Preface

In 1992, Carolyn Sargent said, “You are writing the second edition of your book before you have published the first.” Her assertion was correct. We wrote 90 percent of this book between 1988 and 1994, but completed it only in 2012. Richard Blundell’s invitation to deliver the Gorman Lectures at University College London convinced us to abandon our earlier intentions to publish this book only after we had implemented the many improvements that we know are still possible.

James Tobin said that macroeconomics, or what he also liked to call aggregate economics, is a subject that ignores distribution effects. Tobin referred to theories of prices, interest rates, and aggregate quantities that are self-contained in the sense that they restrict aggregate quantities without needing also to determine distributions of quantities across people. The great economist Sherwin Rosen said that “the whole damn subject of economics is macroeconomics.” His quip aptly describes Sherwin’s models of markets for cattle, houses, and workers, all of which are cast in terms of demand and supply functions best thought of as describing behaviors of representative agents. Big parts of macroeconomics, but not all, continue to ignore distribution effects in the analytical tradition of Tobin and Rosen. (See Ljungqvist and Sargent (2012) for an introduction to macroeconomic models in which heterogeneity across consumers and firms plays a big part.)

Though some of our leading examples are about microeconomic topics, this book is mostly about macroeconomics in the sense of Tobin and Rosen, the models being cast in terms of a representative consumer. Such models are useful but restrictive. More general structures with heterogeneous consumers do not possess a representative household of the type that this book extensively uses to facilitate analysis of aggregate quantities and prices. This book demonstrates the analytical benefits acquired when an aggregate analysis is possible, but characterizes how restrictive are the assumptions under which there exists the representative household that justifies a purely aggregative analysis.

Thus, for us, among the most interesting parts of this book are two chapters about different ways of aggregating heterogeneous households' preferences into a representative household and the senses in which they do or don't justify an aggregative economic analysis. These chapters extend ideas of W. M. Gorman to a dynamic setting. We intend to honor W. M. Gorman by thinking hard about his ideas.