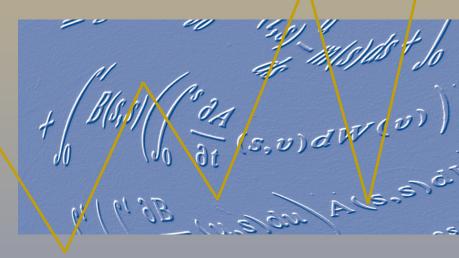
# Volume 14, Number 3, June 2010

# MACROECONOMIC DYNAMICS



EDITOR: WILLIAM A. BARNETT

CAMBRIDGE UNIVERSITY PRESS

#### MACROECONOMIC DYNAMICS

Editor: William A. Barnett, University of Kansas, Department of Economics, 356 Snow Hall, 1460 Jayhawk Boulevard, Lawrence, KS 66045–7523, USA.

**Book Review Editors:** Michele Boldrin, Department of Economics, Washington University, One Brookings Drive, St. Louis, MO63130, and Universidad Carlos III, Madrid; Gregory D. Hess, Department of Economics, 500 East 9th Street, Claremont McKenna College, Claremont, CA 91711.

Special Issues Editors: Stephen Turnovsky, Department of Economics, Box 353330, University of Washington, Seattle, WA 98195; Lee Ohanian, Department of Economics, UCLA, 2261 Bunche Hall, 405 Hilgard Avenue, Los Angeles, CA 90024.

Editorial Information System Manager: Stephen E. Spear, Graduate School of Industrial Administration, Carnegie Mellon University, Pittsburgh, PA 15213.

Local Area Network Manager: Nathan Haley, Lawrence, Kansas.

Editorial Associate: Melinda Barnett, University of Kansas.

#### **Advisory Editors:**

Jean-Pascal Bénassy (CEPREMAP, Paris), Willem Buiter (London School of Economics and Political Science, London), Francis X. Diebold (University of Pennsylvania), Steven Durlauf (University of Wisconsin), Douglas Gale (New York University), Giancarlo Gandolfo (University of Rome), Roger Guesnerie (DELTA, Paris), Takatoshi Ito (University of Tokyo), Timothy Kehoe (University of Minnesota), Finn Kydland (Carnegie Mellon University), Lung-Fei Lee (Ohio State University), Adrian Pagan (Australian National University), Robert Townsend (Massachusetts Institute of Technology), Mark Watson (Princeton University), Kenneth West (University of Wisconsin), Michael Woodford (Columbia University), Randall Wright (University of Pennsylvania)

#### **Associate Editors:**

Klaus Adam (Mannheim University, Germany), Gaetano Antinolfi (Washington University), Jasmina Arifovic (Simon Fraser University), Roland Benabou (Princeton University), Volker Böhm (University of Bielefeld, Germany), Jean Boivin (HEC Montreal), Raouf Boucekkine (Université Catholique de Louvain, Belgium), Satyajit Chatterjee (Federal Reserve Bank of Philadelphia), Marcelle Chauvet (University of California at Riverside), Juan Carlos Conesa (Universitat Autònoma de Barcelona), Isabel Correia (Banco de Portugal), Rose-Anne Dana (Université Paris IX-Dauphine), Christophe Deissenberg (University d'Aix-Marseille II), Matthias Doepke (UCLA), Alvaro Escribano (Universidad Carlos III de Madrid, Spain), George Evans (University of Oregon), Roger Farmer (UCLA), Jonas Fisher (Federal Reserve Bank of Chicago), Luisa Fuster (Madrid Institute of Advanced Studies), Oded Galor (Brown University and Hebrew University of Jerusalem), Marc Giannoni (Columbia University), Thorvaldur Gylfason (University of Iceland), Melvin Hinich (University of Texas), Cars Hommes (University of Amsterdam, The Netherlands), Seppo Honkapohja (Bank of Finland, Helsinki), Svend Hylleberg (Aarhus University, Denmark), Peter Ireland (Boston College), Todd Keister (Federal Bank of New York), Sharon Kozicki (Bank of Canada), Helmut Lütkepohl (European University Institute, Florence), Iourii Manovskii (University of Pennsylvania), David Marshall (Federal Reserve Bank of Chicago), Alfredo Medio (University of Udine, Italy), Ilian Mihov (INSEAD, France), Omer Moav (The Hebrew University of Jerusalem), Pablo Neumeyer (Universidad Torcuato Di Tella), Lee Ohanian (UCLA), Patrick Pintus (Université de la Méditerranée & GREQAM France), Simon Potter (Federal Reserve Bank of New York), Neil Rankin (University of York, UK), Lucrezia Reichlin (Free University of Brussels, Belgium, and European Central Bank), Gilles Saint-Paul (Université de Toulouse, France), Klaus Martin Schneider (New York University), Apostolos Serletis (University of Calgary, Canada), Anne Sibert (Birkbeck College, UK), Tony Smith (Yale University), Peter Norman Sorensen (University of Copenhagen, Denmark), Stephen Spear (Carnegie Mellon University), Alan Sutherland (University of St. Andrews), Stephen Turnovsky (University of Washington), François R. Velde (Federal Reserve Bank of Chicago), Nicolaas Vriend (Queen Mary, University of London), Noah Williams (Princeton University), Joseph Zeira (The Hebrew University of Jerusalem), Tao Zha (Federal Reserve Bank of Atlanta)

### MACROECONOMIC DYNAMICS

Volume 14, Number 3, June 2010 Contents

A	R7	77	CI	7.5

Endogenous Inequality of Nations through Financial Asset Market Integration			
Volker Böhm and George Vachadze			
Robust Policies in a Sticky Information Economy Francesco Giuli	311		
Dynamic Relationship between Inflation and Financial Development <b>Dong-Hyeon Kim and Shu-Chin Lin</b>			
Savings, Investment, Employment, and Inflation in a Small Open Economy with Habit Persistence Arman Mansoorian, Leo Michelis, and Mohammed Mohsin	365		
MD INTERVIEW			
An Interview with Roger Guesnerie			
Interviewed by Pierre-André Chiappori	388		
NOTES			
The Signal Extraction Problem Revisited: A Note on Its Impact on a Model of Monetary Policy			
Benjamin D. Keen	405		

SUBSCRIPTION INFORMATION: Macroeconomic Dynamics (ISSN 1365-1005) is published five times a year plus supplement. Annual subscription rates for Volume 14, 2010: Institutional rate is (print and electronic) \$547.00 in the USA, Canada, and Mexico, £325.00 elsewhere. Institutional rate (electronic only) \$457.00 in the USA, Canada, and Mexico, £275.00 elsewhere. Institutional rate (print only) \$503.00 in the USA, Canada, and Mexico, £294.00 elsewhere. Individual rate is (print and electronic) \$178.00 in the USA, Canada, and Mexico, £100.00 elsewhere. Individual rate (print only) \$173.00 in the USA, Canada, and Mexico, £95.00 elsewhere. Students (print only) \$122.00 in the USA, Canada, and Mexico, £46.00 elsewhere. For members of the Econometric Society, the Society for the Advancement of Economic Theory, the Society for Nonlinear Dynamics and Econometrics, the Society for Computational Economics, and the Society for the Promotion of Economic Theory the rate is \$100.00 in the USA, Canada, and Mexico, £62.00 elsewhere. Institutional access is via IP address range(s) or domain name(s); individual subscriber access is via a username and password. Prices include postage; airmail is extra. Write to Cambridge University Press, 32 Avenue of the Americas, New York, NY 10013-2473, or outside the USA, Canada, and Mexico to Cambridge University Press, The Edinburgh Building, Shaftesbury Road, Cambridge CB2 8RU, England. Claims for missing issues should be made immediately after receipt of the next issue.

Periodicals postage pending at NewYork, NY and additional mailing offices. Postmaster: send address changes in the USA, Canada, and Mexico to: *Macroeconomic Dynamics*, Cambridge University Press, 100 Brook Hill Drive, West Nyack, NY 10994-2133. Send address changes elsewhere to: *Macroeconomic Dynamics*, Journals Dept., Cambridge University Press, The Edinburgh Building, Shaftesbury Road, Cambridge, CB2 8RU, U.K.

© 2010 Cambridge University Press. Photocopying information for users in the USA: The Item-Fee Code for this publication indicates that copying for internal or personal use beyond that permitted by Section 107 or 108 of the US Copyright Law is authorized for users duly registered with the Copyright Clearance Center (CCC) Transactional Reporting Service, provided that the appropriate remittance of \$18.00 per article is paid directly to: CCC, 222 Rosewood Drive, Danvers, MA 01923. Specific written permission must be obtained from the publisher for all other copying. The Item-Fee Code for this journal is 1365-1005/10 \$18.00.

ISI Tearsheet Service, 3501 Market Street, Philadelphia, PA 19104, USA is authorized to supply single copies of separate article for private use only. Article reprints are available from the authors. For orders of 50 or more reprints, contact Cambridge University Press.

Macroeconomic Dynamics is indexed in EconLit; The Journal of Economic Literature (e-JEL and JEL on CD); ISI: Current Contents/Social & Behavioral Sciences; Social Sciences Citation Index; Research Alert; Mathematical Reviews; MathSciNet; Zentralblatt fur Mathematik.

## **EDITORIAL POLICY**

Macroeconomic Dynamics publishes research of the highest theoretical, empirical or quantitative sophistication. Papers of high quality are welcomed from all areas of advanced macroeconomics and allied fields, so long as the research is founded in a rigorous scientific approach. Major advances in macroeconomics without immediate policy applications also are accepted, if they show potential for application in the future. Occasional book reviews, software reviews, announcements, conference proceedings and interviews are published.

An **electronic version of the journal** is published just prior to the paper version at **journals.cambridge.org/mdy**. Access to the full-text articles of the electronic version will be limited to institutional subscribers of the hard copy version of the journal, with access available to all online users at that institution's registered domain. Tables of Contents, abstracts, searching and alerting services will remain free of charge. To view the full text of *Macroeconomic Dynamics*, you will need to use the Adobe Acrobat Reader software. If you do not have a copy already, you can get it free of charge. Just follow the link from our Cambridge Journals Online home page, download it, and install it as a plug-in helper application for your browser.