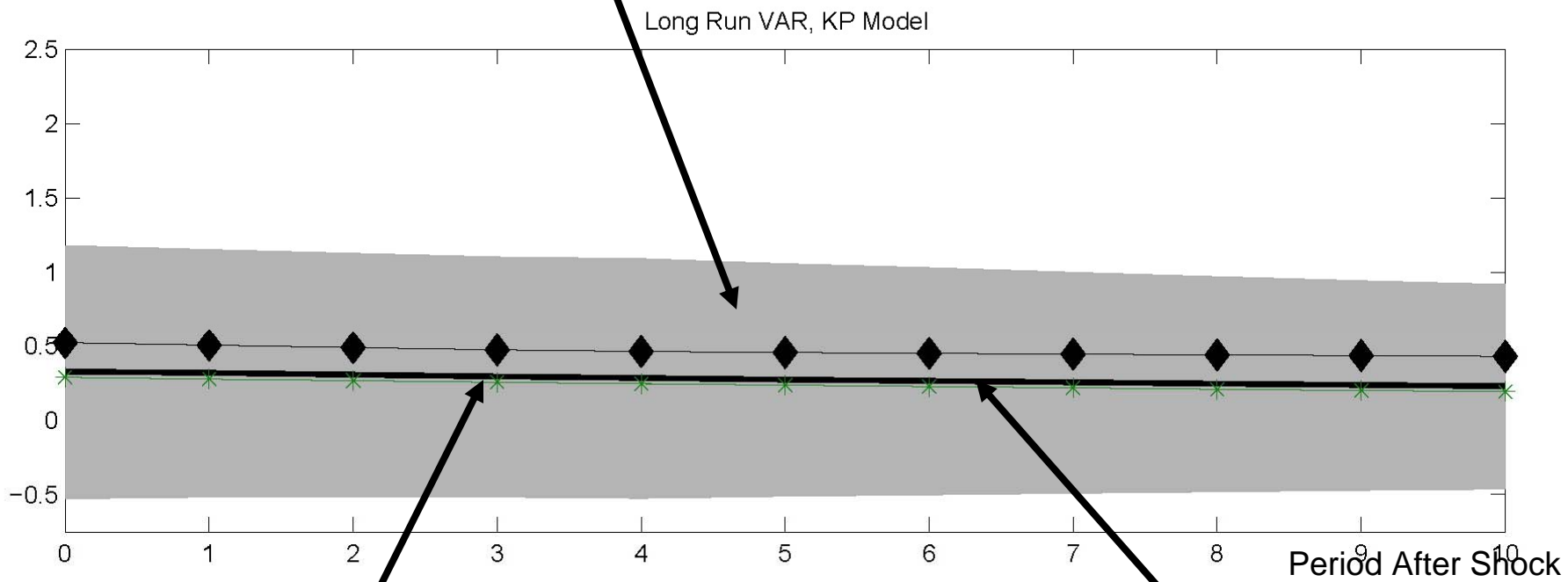


True Response
Economic Model

Mean of Small Sample Estimator
Basis of our Distortion Metric: Bias

What an Economist Using a VAR(4)
With Infinite Data Would Find
Basis for CKM Metric

Percent Response
of Hours Worked



True Response
Economic Model

Mean of Small Sample Estimator
Basis of our Distortion Metric: Bias