The present special issue of Recherches Economiques de Louvain stems from a European HCM network devoted to “Imperfect Competition in Intertemporal General Equilibrium Macro-Models”. This group, involving seven teams of academic institutions from various E.C. countries, works on a common objective: narrowing the gap between presently available theory-based models and usual macroeconometric practice.

As a matter of fact, over the last two decades, following Lucas' devastating critique and the dismissal of early Keynesian macro-models, theorists have devoted a lot of effort to a reconstruction of macroeconomic theory on sound, choice-theoretic foundations. These efforts have resulted in an increasingly large variety of models framed in the common set-up of intertemporal general equilibrium, but embedding specific features more consistent with some stylised facts, and calibrated / tested on actual data. Such models remain however still too sketchy and are not realistic enough to be amenable to fully operational tools for economic policy evaluation of real world economies, comparable to the role played by traditional Keynesian IS-LM large scale macro-models. Recently, important efforts have been made toward reaching dynamic simulation models embodying a sufficient number of features that are considered as essential ingredients for a correct understanding of the working of our economies. The main difficulty is indeed to “explain” consistently observed phenomena (stylised facts) and not only to represent them quantitatively as is current practice in traditional modelling.

The nine papers delivered in the present volume form a representative sample of the studies dealing with the various aspects of our research programme. They cover the development of theoretical models, clarifying sources of real and nominal rigidities, with special attention to the description of the labour market, as well as quantitative evaluation and testing of empirical models by adequate econometric techniques, and analysis of the dynamic properties of these macro-models by means of simulation tools.
Sources of real and nominal rigidities

The first three papers use simple overlapping generations models to study the effect of particular market imperfections on the macroeconomic outcome.

In their paper entitled “Nominal inertia in a competitive model with an incomplete capital market”, Andersen and Christensen show how nominal inertia may arise in a competitive economy as a consequence of the interplay between incomplete capital markets and imperfect information. They consider a simple OLG model, with money as the unique asset and with perfect competition in the labour and product market. Intertemporal considerations are introduced through labour supply and incompleteness of capital markets makes it impossible to insure the real purchasing power of savings. This causes the current labour supply to depend on future output prices. The unique rational expectations equilibrium displays nominal inertia. The results clarify that nominal inertia may be linked to the information structure and not necessarily to the market structure.

The paper “Internal finance and capital accumulation in a dynamic general equilibrium model with credit constraints” by Sneessens and Stefani deal with financial constraints derived from moral hazard in an OLG model. They assume that banks do not have full information on the use of borrowed funds by entrepreneurs and introduce an incentive compatibility constraint that can entail credit rationing. The level at which the incentive compatibility constraint become binding is shown to depend on the firm’s internal wealth. The macroeconomic consequence is to lower the equilibrium interest rate. Since the credit constraint story is embedded in a general equilibrium set-up, Sneessens and Stefani study its effect on capital accumulation and optimal policies. Their conclusion is that even though Pareto improving policies do exist, they seem to be very difficult to implement in practice.

Bénassy’s paper, “Analytical solutions to an RBC model with imperfect competition, increasing returns and underemployment”, proposes a real business cycle model with analytical solutions to study the role of imperfect competition on goods and labour markets. His simple and pedagogic model aims at making transparent certain mechanisms at work in more complicated models. The model can serve as a benchmark case to understand the respective role of imperfect competition and increasing return in generating output persistence.

Extensions of RBC models

The next two papers propose dynamic models which are designed to answer various questions qualitatively and quantitatively. Two pa-
pers are full-fledged real business cycle models, extending the standard approach to non-Walrasian labour market and to international macroeconomic policy questions.

The paper "Participation, unemployment and wage bargaining in a real business cycle model" by Langot and Pucci makes an attempt to integrate workers' decision to participate in the labour force in a dynamic general equilibrium model with trade frictions in the labour market. This set-up treats the labour force as endogenous. Endogenising the participation decision is an important issue to be addressed, since it has the potential for changing the cyclical characteristics of labour market variables as predicted by existing dynamic models which ignore this decision. The authors' simulation exercises show that the endogenization of the participation rate improves the ability of this kind of non-Walrasian model to match important stylised facts of the labour market.

The study of Bec and Hairault entitled "Fiscal policies, public deficit restraints and European stabilisation" explores a worthwhile question, namely whether the terms of the Maastricht treaty are costly if fiscal policy is the only means of stabilisation left to individual countries. The analysis is performed within the framework of a stochastic and explicit dynamic modelling of an open economy. The authors conclude that if governments have to respect the Maastricht criteria, their ability to stabilise is considerably restricted. Moreover, they will adopt pro-cyclical fiscal policies. This implies that the Member States should allow the Community to adopt stabilisation objectives, beyond its current redistribution activities.

Further analysis of specific propagation mechanisms

The paper by Chambin and Portier "Big shock, slow growth and the dynamics of aggregate labour demand with firing costs" studies a partial equilibrium model of employment in a dynamic setting that allows for asymmetric linear adjustment costs. A big shock is considered, which affects the steady state parameters and hence induces transitional dynamics as the economy moves from the old to the new steady state. This adjustment is simulated for two types of economies, one with high and the other with low hiring and firing costs. These simulations suggest the somewhat counterintuitive result that, after a big negative shock, unemployment is more persistent in the flexible economy (i.e. the one with low adjustment costs). The authors conclude that high firing costs cannot be considered as responsible for high and persistent unemployment.

It is well known that Hall's intertemporal substitution consumption model is hardly consistent with actual data. Classical puzzles are
the excess smoothness of consumption with respect to the prediction of the theory, its excess sensitivity to actual income and the persistent effects of shocks. ADDA and BOUCEKKINE, in their contribution "Liquidity Constraints and Time Non-Separable Preferences", present a dynamic aggregate model of consumer intertemporal choices embedding at the same time habit formation, durability of goods, and liquidity constraints. Within this general framework, they show especially that it is often difficult to disentangle liquidity constraints and habit formation. The contribution of WINDEN and PALM, "Stochastic Implications of the Life Cycle Consumption Model under Rational Expectations", also deals with consumption habit formations, formalised as time nonseparable utility function. They show that the resulting dynamic structure of consumption consists of an ARIMA process between consumption and innovations in income. The derivation is carried analytically in the case of exponential utility functions.

The objective of FEVE and LANGOT, in "Can animal spirits explain the dynamics of European Unemployment?" is to give a realistic illustration of the possibility to explain fluctuations endogenously, without intervention of exogenous shocks as it is traditionally supposed in the RBC literature. They develop a RBC model characterised by a non-Walrasian working of the labour market (matching function). An important feature of this model is that the occurrence of increasing returns in the matching function may give rise to indetermination of the steady state equilibrium, and hence to sunspots phenomena. The model is carefully estimated by GMM on quarterly British, French and German data. They observe that the restrictions necessary to obtain indeterminacy of equilibrium are statistically satisfied in the 3 countries, and that simulations reproduce qualitatively several stylised facts of the labour market.

Even though we are still far from being able to propose a macro-model with strong theoretical an empirical bases which can address a list of issues relevant to policy makers, we hope that the ongoing research will serve to bridge the gap between theory and practice, reinforcing therefore the credibility of macroeconomics.