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## XMAS: An extended model for analysis and simulations \*

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### Abstract

The Extended Model for Analysis and Simulations (XMAS) is the Central Bank of Chile's newest dynamic stochastic general equilibrium (DSGE) model for macroeconomic projections and monetary policy analysis. Building on Medina and Soto (2007), the model includes several new features, in line with recent developments in the modeling of small open economies, particularly commodity-exporting emerging economies such as Chile. The extensions over the base model include the modeling of non-core inflation dynamics, a commodity sector with endogenous production and investment, a labor market with search and matching frictions that allows for labor variation on both the intensive and extensive margins, an augmented fiscal block, as well as additional shocks and other real and nominal frictions. These features allow for a more granular analysis and more comprehensive forecasts of the Chilean economy, improving the fit of the model to macroeconomic data in several dimensions.

### Resumen

Basado en el trabajo de Medina y Soto (2007), el XMAS es el modelo dinámico-estocástico de equilibrio general (DSGE) más reciente del Banco Central de Chile. Es usado para proyecciones macroeconómicas y análisis de política monetaria. En línea con los nuevos desarrollos en la modelación de economías pequeñas y abiertas, en particular, de países emergentes y exportadores de *commodities* como Chile, el modelo considera varias características adicionales. Estas extensiones incluyen la modelación de dinámicas inflacionarias no-subyacentes, un sector de *commodity* con inversión y producción endógena, un mercado laboral con fricciones de búsqueda que posibilita variaciones del factor trabajo tanto en sus márgenes intensivo como extensivo, un bloque fiscal extendido, además de shocks adicionales y otras fricciones nominales y reales. Estas características posibilitan un análisis más granular y proyecciones más completas de la economía chilena, mejorando el ajuste del modelo a los datos en varias dimensiones.

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# 1 Introduction

This paper presents the Central Bank of Chile’s Extended Model for Analysis and Simulations (XMAS), a dynamic stochastic general equilibrium (DSGE) model of the Chilean economy for monetary policy analysis and macroeconomic forecasting purposes. The model incorporates a range of new features, motivated by advances of the literature and the experience of commodity-exporting emerging economies such as Chile over the past several years.

The Central Bank of Chile has been using dynamic stochastic general equilibrium (DSGE) models for regular policy analysis and medium-term projections for its Monetary Policy Report since the late 2000s. The first DSGE model used at the Central Bank was the Model for Analysis and Simulations (MAS), developed by Medina and Soto (2007), “base model” hereafter. This is a quantitative New Keynesian small open economy model with several features to describe the Chilean economy, including a commodity sector and a structural balance rule for fiscal policy. The model also includes a number of other non-standard elements, such as non-Ricardian households as well as oil imports as an intermediate input for consumption and production. Otherwise, the base model incorporates all the typical elements (sticky prices and wages, habit formation in consumption, physical capital with adjustments costs in investment, etc.) of second-generation New Keynesian DSGE models à la Christiano et al. (2005) and Smets and Wouters (2007) and small open economy features (including a simple financial friction, a debt-elastic country premium) similar to Adolfson et al. (2007).

Since the late 2000s, the macroeconomic literature has advanced in a number of directions that could be considered for the next generation of DSGE models for policy analysis and forecasting at central banks in emerging market economies such as Chile. XMAS considers several extensions that are closely linked to the experience of commodity-exporting emerging economies in general, and Chile in particular, over the past decade. Through these extensions, the model allows a more detailed analysis and more comprehensive forecasts of the Chilean economy. In this paper, we describe each extension in detail and discuss its relevance for monetary policy analysis and forecasting purposes.

A first major extension of XMAS is a commodity sector with endogenous production. In the base model, commodity exports are modeled as a stochastic endowment. In XMAS, production in the commodity sector is conducted through sector-specific capital, subject to adjustment costs and time-to-build frictions in investment. This extension allows to capture the important role of commodity price changes for investment fluctuations in commodity-exporting economies (see Fornero et al., 2015; Fornero and Kirchner, 2018). Adjustment costs and time to build reflect the difficulty of adjusting commodity-specific capital in the short run.

A second main extension is an augmented fiscal block including additional structure on both the spending side and the income side of the government budget. The base model includes government consumption as the only item on the spending side, and non-distortionary lump-sum taxes (in addition to one-period debt) on the income side. In

XMAS, the government investment and transfers are added on the spending side, while on the income side a set of distortionary taxes on consumption as well as labor and capital income is included. This extension allows to capture the importance of all of these fiscal instruments for government income and spending in Chile, where spending items are determined jointly under the structural balance rule.<sup>1</sup> A related extension is government smoothing of oil prices, which is introduced to capture the administrated character of oil prices in Chile.

A third main extension is the incorporation of search and matching frictions with endogenous separation and involuntary unemployment in the labor market. This extension is thought to resolve a major potential weakness in the base model, which is that all fluctuations in labor supply originate from the intensive margin (hours per worker) but there is no variation in the extensive margin (number of employed workers). This stands in stark contrast to actual data for Chile which shows that a significant fraction of the variation in total hours is explained by the extensive margin (see Guerra-Salas et al., 2018). Thus, unlike the base model, this extension also allows to match employment series in the estimation and condition the model's forecasts for output, wages, inflation etc. on the evolution of those variables.

Finally, XMAS incorporates some other features from the literature, including variable capacity utilization and delayed pass-through of global prices and productivity, as well as several additional shocks.

As we show in detail in the following, despite the significantly added complexity of XMAS, its empirical fit and out-of-sample forecast accuracy is comparable or better compared to the base model. The main dimensions where XMAS outperforms the base model are consumption, nominal interest rates, and labor intensity.

Overall, our results may be relevant for economic modellers at central banks, especially from commodity-exporting emerging economies.

The rest of the paper is structured as follows. Section 2 presents a comprehensive description of the extended model. Section 3 describes the estimation strategy. Section 4 describes the main additional channels with respect to Medina and Soto (2007) and shows some forecasting exercises. Section 5 concludes, highlighting a number of directions for future work.

## 2 The Model

Following Medina and Soto (2007), García-Cicco et al. (2015), and Guerra-Salas et al. (2018), we present a small open economy model with nominal and real rigidities, Ricardian and non-Ricardian households, search and matching frictions with endogenous separation in the labor market and involuntary unemployment. Domestic goods are produced with capital and labor, there is habit formation in consumption, there are adjustment costs in investment, firms face a Calvo-pricing problem with partial indexation, and there is imperfect exchange rate pass-through into

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<sup>1</sup>For related studies for Chile, see Kumhof and Laxton (2010) and Medina and Soto (2016). Other related studies include Coenen et al. (2012) and Leeper et al. (2010).

import prices in the short run due to local currency price stickiness. The economy also exports a commodity good. The economy is subject to shocks to preferences, labor market, technology (for the home, commodity and investment production sectors), government expenditures on consumption, investment and transfers, monetary policy, foreign GDP, foreign inflation, foreign interest rates and the international price of the import basket, oil and the commodity good.

## 2.1 Households

There is a continuum of infinitely lived households of two types: non-Ricardian and Ricardian, with mass  $\omega$  and  $1 - \omega$  respectively. Each type of household has identical asset endowments and identical preferences. Instantaneous utility in period  $t = \{0, 1, 2, \dots\}$  depends on consumption ( $\hat{C}_t$ ) and the number of hours worked ( $h_t$ ) by the household's employed members ( $n_t$ ). As in Merz (1995), there is full risk-sharing within each household, so that consumption is equal among its members, independent of employment status.

Similar to Coenen et al. (2013), but with habits in private consumption instead of the aggregate consumption bundle, the consumption for households of type  $j = \{R, NR\}$  is specified as a constant elasticity of substitution (CES) aggregate of the households' purchases for consumption purposes ( $C_t^j$ ) and government consumption ( $C_t^G$ ):

$$\hat{C}_t^j \equiv \hat{C} \left( C_t^j - \varsigma \check{C}_{t-1}^j, C_t^G \right) = \left[ (1 - o_{\hat{C}})^{\frac{1}{\eta_{\hat{C}}}} \left( C_t^j - \varsigma \check{C}_{t-1}^j \right)^{\frac{\eta_{\hat{C}} - 1}{\eta_{\hat{C}}}} + o_{\hat{C}}^{\frac{1}{\eta_{\hat{C}}}} (C_t^G)^{\frac{\eta_{\hat{C}} - 1}{\eta_{\hat{C}}}} \right]^{\frac{\eta_{\hat{C}}}{\eta_{\hat{C}} - 1}}$$

Where and  $\check{C}_t^j$  denotes average consumption across households of type  $j$  (with  $C_t^j = \check{C}_t^j$  in equilibrium), and  $1 \geq \varsigma \geq 0$ .<sup>2</sup>

Expected discounted utility of a representative household<sup>3</sup> of type  $j \in \{R, NR\}$  is given by<sup>4</sup>

$$E_t \sum_{s=0}^{\infty} \beta^s \varrho_{t+s} \left[ \frac{1}{1 - \sigma} \left( \hat{C}_{t+s}^j \right)^{1 - \sigma} - n_{t+s} \ell_{t+s}^j \right], \quad j \in \{R, NR\} \quad (1)$$

Where  $\ell_t^j = \Theta_t^j \kappa_t (A_{t-1}^H)^{1 - \sigma} \frac{h_t^{1 + \phi}}{1 + \phi}$  is the disutility of work of an employed household member<sup>5</sup>,  $\varrho_t$  is an exogenous preference shock,  $\kappa_t$  is an exogenous disutility shock (common to all households),  $\beta \in (0, 1)$ ,  $\sigma > 0$ ,  $\kappa > 0$ , and  $\phi \geq 0$ .

<sup>2</sup>Throughout, uppercase letters denote nominal variables containing a unit root in equilibrium (either due to technology or to long-run inflation) while lowercase letters indicate variables with no unit root. Real variables are constructed using the domestic consumption good as the numeraire. In the appendix we describe how each variable is transformed to achieve stationarity in equilibrium. Variables without time subscript denote non-stochastic steady state values in the stationary model.

<sup>3</sup>The household instantaneous utility is defined as the sum of every member  $i$ 's utility:  $U_t^j = \int U_t^j(i) di$ .

<sup>4</sup>The variable  $A_t^H$  (with  $a_t^H \equiv A_t^H / A_{t-1}^H$ ) is a non-stationary technology disturbance in home goods, and  $A_t$  (with  $a_t \equiv A_t / A_{t-1}$ ) is its global counterpart, see below.

<sup>5</sup>By assumption, unemployed members do not derive any labor related disutility.

As in Galí et al. (2012) we introduce the variable  $\Theta_t^j$  as an endogenous preference shifter that satisfies<sup>6</sup>

$$\Theta_t^j = \tilde{\chi}_t^j (A_{t-1}^H)^\sigma \left( \hat{C} \left( \check{C}_t^j - \varsigma \check{C}_{t-1}^j, \overline{C}_t^G \right) \right)^{-\sigma}, \quad \tilde{\chi}_{t+s}^j = \left( \tilde{\chi}_{t-1}^j \right)^{1-\nu} (A_{t-1}^H)^{-\sigma\nu} \left( \hat{C} \left( \check{C}_t^j - \varsigma \check{C}_{t-1}^j, \overline{C}_t^G \right) \right)^{\sigma\nu}, \quad \nu \in [0, 1]$$

The employed members of the representative household earn a total real wage of  $W_t h_t n_t$ , where  $W_t$  denote the hourly wage of employed members. Each one of the unemployed members earn  $UB_t = A_{t-1} ub$  of unemployment benefits which are paid out by an unemployment funds administrator (UFA). Households also derive income from lump sum transfers from the government amounting  $TR_t^j$ .

Households pay lump sum taxes in amount of  $T_t^j$ , a tax rate of  $\tau_t^C$  over the purchase of consumption goods, and a tax rate of  $\tau_t^L$  on their labor income. The labor tax is composed by a general wage tax and a forced contribution to an unemployment insurance fund (i.e  $\tau_t^L \equiv \tau_t^W + \tau_t^{UFA}$ ). The first component is collected by the government while the second goes to the UFA.

### 2.1.1 Ricardian Households

Only Ricardian households can save and borrow by purchasing domestic currency denominated government bonds ( $B_t^R$ ) and by trading foreign currency bonds ( $B_t^{R*}$ ) with foreign agents, both being non-state contingent assets. They also purchase an investment good, ( $I_t^R$ ) which determines their physical capital stock for next period ( $K_t^R$ ), and receive dividends ( $D_t^R$ ) from the ownership of domestic firms as well as rents ( $REN_t^{R*}$ ) due to ownership of firms abroad (the latter are assumed to evolve stochastically according to  $ren_t^{R*} = \overline{ren}^{R*} \xi_t^{ren}$ , where  $\overline{ren}^{R*} \geq 0$  and  $\xi_t^{ren}$  is an exogenous process). They pay a tax rate of  $\tau_t^D$  on dividends and  $\tau_t^K$  on capital income.

Let  $r_t$ ,  $r_t^*$  and  $r_t^K$  denote the gross real returns on  $B_{t-1}^R$ ,  $B_{t-1}^{R*}$  and  $K_t^{S,R}$  respectively, and let  $rer_t$  be the real exchange rate (i.e. the price of foreign consumption goods in terms of domestic consumption goods). We allow for the distinction between capital services (denoted as  $K_t^{S,R}$ ) used in the production of goods, and physical units of capital ( $K_t^R$ ), owned by the households, with a law of motion governed by the investment and depreciation rates. The former is defined as the productive potential of the available physical capital stock for a given utilization rate  $\bar{u}_t$  chosen by the households, where

$$K_t^{S,R} = \bar{u}_t K_{t-1}^R \quad (2)$$

We follow Christiano et al. (2011) by introducing  $\phi_{\bar{u}}(\bar{u}_t) K_{t-1}$ , the investment goods used for private capital maintenance, as a part of the total private investment, alongside with the investment goods used for increasing the households physical capital. By assumption, these maintenance costs are deducted from capital taxation, and follow

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<sup>6</sup>In order to avoid unintended fluctuations in the labor supply due to shifts in the government consumption path, the consumption measure that enters the preference shifter is defined as the average consumption bundle across households of type  $j$  if government consumption were at its long term level.

the same structure as in García-Cicco et al. (2015):

$$\phi_{\bar{u}}(\bar{u}_t) = \frac{r^k}{\Phi_{\bar{u}}} \left( e^{\Phi_{\bar{u}}(\bar{u}_t-1)} - 1 \right) \quad (3)$$

Where the parameter  $\Phi_{\bar{u}} \equiv \phi''_{\bar{u}}(1)/\phi'_{\bar{u}}(1) > 0$  governs the importance of these utilization costs. The physical capital stock evolves according to the law of motion:

$$K_t^R = (1 - \delta)K_{t-1}^R + \left[ 1 - \phi_I \left( \frac{I_t^R}{I_{t-1}^R} \right) \right] \varpi_t I_t^R, \quad (4)$$

With depreciation rate  $\delta \in (0, 1]$ , where  $\varpi_t$  is an investment shock that captures changes in the efficiency of the investment process (see Justiniano et al., 2011),  $I_t^R$  denotes capital augmenting investment expenditures, and  $\phi_I(I_t^R/I_{t-1}^R) \equiv (\Phi_I/2)(I_t^R/I_{t-1}^R - a)^2$  are convex investment adjustment costs with elasticity  $\Phi_I = \phi''_I(a) \geq 0$ .

The period-by-period budget constraint of the representative Ricardian household is then given by

$$\begin{aligned} (B_t^R + rer_t B_t^{R*}) - (B_{t-1}^R + rer_t B_{t-1}^{R*}) &= rer_t REN_t^{R*} + TR_t^R + (1 - \tau_t^L)W_t h_t n_t + (1 - n_t)UB_t \\ &+ (r_t - 1)B_{t-1}^R + (r_t^* - 1)rer_t B_{t-1}^{R*} + (1 - \tau_t^D)D_t^R \\ &+ K_{t-1}^R [r_t^K \bar{u}_t (1 - \tau_t^K) + \tau_t^K p_t^I (\delta + \phi_{\bar{u}}(\bar{u}_t))] \\ &- (1 + \tau_t^C)C_t^R - p_t^I (I_t^R + K_{t-1}^R \phi_{\bar{u}}(\bar{u}_t)) - T_t^R \end{aligned} \quad (5)$$

The household chooses  $C_t^R$ ,  $I_t^R$ ,  $K_t^R$ ,  $B_t^R$ ,  $B_t^{R*}$ , and  $\bar{u}_t$  to maximize (1) subject to (2)-(5), taking  $r_t$ ,  $r_t^*$ ,  $r_t^K$ ,  $rer_t$ ,  $T_t^R$ ,  $REN_t^{R*}$ ,  $TR_t^R$ ,  $D_t^R$  and  $\check{C}_t^R$  as given. This intertemporal decision problem is associated with the following Lagrangian:

$$\mathcal{L}_t^R = E_t \sum_{s=0}^{\infty} \beta^s \varrho_{t+s} \left\{ \begin{aligned} &\frac{1}{1-\sigma} \left( \widehat{C}_{t+s}^R \right)^{1-\sigma} - \Theta_{t+s}^R \kappa_{t+s} \frac{1}{1+\phi} \left( A_{t+s-1}^H \right)^{1-\sigma} h_{t+s}^{1+\phi} \\ &+ \Lambda_{t+s}^R \left[ \begin{aligned} &rer_{t+s} REN_{t+s}^{R*} + TR_{t+s}^R + (1 - \tau_{t+s}^L)W_{t+s} h_{t+s} n_{t+s} + (1 - n_{t+s})UB_{t+s} \\ &+ K_{t+s-1}^R [r_{t+s}^K \bar{u}_{t+s} (1 - \tau_{t+s}^K) + \tau_{t+s}^K p_{t+s}^I (\delta + \phi_{\bar{u}}(\bar{u}_{t+s}))] \\ &+ (1 - \tau_{t+s}^D)D_{t+s}^R + rer_{t+s} r_{t+s}^* B_{t+s-1}^{R*} + r_{t+s} B_{t+s-1}^R - B_{t+s}^R - rer_{t+s} B_{t+s}^{R*} \\ &- (1 + \tau_{t+s}^C)C_{t+s}^R - p_{t+s}^I (I_{t+s}^R + K_{t+s-1}^R \phi_{\bar{u}}(\bar{u}_{t+s})) - T_{t+s}^R \end{aligned} \right] \\ &+ \Lambda_{t+s}^R q_{t+s} [(1 - \delta)K_{t+s-1}^R + (1 - \phi_I(I_{t+s}^R/I_{t+s-1}^R)) \varpi_{t+s} I_{t+s}^R - K_{t+s}^R] \end{aligned} \right\}$$

Where  $\Lambda_t^R$  denotes the Lagrange multiplier associated with the budget constraint and  $\Lambda_t^R q_t$  denotes the multiplier



associated with the law of motion for capital. The corresponding first-order optimality conditions are:

$$C_t^R : \quad \Lambda_t^R = \frac{1}{(1 + \tau_t^C)} \left( \hat{C}_t^R \right)^{-\sigma} \left( \frac{(1 - o_{\hat{C}}) \hat{C}_t^R}{C_t^R - \varsigma \hat{C}_{t-1}^R} \right)^{\frac{1}{\eta_{\hat{C}}}}, \quad (6)$$

$$B_t^R : \quad \Lambda_t^R = \beta E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \Lambda_{t+1}^R r_{t+1} \right\}, \quad (7)$$

$$B_t^{R*} : \quad \Lambda_t^R = \beta E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \Lambda_{t+1}^R \frac{rer_{t+1}}{rer_t} r_{t+1}^* \right\}, \quad (8)$$

$$K_t^R : \quad \Lambda_t^R q_t = \beta E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \Lambda_{t+1}^R \left[ \begin{array}{l} r_{t+1}^K \bar{u}_{t+1} (1 - \tau_{t+1}^K) + q_{t+1} (1 - \delta) \\ + p_{t+1}^I [\tau_{t+1}^K \delta - \phi_{\bar{u}} (\bar{u}_{t+1}) (1 - \tau_{t+1}^K)] \end{array} \right] \right\}, \quad (9)$$

$$I_t^R : \quad \frac{p_t^I}{q_t} = \left\{ 1 - \phi_I \left( \frac{I_t^R}{I_{t-1}^R} \right) - \phi_I' \left( \frac{I_t^R}{I_{t-1}^R} \right) \frac{I_t^R}{I_{t-1}^R} \right\} \varpi_t \quad (10)$$

$$+ \beta E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\Lambda_{t+1}}{\Lambda_t} \frac{q_{t+1}}{q_t} \phi_I' \left( \frac{I_{t+1}^R}{I_t^R} \right) \left( \frac{I_{t+1}^R}{I_t^R} \right)^2 \varpi_{t+1} \right\} \quad (11)$$

$$\bar{u}_t : \quad r_t^K = p_t^I \phi_{\bar{u}}' (\bar{u}_t) \quad (12)$$

Notice that from (3) and (12), we can express the optimal utilization rate as a function with a standard deviation inversely proportional to  $\Phi_{\bar{u}}$ :

$$\bar{u}_t = 1 + \frac{\log \left( \frac{r_t^K}{r_t^K} \right) - \log (p_t^I)}{\Phi_{\bar{u}}} \quad (13)$$

The nominal interest rates are implicitly defined as

$$\begin{aligned} r_t &= R_{t-1} (\pi_t)^{-1}, \\ \pi_t &= \left( \frac{P_t}{P_{t-1}} \right) \frac{1 + \tau_t^C}{1 + \tau_{t-1}^C}, \\ r_t^* &= R_{t-1}^* \xi_{t-1} (\pi_t^*)^{-1}, \\ \pi_t^* &= \frac{P_t^*}{P_{t-1}^*} \end{aligned}$$

Where  $\pi_t$  and  $\pi_t^*$  denote the gross inflation rates of the domestic and foreign consumption-based price indices, after tax in the domestic case. A debt elastic country premium ( $\xi_t$ ) is given by :

$$\xi_t = \bar{\xi} \exp \left[ -\psi \left( \frac{rer_t B_t^*}{p_t^Y Y_t} - \frac{rer_t^* B_t^*}{p_t^Y y} \right) + \frac{\zeta_t^O - \zeta^O}{\zeta^O} + \frac{\zeta_t^U - \zeta^U}{\zeta^U} \right], \quad \psi > 0, \quad \bar{\xi} \geq 1,$$

Where  $\zeta_t^O$  and  $\zeta_t^U$  are respectively observed and unobserved exogenous shocks to the country premium, and  $\psi$  denotes the elasticity of the premium to the country's net asset position (see Adolfson et al., 2008; Schmitt-Grohé and Uribe, 2003). The foreign nominal interest rate  $R_t^*$  evolves exogenously, whereas the domestic central bank sets  $R_t$ . The country net asset position ( $B_t^*$ ), is composed of private ( $B_t^{Pr*}$ ) and government ( $B_t^{G*}$ ) net foreign asset holdings:

$$B_t^* = B_t^{Pr*} + B_t^{G*}$$

### 2.1.2 Non-Ricardian Households

The subset of households that don't have access to asset markets face the following budget constraint:

$$(1 + \tau_t^C)C_t^{NR} = (1 - \tau_t^L)W_t h_t n_t + (1 - n_t)UB_t + TR_t^{NR} - T_t^{NR} \quad (14)$$

Thus they solve a much simpler period by period problem associated with the following Lagrangian and optimality condition:

$$\mathcal{L}^{NR} = \frac{1}{1-\sigma} \left( \hat{C}_t^{NR} \right)^{1-\sigma} - \Theta_t^{NR} \kappa_t \frac{1}{1+\phi} \left( A_{t-1}^H \right)^{1-\sigma} h_t^{1+\phi} + \Lambda_t^{NR} \left[ \begin{array}{l} (1 - \tau_t^L)W_t h_t n_t + (1 - n_t)UB_t + TR_t^{NR} \\ -T_t^{NR} - (1 + \tau_t^C)C_t^{NR} \end{array} \right]$$

$$\Lambda_t^{NR} = \frac{1}{(1 + \tau_t^C)} \left( \hat{C}_t^{NR} \right)^{-\sigma} \left( \frac{(1 - o_{\hat{C}}) \hat{C}_t^{NR}}{\bar{C}_t^{NR} - \varsigma \bar{C}_{t-1}^{NR}} \right)^{\frac{1}{\eta_{\hat{C}}}}$$

## 2.2 Labor Market

Similar to Kirchner and Tranamil (2016); Guerra-Salas et al. (2018), the labor market is modeled with search and matching frictions as in Mortensen and Pissarides (1994), allowing for both exogenous and endogenous separations, as in Cooley and Quadrini (1999) and den Haan et al. (2000).

By assumption, Ricardian and non-Ricardian workers have the same productivity. Additionally, as in Boscá et al. (2011), a labor union negotiates a unique labor contract for both types of households. This implies that firms are indifferent between different kind of workers, and thus all workers have the same wages, work the same number of hours and have the same probability of being employed. The matching function,  $\mathcal{M}_t = m_t v_t^{1-\mu} u_t^\mu$ , gives the number of new employment relationships which are productive in period  $t + 1$ . The variable  $u_t$  is the number of unemployed workers searching for a job,  $v_t$  is the number of vacancies posted by the firms, and  $m_t$  is the stochastic match efficiency at time  $t$ .  $\mu$  is the match elasticity parameter. At the beginning of each period, a fraction  $\rho_t^x$  of employment relationships is assumed to terminate exogenously. After this and before production starts, the surviving workers may separate endogenously at rate  $\rho_t^n$ . This occurs if the worker's operating cost  $\tilde{c}_t$  is greater than an endogenously determined threshold  $\bar{c}_t$ . The operating cost is assumed to be a random variable which is i.i.d across workers and time with c.d.f.  $F$ , which implies that  $\rho_t^n = P(\tilde{c}_t > \bar{c}_t) = 1 - F(\bar{c}_t)$ . The evolution of employment is given by  $n_t = (1 - \rho_t)[n_{t-1} + \mathcal{M}_{t-1}]$  where  $\rho_t$  is the total separation rate which is given by  $\rho_t = \rho_t^x + (1 - \rho_t^x)\rho_t^n$ .

Normalizing the total population of workers to 1, we have that  $n_t = 1 - u_t$ . The probability that a searching worker is matched to a new job at the end of period  $t$  is  $s_t = \mathcal{M}_t/u_t$ , and the probability that a firm fills a vacancy is  $e_t = \mathcal{M}_t/v_t$ . The number of vacancies posted, as well as the job termination threshold  $\bar{c}_t$  is optimally determined by profit maximizing firms. The wage earned by employed members, as well as their labor effort (hours worked), is the outcome of a bargaining process between firms and a union that represent the households interests.

## 2.3 Production and Pricing

The supply side of the economy is composed by 5 different types of firms: First, there is a perfectly competitive representative firm producing homogeneous home wholesale goods ( $Y_t^{\tilde{H}}$ ), with oil and a core wholesale good ( $Y_t^{\tilde{Z}}$ ) (which is produced by the same firm with labor and capital). Second, two sets of monopolistically competitive firms turn home wholesale goods into differentiated varieties of the home and exportable goods ( $Y_t^H(j)Y_t^{H*}(j)$ ) and a third set turns imported goods into the differentiated varieties of the foreign good ( $Y_t^F(j)$ ) in the same fashion. Third, there are three perfectly competitive aggregators packing the different varieties of the home, exportable and foreign goods into corresponding composite goods ( $Y_t^H, Y_t^{H*}, Y_t^F$ ). The fourth type consists of two more competitive aggregators: one that bundles the composite home and foreign goods to create different types of goods for consumption (core, agricultural and government,  $C_t^Z, C_t^A, C_t^G$ ) and investment (private, government and commodity,  $I_t^f, I_t^G, I_t^{Co,f}$ ), and another that bundles the core and agricultural goods with oil to produce a final consumption good for the households ( $C_t$ ). And finally, a competitive representative firm produces commodity goods for export ( $Y_t^{Co}$ ) using only sector-specific capital. The different types of final goods are purchased by the households ( $C_t, I_t^f$ ), the government ( $C_t^G, I_t^G$ ) and the commodity exporting firm ( $I_t^{Co,f}$ ). All firms are owned by the Ricardian households, with the exception of the commodity-exporting firm that is owned by the government and foreign agents.

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<b>Capital Stock</b>	$I^f$ $I^{Co,f}$	$\rightarrow$ $\rightarrow$	$K$ $K^{Co}$	;	$I^G$	$\rightarrow$	$K^G$
<b>Home Wholesale Good</b>	$\{n \times h, K, K^G\}$	$\rightarrow$	$Y^{\tilde{Z}}$	;	$\{X^{\tilde{Z}}, X^O\}$	$\rightarrow$	$Y^{\tilde{H}}$
<b>Differentiated Varieties</b>	$X^{\tilde{H}}$	$\rightarrow$	$\begin{cases} Y^H(j) \\ Y^{H*}(j) \end{cases}$	;	$M^*$	$\rightarrow$	$Y^F(j)$
<b>Composite Goods</b>	$\int X^H(j)dj$ $\int X^{H*}(j)dj$	$\rightarrow$ $\rightarrow$	$Y^H$ $Y^{H*}$	;	$\int X^F(j)dj$	$\rightarrow$	$Y^F$
<b>Final Goods and Services</b>	$\{X^H, X^F\}$	$\rightarrow$	$\begin{cases} C^Z \\ C^A \\ C^G \\ I^f \\ I^G \\ I^{Co,f} \end{cases}$	;	$\{C^Z, C^O, C^A\}$	$\rightarrow$	$C$
<b>Commodity Good</b>	$K^{Co}$	$\rightarrow$	$Y^{Co}$				

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Figure 1: Input/Output characterization of the model's real economy

### 2.3.1 Final Goods

For the final consumption good, a representative final goods firm combines a core consumption good with an agricultural good and oil. Another representative final goods firm demands composite home and foreign goods in the amounts  $X_t^{J,H}$  and  $X_t^{J,F}$ , in order to produce core ( $C_t^Z$ ), agricultural ( $C_t^A$ ) and government ( $C_t^G$ ) consumption goods, and private ( $I_t^f \equiv I_t + \phi_{\bar{u}}(\bar{u}_t) K_{t-1}$ ), commodity ( $I_t^{Co,f} \equiv I_t^{Co} + \phi_{\bar{u}}^C(\bar{u}_t^{Co}) K_{t-1}^{Co}$ ), and government ( $I_t^G$ ) investment goods, where  $J \in \{C^Z, C^G, I^f, I^{Co,f}, I^G\}$ . The respective CES technologies are given by:

$$C_t = \left[ (1 - \kappa_O - \kappa_A)^{\frac{1}{\eta_C}} (C_t^Z)^{\frac{\eta_C-1}{\eta_C}} + \kappa_O^{\frac{1}{\eta_C}} (C_t^O)^{\frac{\eta_C-1}{\eta_C}} + \kappa_A^{\frac{1}{\eta_C}} (C_t^A)^{\frac{\eta_C-1}{\eta_C}} \right]^{\frac{\eta_C}{\eta_C-1}} \quad (15)$$

$$J_t = \left[ (1 - o_J)^{\frac{1}{\eta_J}} (X_t^{J,H})^{\frac{\eta_J-1}{\eta_J}} + o_J^{\frac{1}{\eta_J}} (X_t^{J,F})^{\frac{\eta_J-1}{\eta_J}} \right]^{\frac{\eta_J}{\eta_J-1}} \quad (16)$$

With  $\kappa_O, \kappa_A, o_J \in [0, 1]$ ,  $\kappa_O + \kappa_A \leq 1$  and  $\eta_C, \eta_J > 0$ . Let  $p_t^J, p_t^O, p_t^H$  and  $p_t^F$  denote respectively the relative prices of the good  $J$ , oil, and the composite home and foreign goods with respect to the final consumption good (with  $p_t^C = 1$ ). Subject to the technology constraints (15), (16), and (24), the firms maximize their profits  $\Pi_t^C = C_t - p_t^Z C_t^Z - p_t^O C_t^O - p_t^A C_t^A$  and  $\Pi_t^J = p_t^J J_t - p_t^H X_t^{J,H} - p_t^F X_t^{J,F}$  over the input demands taking the respective prices as given. That is, the firms solve the following optimization problems:

$$\max_{C_t^Z, C_t^O, C_t^A} \left\{ \begin{aligned} & \left[ (1 - \kappa_O - \kappa_A)^{\frac{1}{\eta_C}} (C_t^Z)^{\frac{\eta_C-1}{\eta_C}} + \kappa_O^{\frac{1}{\eta_C}} (C_t^O)^{\frac{\eta_C-1}{\eta_C}} + \kappa_A^{\frac{1}{\eta_C}} (C_t^A)^{\frac{\eta_C-1}{\eta_C}} \right]^{\frac{\eta_C}{\eta_C-1}} \\ & - p_t^Z C_t^Z - p_t^O C_t^O - p_t^A C_t^A \end{aligned} \right\}$$

$$\max_{X_t^{J,H}, X_t^{J,F}} \left\{ p_t^J \left[ (1 - o_J)^{\frac{1}{\eta_J}} \left( X_t^{J,H} \right)^{\frac{\eta_J-1}{\eta_J}} + o_J^{\frac{1}{\eta_J}} \left( X_t^{J,F} \right)^{\frac{\eta_J-1}{\eta_J}} \right]^{\frac{\eta_J}{\eta_J-1}} - p_t^H X_t^{J,H} - p_t^F X_t^{J,F} \right\}$$

The first-order conditions determining the optimal input demands are

$$C_t^Z = (1 - \kappa_O - \kappa_A) (p_t^Z)^{-\eta_C} C_t \quad (17)$$

$$C_t^O = \kappa_O (p_t^O)^{-\eta_C} C_t \quad (18)$$

$$C_t^A = \kappa_A (p_t^A)^{-\eta_C} C_t \quad (19)$$

$$X_t^{J,H} = (1 - o_J) \left( \frac{p_t^H}{p_t^J} \right)^{-\eta_J} J_t \quad (20)$$

$$X_t^{J,F} = o_J \left( \frac{p_t^F}{p_t^J} \right)^{-\eta_J} J_t \quad (21)$$

Substituting (17)-(21) into (15)-(16) yields the following relations:

$$1 = (1 - \kappa_O - \kappa_A) (p_t^Z)^{1-\eta_C} + \kappa_O (p_t^O)^{1-\eta_C} + \kappa_A (p_t^A)^{1-\eta_C} \quad (22)$$

$$p_t^J = \left[ (1 - o_J) (p_t^H)^{1-\eta_J} + o_J (p_t^F)^{1-\eta_J} \right]^{\frac{1}{1-\eta_J}} \quad (23)$$

Showing that the firm earns zero profits in each period:

$$\begin{aligned} \Pi_t^C &= C_t - p_t^Z C_t^Z - p_t^O C_t^O - p_t^A C_t^A \\ &= C_t \left[ 1 - (1 - \kappa_O - \kappa_A) (p_t^Z)^{1-\eta_C} - \kappa_O (p_t^O)^{1-\eta_C} - \kappa_A (p_t^A)^{1-\eta_C} \right] \\ &= 0 \\ \Pi_t^J &= p_t^J J_t - p_t^H X_t^{J,H} - p_t^F X_t^{J,F} \\ &= J_t (p_t^J)^{\eta_J} \left[ (p_t^J)^{1-\eta_J} - (1 - o_J) (p_t^H)^{1-\eta_J} - o_J (p_t^F)^{1-\eta_J} \right] \\ &= 0 \end{aligned}$$

Similar to Medina and Soto (2007), the technology for the agricultural consumption good has an additional stochastic disturbance  $z_t^A$  in order to model the higher volatility of the sector that is observed in the data. Accordingly, the sector's technology, factor demand and prices are given by:

$$C_t^A = z_t^A \left[ (1 - o_A)^{\frac{1}{\eta_A}} \left( X_t^{A,H} \right)^{\frac{\eta_A-1}{\eta_A}} + o_A^{\frac{1}{\eta_A}} \left( X_t^{A,F} \right)^{\frac{\eta_A-1}{\eta_A}} \right]^{\frac{\eta_A}{\eta_A-1}} \quad (24)$$

$$X_t^{A,H} = (z_t^A)^{\eta_A-1} (1 - o_A) \left( \frac{p_t^H}{p_t^A} \right)^{-\eta_A} C_t^A \quad (25)$$

$$X_t^{A,F} = (z_t^A)^{\eta_A-1} o_A \left( \frac{p_t^F}{p_t^A} \right)^{-\eta_A} C_t^A \quad (26)$$

$$p_t^A = \frac{1}{z_t^A} \left[ (1 - o_A) (p_t^H)^{1-\eta_A} + o_A (p_t^F)^{1-\eta_A} \right]^{\frac{1}{1-\eta_A}} \quad (27)$$

### 2.3.2 Composite Goods

Three groups of competitive packing firms demand all varieties  $j \in [0, 1]$  of foreign, home, and exportable goods in amounts  $X^F(j)$ ,  $X^H(j)$  and  $X^{H*}(j)$ , and combines them in order to produce composite foreign ( $Y_t^F$ ), composite home ( $Y_t^H$ ), and exportable ( $Y_t^{H*}$ ) goods. With  $J = \{F, H, H*\}$  the CES technologies that transform inputs  $X_t^J(j)$  into the respective outputs  $Y_t^J$  are given by:

$$Y_t^J = \left[ \int_0^1 X_t^J(j)^{\frac{\epsilon_J-1}{\epsilon_J}} dj \right]^{\frac{\epsilon_J}{\epsilon_J-1}}, \quad \epsilon_J > 0. \quad (28)$$

Let  $P_t^J(j)$  denote the price of the good of variety  $j$ . Subject to the technology constraint (28), the firm maximizes its profits  $\Pi_t^J = P_t^J Y_t^J - \int_0^1 P_t^J(j) X_t^J(j) dj$  over the input demands taking the relative prices as given. That is, the firm solves the following optimization problem:

$$\max_{X_t^J(j)} \left\{ P_t^J \left[ \int_0^1 X_t^J(j)^{\frac{\epsilon_J-1}{\epsilon_J}} dj \right]^{\frac{\epsilon_J}{\epsilon_J-1}} - \int_0^1 P_t^J(j) X_t^J(j) dj \right\}, \quad \text{for all } j.$$

The first-order conditions determining the optimal input demands for each variety are

$$X_t^J(j) = \left( \frac{P_t^J(j)}{P_t^J} \right)^{-\epsilon_J} Y_t^J, \quad \text{for all } j. \quad (29)$$

Substituting (29) into (28) yields

$$(Y_t^J)^{\frac{\epsilon_J-1}{\epsilon_J}} = \int_0^1 (X_t^J(j))^{\frac{\epsilon_J-1}{\epsilon_J}} dj = (Y_t^J)^{\frac{\epsilon_J-1}{\epsilon_J}} \int_0^1 \left( \frac{P_t^J(j)}{P_t^J} \right)^{1-\epsilon_J} dj,$$

Or

$$1 = \int_0^1 \left( \frac{P_t^J(j)}{P_t^J} \right)^{1-\epsilon_J} dj, \quad (30)$$

Showing that the firm earns zero profits in each period:

$$\Pi_t^J = P_t^J Y_t^J - \int_0^1 P_t^J(j) X_t^J(j) dj = P_t^J Y_t^J \left[ 1 - \int_0^1 \left( \frac{P_t^J(j)}{P_t^J} \right)^{1-\epsilon_J} dj \right] = 0.$$

According to (30) the price level  $P_t^J$  satisfies

$$P_t^J = \left[ \int_0^1 P_t^J(j)^{1-\epsilon_J} dj \right]^{\frac{1}{1-\epsilon_J}}. \quad (31)$$

### 2.3.3 Differentiated Varieties

Two sets of monopolistically competitive firms demand home wholesale goods in quantities  $X_t^{\tilde{H}}$  and  $X_t^{\tilde{H}^*}$ , respectively, and differentiate them into domestically sold (home) and exportable varieties,  $Y_t^H(j)$  and  $Y_t^{H^*}(j)$ . It takes one unit of the input good to produce one unit of variety  $j$ , such that  $\int_0^1 Y_t^H(j) dj = X_t^{\tilde{H}}$  and  $\int_0^1 Y_t^{H^*}(j) dj = X_t^{\tilde{H}^*}$ . Another set of monopolistically competitive importing firms demands a quantity  $M_t^*$  of an imported good at the price  $P_t^{M^*}$  and differentiates it into varieties  $Y_t^F(j)$  that are sold domestically, such that  $\int_0^1 Y_t^F(j) dj = M_t^*$ . The firm producing variety  $j$  of the respective good satisfies the demand given by (29) but it has monopoly power for its variety. Domestically sold varieties ( $Y_t^F(j)$  and  $Y_t^H(j)$ ) are invoiced in local currency, while exported varieties ( $Y_t^{H^*}(j)$ ), following Adolfson et al. (2007), Medina and Soto (2007) and others, are priced in foreign currency and indexed to foreign inflation.

**Domestically sold varieties** For varieties priced in local currency, with  $J^X = \{M^*, \tilde{H}\}$  and  $J^Y = \{F, H\}$ , the nominal marginal cost in terms of the associated composite good price is  $P_t^{J^Y} mc_t^{J^Y}(j)$ . As every firm buys their inputs from the same market of homogeneous goods, they all face the same marginal cost:  $P_t^{J^Y} mc_t^{J^Y}(j) = P_t^{J^Y} mc_t^{J^Y} = P_t^{J^X}$  for all  $j$ .<sup>7</sup> In the case of imported goods,  $P_t^M \equiv S_t P_t^{M^*}$  where  $S_t$  is the nominal exchange rate, implicitly defined by  $rer_t = S_t P_t^*/P_t$ . Given marginal costs, the firm producing variety  $j$  chooses its price  $P_t^{J^Y}(j)$  to maximize profits. In setting prices, the firm faces a Calvo-type problem, whereby each period it can change its price optimally with probability  $1 - \theta_{J^Y}$ , and if it cannot optimally change its price, it indexes its previous price according to a weighted product of past and steady state inflation with weights  $\vartheta_{J^Y} \in [0, 1]$  and  $1 - \vartheta_{J^Y}$ . A firm reoptimizing in period  $t$  will choose the price  $\tilde{P}_t^{J^Y}(j)$  that maximizes the current market value of the profits generated until it can reoptimize. As the firms are owned by the Ricardian households, they discount profits by their stochastic discount factor for nominal payoffs:  $\chi_{t,t+s} \equiv \beta^s (\varrho_{t+s}/\varrho_t) (\Lambda_{t+s}^R/\Lambda_t^R) (P_t(1 + \tau_t^C)/P_{t+s}(1 + \tau_{t+s}^C))$ , for  $s \geq 0$ . A reoptimizing firm producing  $J^Y$

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<sup>7</sup>Therefore  $mc_t^{J^Y} = P_t^{J^X}/P_t^{J^Y}$  is the real marginal cost of these firms, in terms of the associated composite goods.

with inputs  $J^X$  therefore solves

$$\begin{aligned} \max_{\tilde{P}_t^{J^Y}(j)} \quad & E_t \sum_{s=0}^{\infty} \theta_{J^Y}^s \chi_{t,t+s} \left( \tilde{P}_t^{J^Y}(j) \Gamma_{t,s}^{J^Y} - P_{t+s}^{J^X} \right) Y_{t+s}^{J^Y}(j), \\ \text{s.t.} \quad & Y_{t+s}^{J^Y}(j) = \left( \frac{\tilde{P}_t^{J^Y}(j) \Gamma_{t,s}^{J^Y}}{P_{t+s}^{J^Y}} \right)^{-\epsilon_{J^Y}} Y_{t+s}^{J^Y}, \\ & P_t^{J^X} = P_t^{J^Y} m c_t^{J^Y}, \end{aligned}$$

where  $\Gamma_{t,s}^{J^Y} = \left[ \left( \frac{P_{t+s-1}(1+\tau_{t+s-1}^C)}{P_{t-1}(1+\tau_{t-1}^C)} \right)^{\vartheta_\pi} \left( \frac{P_{t+s-1}^Z(1+\tau_{t+s-1}^C)}{\tilde{P}_{t-1}^Z(1+\tau_{t-1}^C)} \right)^{1-\vartheta_\pi} \right]^{\vartheta_{J^Y}} \pi^{(1-\vartheta_{J^Y})s}$  is an indexation variable defined as a weighted average between past CPI, past core, and steady state inflation that satisfies  $\Gamma_{t,0}^{J^Y} = 1$ ,  $\Gamma_{t,s}^{J^Y} = \Gamma_{t,s-1}^{J^Y} g_{t,s-1}^{J^Y}$  and  $\Gamma_{t,s+1}^{J^Y} = g_t^{J^Y} \Gamma_{t+1,s}^{J^Y}$ . Here  $g_{t+s}^{J^Y} \equiv \left[ (\pi_{t+s})^{\vartheta_\pi} (\pi_{t+s}^Z)^{1-\vartheta_\pi} \right]^{\vartheta_{J^Y}} \pi^{1-\vartheta_{J^Y}}$  for  $s \geq 1$  is the gross growth rate of the indexation variable. Substituting out the demand constraint in the objective function yields

$$\max_{\tilde{P}_t^{J^Y}(j)} E_t \sum_{s=0}^{\infty} \theta_{J^Y}^s \chi_{t,t+s} \left[ \tilde{P}_t^{J^Y}(j)^{1-\epsilon_{J^Y}} \left( \Gamma_{t,s}^{J^Y} \right)^{1-\epsilon_{J^Y}} - \tilde{P}_t^{J^Y}(j)^{-\epsilon_{J^Y}} \left( \Gamma_{t,s}^{J^Y} \right)^{-\epsilon_{J^Y}} P_{t+s}^{J^Y} m c_{t+s}^{J^Y} \right] \left( P_{t+s}^{J^Y} \right)^{\epsilon_{J^Y}} Y_{t+s}^{J^Y}.$$

The first-order condition determining the optimal price is given by<sup>8</sup>

$$\begin{aligned} & E_t \sum_{s=0}^{\infty} \theta_{J^Y}^s \chi_{t,t+s} (-\epsilon_{J^Y}) \left( \tilde{P}_t^{J^Y} \right)^{-\epsilon_{J^Y}-1} \left( \Gamma_{t,s}^{J^Y} \right)^{-\epsilon_{J^Y}} P_{t+s}^{J^Y} m c_{t+s}^{J^Y} \left( P_{t+s}^{J^Y} \right)^{\epsilon_{J^Y}} Y_{t+s}^{J^Y} \\ &= E_t \sum_{s=0}^{\infty} \theta_{J^Y}^s \chi_{t,t+s} (1 - \epsilon_{J^Y}) \left( \tilde{P}_t^{J^Y} \right)^{-\epsilon_{J^Y}} \left( \Gamma_{t,s}^{J^Y} \right)^{1-\epsilon_{J^Y}} \left( P_{t+s}^{J^Y} \right)^{\epsilon_{J^Y}} Y_{t+s}^{J^Y}, \end{aligned}$$

or, multiplying by  $\tilde{P}_t^{J^Y}/P_t^{J^Y}$  and dividing by  $-\epsilon_{J^Y}$  on both sides:

$$\begin{aligned} & E_t \sum_{s=0}^{\infty} \theta_{J^Y}^s \chi_{t,t+s} \left( \tilde{P}_t^{J^Y} \right)^{-\epsilon_{J^Y}} \left( \Gamma_{t,s}^{J^Y} \right)^{-\epsilon_{J^Y}} \left( P_t^{J^Y} \right)^{-1} P_{t+s}^{J^Y} m c_{t+s}^{J^Y} \left( P_{t+s}^{J^Y} \right)^{\epsilon_{J^Y}} Y_{t+s}^{J^Y} \\ &= E_t \sum_{s=0}^{\infty} \theta_{J^Y}^s \chi_{t,t+s} \left( \tilde{P}_t^{J^Y} \right)^{1-\epsilon_{J^Y}} \left( \Gamma_{t,s}^{J^Y} \right)^{1-\epsilon_{J^Y}} \left( P_t^{J^Y} \right)^{-1} \left( P_{t+s}^{J^Y} \right)^{\epsilon_{J^Y}} Y_{t+s}^{J^Y} \left( \frac{\epsilon_{J^Y} - 1}{\epsilon_{J^Y}} \right). \end{aligned}$$

Letting  $\tilde{p}_t^{J^Y} \equiv \tilde{P}_t^{J^Y}/P_t^{J^Y}$  denote the optimal price in terms of the corresponding composite good price and defining also  $p_t^{J^Y} \equiv P_t^{J^Y}/P_t$ , the first-order condition can be re-written in recursive form as follows:

$$F_t^{J^Y 1} = F_t^{J^Y 2} = F_t^{J^Y},$$

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<sup>8</sup>By symmetry, the optimal price is identical across firms, i.e.,  $\tilde{P}_t^{J^Y}(j) = \tilde{P}_t^{J^Y}$  for all  $j$ .



where

$$\begin{aligned}
F_t^{J^Y 1} &= E_t \sum_{s=0}^{\infty} (\beta \theta_{J^Y})^s \frac{\varrho_{t+s}}{\varrho_t} \frac{\Lambda_{t+s}^R}{\Lambda_t^R} \frac{P_t(1+\tau_t^C)}{P_{t+s}(1+\tau_{t+s}^C)} \tilde{P}_t^{J^Y} (j)^{-\epsilon_{J^Y}} \left( \Gamma_{t,s}^{J^Y} \right)^{-\epsilon_{J^Y}} \left( P_t^{J^Y} \right)^{-1} P_{t+s}^{J^Y} m c_{t+s}^{J^Y} \left( P_{t+s}^{J^Y} \right)^{\epsilon_{J^Y}} Y_{t+s}^{J^Y}, \\
&= \left( \frac{\tilde{P}_t^{J^Y}}{P_t^{J^Y}} \right)^{-\epsilon_{J^Y}} m c_t^{J^Y} Y_t^{J^Y} + \beta \theta_{J^Y} E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\Lambda_{t+1}^R}{\Lambda_t^R} \frac{(1+\tau_t^C)}{(1+\tau_{t+1}^C)} \frac{P_t}{P_{t+1}} \left( g_t^{J^Y} \frac{\tilde{P}_t^{J^Y}}{\tilde{P}_{t+1}^{J^Y}} \right)^{-\epsilon_{J^Y}} \left( \frac{P_t^{J^Y}}{P_{t+1}^{J^Y}} \right)^{-1} F_{t+1}^{J^Y 1} \right\}, \\
&= \left( \tilde{p}_t^{J^Y} \right)^{-\epsilon_{J^Y}} m c_t^{J^Y} Y_t^{J^Y} + \beta \theta_{J^Y} E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\Lambda_{t+1}^R}{\Lambda_t^R} \left( \frac{g_t^{J^Y} \tilde{p}_t^{J^Y}}{\pi_{t+1} \tilde{p}_{t+1}^{J^Y}} \right)^{-\epsilon_{J^Y}} \left( \frac{p_t^{J^Y}}{p_{t+1}^{J^Y}} \frac{(1+\tau_{t+1}^C)}{(1+\tau_t^C)} \right)^{-1-\epsilon_{J^Y}} F_{t+1}^{J^Y 1} \right\},
\end{aligned}$$

and

$$\begin{aligned}
F_t^{J^Y 2} &= E_t \sum_{s=0}^{\infty} (\beta \theta_{J^Y})^s \frac{\varrho_{t+s}}{\varrho_t} \frac{\Lambda_{t+s}^R}{\Lambda_t^R} \frac{P_t(1+\tau_t^C)}{P_{t+s}(1+\tau_{t+s}^C)} \left( \tilde{P}_t^{J^Y} \right)^{1-\epsilon_{J^Y}} \left( \Gamma_{t,s}^{J^Y} \right)^{1-\epsilon_{J^Y}} \left( P_t^{J^Y} \right)^{-1} \left( P_{t+s}^{J^Y} \right)^{\epsilon_{J^Y}} Y_{t+s}^{J^Y} \left( \frac{\epsilon_{J^Y}-1}{\epsilon_{J^Y}} \right), \\
&= \left( \frac{\tilde{P}_t^{J^Y}}{P_t^{J^Y}} \right)^{1-\epsilon_{J^Y}} Y_t^{J^Y} \left( \frac{\epsilon_{J^Y}-1}{\epsilon_{J^Y}} \right) + \beta \theta_{J^Y} E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\Lambda_{t+1}^R}{\Lambda_t^R} \frac{(1+\tau_t^C)}{(1+\tau_{t+1}^C)} \frac{P_t}{P_{t+1}} \left( g_t^{J^Y} \frac{\tilde{P}_t^{J^Y}}{\tilde{P}_{t+1}^{J^Y}} \right)^{1-\epsilon_{J^Y}} \left( \frac{P_t^{J^Y}}{P_{t+1}^{J^Y}} \right)^{-1} F_{t+1}^{J^Y 2} \right\}, \\
&= \left( \tilde{p}_t^{J^Y} \right)^{1-\epsilon_{J^Y}} Y_t^{J^Y} \left( \frac{\epsilon_{J^Y}-1}{\epsilon_{J^Y}} \right) + \beta \theta_{J^Y} E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\Lambda_{t+1}^R}{\Lambda_t^R} \left( \frac{g_t^{J^Y} \tilde{p}_t^{J^Y}}{\pi_{t+1} \tilde{p}_{t+1}^{J^Y}} \right)^{1-\epsilon_{J^Y}} \left( \frac{p_t^{J^Y}}{p_{t+1}^{J^Y}} \frac{(1+\tau_{t+1}^C)}{(1+\tau_t^C)} \right)^{-\epsilon_{J^Y}} F_{t+1}^{J^Y 2} \right\}.
\end{aligned}$$

Further, let  $\Psi^{J^Y}(t)$  denote the set of firms that cannot optimally choose their price in period  $t$ . By (31), the price level  $P_t^{J^Y}$  evolves as follows:

$$\begin{aligned}
\left( P_t^{J^Y} \right)^{1-\epsilon_{J^Y}} &= \int_0^1 P_t^{J^Y}(j)^{1-\epsilon_{J^Y}} dj = (1-\theta_{J^Y}) \left( \tilde{P}_t^{J^Y} \right)^{1-\epsilon_{J^Y}} + \int_{\Psi^{J^Y}(t)} \left( g_{t-1}^{J^Y} P_{t-1}^{J^Y}(j) \right)^{1-\epsilon_{J^Y}} dj, \\
&= (1-\theta_{J^Y}) \left( \tilde{P}_t^{J^Y} \right)^{1-\epsilon_{J^Y}} + \theta_{J^Y} \left( g_{t-1}^{J^Y} P_{t-1}^{J^Y} \right)^{1-\epsilon_{J^Y}}.
\end{aligned}$$

Dividing both sides by  $\left( P_t^{J^Y} \right)^{1-\epsilon_{J^Y}}$  yields

$$1 = (1-\theta_{J^Y}) \left( \tilde{p}_t^{J^Y} \right)^{1-\epsilon_{J^Y}} + \theta_{J^Y} \left( \frac{p_{t-1}^{J^Y}}{p_t^{J^Y}} \frac{g_{t-1}^{J^Y}}{\pi_t} \frac{(1+\tau_t^C)}{(1+\tau_{t-1}^C)} \right)^{1-\epsilon_{J^Y}}.$$

The second equality above follows from the fact that the distribution of prices among firms not reoptimizing in period  $t$  corresponds to the distribution of effective prices in period  $t-1$ , though with total mass reduced to  $\theta_{J^Y}$ .

**Exported varieties** For exported varieties, priced in foreign currency, the setup is equivalent. The only differences are that both the nominal rigidities and the relevant stochastic discount factor are defined in terms of the foreign currency. The nominal marginal cost of exporter  $j$  in terms of the exportable composite good price is  $S_t P_t^{H*} m c_t^{H*}(j)$ . As every firm buys their inputs from the same market of homogeneous goods, they all face the same marginal

costs:  $S_t P_t^{H*} m c_t^{H*}(j) = S_t P_t^{H*} m c_t^{H*} = P_t^{\tilde{H}}$  for all  $j$ . Given marginal costs, the firm producing variety  $j$  chooses its price  $P_t^{H*}(j)$  to maximize profits. In setting prices, the firm faces a Calvo-type problem, whereby each period it can change its price optimally with probability  $1 - \theta_{H*}$ , and if it cannot optimally change its price, it indexes its previous price according to a weighted product of past and steady state inflation with weights  $\vartheta_{H*} \in [0, 1]$  and  $1 - \vartheta_{H*}$ . A firm reoptimizing in period  $t$  will choose the price  $\tilde{P}_t^{H*}(j)$  that maximizes the current market value of the profits generated until it can reoptimize. As the firms are owned by the Ricardian households, they discount profits by their stochastic discount factor for nominal payoffs in foreign currency:  $\chi_{t,t+s}^* \equiv \beta^s (\varrho_{t+s}/\varrho_t) (\Lambda_{t+s}^R/\Lambda_t^R) (P_t(1 + \tau_t^C)/P_{t+s}(1 + \tau_{t+s}^C)) (S_{t+s}/S_t)$ , for  $s \geq 0$ . A reoptimizing firm therefore solves

$$\begin{aligned} \max_{\tilde{P}_t^{H*}(j)} \quad & E_t \sum_{s=0}^{\infty} \theta_{H*}^s \chi_{t,t+s}^* \left( \tilde{P}_t^{H*}(j) \Gamma_{t,s}^{H*} - \frac{P_{t+s}^{\tilde{H}}}{S_{t+s}} \right) Y_{t+s}^{H*}(j), \\ \text{s.t.} \quad & Y_{t+s}^{H*}(j) = \left( \frac{\tilde{P}_t^{H*}(j) \Gamma_{t,s}^{H*}}{P_{t+s}^{H*}} \right)^{-\epsilon_{H*}} Y_{t+s}^{H*}, \\ & P_t^{\tilde{H}} = S_t P_t^{H*} m c_t^{H*}, \end{aligned}$$

where  $\Gamma_{t,s}^{H*} = \left( \frac{P_{t+s-1}^{H*}}{P_{t-1}^{H*}} \right)^{\vartheta_{H*}} (\pi^*)^{(1-\vartheta_{H*})s}$  is an indexation variable that satisfies  $\Gamma_{t,0}^{H*} = 1$  and  $\Gamma_{t,s}^{H*} = \Gamma_{t,s-1}^{H*} g_{t+s-1}^{H*}$  with  $g_{t+s}^{H*} \equiv (\pi_{t+s}^*)^{\vartheta_{H*}} (\pi^*)^{1-\vartheta_{H*}}$  for  $s \geq 1$ . Substituting out the demand constraint in the objective function yields

$$\max_{\tilde{P}_t^{H*}(j)} E_t \sum_{s=0}^{\infty} \theta_{H*}^s \chi_{t,t+s}^* \left[ \tilde{P}_t^{H*}(j)^{1-\epsilon_{H*}} (\Gamma_{t,s}^{H*})^{1-\epsilon_{H*}} - \tilde{P}_t^{H*}(j)^{-\epsilon_{H*}} (\Gamma_{t,s}^{H*})^{-\epsilon_{H*}} P_{t+s}^{H*} m c_{t+s}^{H*} \right] (P_{t+s}^{H*})^{\epsilon_{H*}} Y_{t+s}^{H*}.$$

The first-order condition determining the optimal price is given by<sup>9</sup>

$$\begin{aligned} & E_t \sum_{s=0}^{\infty} \theta_{H*}^s \chi_{t,t+s}^* (-\epsilon_{H*}) \left( \tilde{P}_t^{H*} \right)^{-\epsilon_{H*}-1} (\Gamma_{t,s}^{H*})^{-\epsilon_{H*}} P_{t+s}^{H*} m c_{t+s}^{H*} (P_{t+s}^{H*})^{\epsilon_{H*}} Y_{t+s}^{H*} \\ &= E_t \sum_{s=0}^{\infty} \theta_{H*}^s \chi_{t,t+s}^* (1 - \epsilon_{H*}) \left( \tilde{P}_t^{H*} \right)^{-\epsilon_{H*}} (\Gamma_{t,s}^{H*})^{1-\epsilon_{H*}} (P_{t+s}^{H*})^{\epsilon_{H*}} Y_{t+s}^{H*}, \end{aligned}$$

or, multiplying by  $\tilde{P}_t^{H*}/P_t^{H*}$  and dividing by  $-\epsilon_{H*}$  on both sides:

$$\begin{aligned} & E_t \sum_{s=0}^{\infty} \theta_{H*}^s \chi_{t,t+s}^* \left( \tilde{P}_t^{H*} \right)^{-\epsilon_{H*}} (\Gamma_{t,s}^{H*})^{-\epsilon_{H*}} (P_t^{H*})^{-1} P_{t+s}^{H*} m c_{t+s}^{H*} (P_{t+s}^{H*})^{\epsilon_{H*}} Y_{t+s}^{H*} \\ &= E_t \sum_{s=0}^{\infty} \theta_{H*}^s \chi_{t,t+s}^* \left( \tilde{P}_t^{H*} \right)^{1-\epsilon_{H*}} (\Gamma_{t,s}^{H*})^{1-\epsilon_{H*}} (P_t^{H*})^{-1} (P_{t+s}^{H*})^{\epsilon_{H*}} Y_{t+s}^{H*} \left( \frac{\epsilon_{H*} - 1}{\epsilon_{H*}} \right). \end{aligned}$$

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<sup>9</sup>By symmetry, the optimal price is identical across firms, i.e.,  $\tilde{P}_t^{H*}(j) = \tilde{P}_t^{H*}$  for all  $j$ .

Letting  $\tilde{p}_t^{H*} \equiv \tilde{P}_t^{H*}/P_t^{H*}$  denote the optimal price in terms of the corresponding composite good price and defining also  $p_t^{H*} \equiv P_t^{H*}/P_t^*$ , the first-order condition can be re-written in recursive form as follows:

$$F_{t+1}^{H*1} = F_{t+1}^{H*2} = F_{t+1}^{H*},$$

where

$$\begin{aligned} F_t^{H*1} &= E_t \sum_{s=0}^{\infty} (\theta_{H*}\beta)^s \frac{\varrho_{t+s}}{\varrho_t} \frac{\Lambda_{t+s}^R}{\Lambda_t^R} \frac{P_t(1+\tau_t^C)}{P_{t+s}(1+\tau_{t+s}^C)} \frac{S_{t+s}}{S_t} \left(\tilde{P}_t^{H*}\right)^{-\epsilon_{H*}} \left(\Gamma_{t,s}^{H*}\right)^{-\epsilon_{H*}} \left(P_t^{H*}\right)^{-1} P_{t+s}^{H*} mc_{t+s}^{H*} \left(P_{t+s}^{H*}\right)^{\epsilon_{H*}} Y_{t+s}^{H*}, \\ &= \left(\frac{\tilde{P}_t^{H*}}{P_t^{H*}}\right)^{-\epsilon_{H*}} mc_t^{H*} Y_t^{H*} + \beta \theta_{H*} E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\Lambda_{t+1}^R}{\Lambda_t^R} \frac{P_t(1+\tau_t^C)}{P_{t+1}(1+\tau_{t+1}^C)} \frac{S_{t+1}}{S_t} \left(g_t^{\Gamma_{t+1}^{H*}} \frac{\tilde{P}_t^{H*}}{\tilde{P}_{t+1}^{H*}}\right)^{-\epsilon_{H*}} \left(\frac{P_t^{H*}}{P_{t+1}^{H*}}\right)^{-1} F_{t+1}^{H*1} \right\}, \\ &= \left(\tilde{p}_t^{H*}\right)^{-\epsilon_{H*}} mc_t^{H*} Y_t^{H*} + \beta \theta_{H*} E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\Lambda_{t+1}^R}{\Lambda_t^R} \frac{rer_{t+1}}{rer_t} \left(\frac{g_t^{\Gamma_{t+1}^{H*}} \tilde{p}_t^{H*}}{\pi_{t+1}^* \tilde{p}_{t+1}^{H*}}\right)^{-\epsilon_{H*}} \left(\frac{p_t^{H*}}{p_{t+1}^{H*}}\right)^{-1-\epsilon_{H*}} F_{t+1}^{H*1} \right\}, \end{aligned}$$

and

$$\begin{aligned} F_t^{H*2} &= E_t \sum_{s=0}^{\infty} (\theta_{H*}\beta)^s \frac{\varrho_{t+s}}{\varrho_t} \frac{\Lambda_{t+s}^R}{\Lambda_t^R} \frac{P_t(1+\tau_t^C)}{P_{t+s}(1+\tau_{t+s}^C)} \frac{S_{t+s}}{S_t} \left(\tilde{P}_t^{H*}\right)^{1-\epsilon_{H*}} \left(\Gamma_{t,s}^{H*}\right)^{1-\epsilon_{H*}} \left(P_t^{H*}\right)^{-1} \left(P_{t+s}^{H*}\right)^{\epsilon_{H*}} Y_{t+s}^{H*} \left(\frac{\epsilon_{H*}-1}{\epsilon_{H*}}\right), \\ &= \left(\frac{\tilde{P}_t^{H*}}{P_t^{H*}}\right)^{1-\epsilon_{H*}} Y_{t+s}^{H*} \left(\frac{\epsilon_{H*}-1}{\epsilon_{H*}}\right) + \theta_{H*}\beta E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\Lambda_{t+1}^R}{\Lambda_t^R} \frac{P_t(1+\tau_t^C)}{P_{t+1}(1+\tau_{t+1}^C)} \frac{S_{t+1}}{S_t} \left(g_t^{\Gamma_{t+1}^{H*}} \frac{\tilde{P}_t^{H*}}{\tilde{P}_{t+1}^{H*}}\right)^{1-\epsilon_{H*}} \left(\frac{P_t^{H*}}{P_{t+1}^{H*}}\right)^{-1} F_{t+1}^{H*2} \right\}, \\ &= \left(\tilde{p}_t^{H*}\right)^{1-\epsilon_{H*}} Y_t^{H*} \left(\frac{\epsilon_{H*}-1}{\epsilon_{H*}}\right) + \theta_{H*}\beta E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\Lambda_{t+1}^R}{\Lambda_t^R} \frac{rer_{t+1}}{rer_t} \left(\frac{g_t^{\Gamma_{t+1}^{H*}} \tilde{p}_t^{H*}}{\pi_{t+1}^* \tilde{p}_{t+1}^{H*}}\right)^{1-\epsilon_{H*}} \left(\frac{p_t^{H*}}{p_{t+1}^{H*}}\right)^{-\epsilon_{H*}} F_{t+1}^{H*2} \right\}. \end{aligned}$$

Further, let  $\Psi^{H*}(t)$  denote the set of firms that cannot optimally choose their price in period  $t$ . By (31), the price level  $P_t^{H*}$  evolves as follows:

$$\begin{aligned} (P_t^{H*})^{1-\epsilon_{H*}} &= \int_0^1 P_t^{H*}(j)^{1-\epsilon_{H*}} dj = (1-\theta_{H*}) \left(\tilde{P}_t^{H*}\right)^{1-\epsilon_{H*}} + \int_{\Psi^{H*}(t)} \left(g_{t-1}^{\Gamma_{t-1}^{H*}} P_{t-1}^{H*}(j)\right)^{1-\epsilon_{H*}} dj, \\ &= (1-\theta_{H*}) \left(\tilde{P}_t^{H*}\right)^{1-\epsilon_{H*}} + \theta_{H*} \left(g_{t-1}^{\Gamma_{t-1}^{H*}} P_{t-1}^{H*}\right)^{1-\epsilon_{H*}}. \end{aligned}$$

Dividing both sides by  $(P_t^{H*})^{1-\epsilon_{H*}}$  yields

$$1 = (1-\theta_{H*}) \left(\tilde{p}_t^{H*}\right)^{1-\epsilon_{H*}} + \theta_{H*} \left(\frac{p_{t-1}^{H*} g_{t-1}^{\Gamma_{t-1}^{H*}}}{p_t^{H*} \pi_t^*}\right)^{1-\epsilon_{H*}}.$$

The second equality above follows from the fact that the distribution of prices among firms not reoptimizing in period  $t$  corresponds to the distribution of effective prices in period  $t-1$ , though with total mass reduced to  $\theta_{H*}$ .

### 2.3.4 Wholesale Domestic Goods

The technology of the representative firm producing the homogeneous home good requires the utilization of imported oil as a complementary input, together with capital and labor.

$$Y_t^{\tilde{H}} = z_t \left[ (1 - o_O)^{\frac{1}{\eta_O}} \left( X_t^{\tilde{Z}} \right)^{\frac{\eta_O - 1}{\eta_O}} + o_O^{\frac{1}{\eta_O}} \left( X_t^O \right)^{\frac{\eta_O - 1}{\eta_O}} \right]^{\frac{\eta_O}{\eta_O - 1}}, \quad o_O \in (0, 1), \quad \eta_O > 0 \quad (32)$$

Where  $z_t$  is an exogenous stationary shock,  $X_t^O$  is the amount of oil used as an intermediate input, and  $X_t^{\tilde{Z}}$  is the demand for the core (non-oil) productive input  $Y_t^{\tilde{Z}}$ , a composite of labor and capital produced using a Cobb-Douglas technology:

$$Y_t^{\tilde{Z}} = \left( \tilde{K}_t \right)^\alpha \left( A_t^H n_t h_t \right)^{1-\alpha}, \quad \alpha \in (0, 1), \quad (33)$$

Where  $A_t^H$  (with  $a_t^H \equiv A_t^H / A_{t-1}^H$ ) is a non-stationary labor-augmenting technology disturbance. Similar to Coenen et al. (2012, 2013),  $\tilde{K}_t$ , the capital good used in the production of the homogeneous good, is a CES composite between private and public capital:

$$\tilde{K}_t = \left[ (1 - o_{KG})^{\frac{1}{\eta_{KG}}} \left( K_t^S \right)^{\frac{\eta_{KG} - 1}{\eta_{KG}}} + o_{KG}^{\frac{1}{\eta_{KG}}} \left( K_{t-1}^G \right)^{\frac{\eta_{KG} - 1}{\eta_{KG}}} \right]^{\frac{\eta_{KG}}{\eta_{KG} - 1}}, \quad o_{KG} \in (0, 1), \quad \eta_{KG} > 0 \quad (34)$$

Denote  $\tilde{c}_t^i$  as worker  $i$ 's operating cost for the firm. Recall that when this cost is too high ( $\tilde{c}_t \geq \bar{c}_t$ ), production does not take place. Then, the average operating cost per worker is given by  $H_t^C = A_{t-1}^H \int_0^{\bar{c}_t} \tilde{c}_t \frac{dF(\tilde{c}_t)}{F(\bar{c}_t)}$ . The threshold value  $\bar{c}_t$  is optimally decided by the firm in each period. There is a posting cost per vacancy identical for all firms with the form  $\Omega_t = A_{t-1}^H \Omega_v$ , where  $\Omega_v$  is a constant. We allow  $H_t^C$  and  $\Omega_t$  to grow proportionately with the productivity trend  $A_{t-1}^H$  in order to maintain a balanced steady-state growth path. As in Christiano et al. (2011), these costs are assumed to be paid in terms of composite home goods. The firm's workforce evolves over time as

$$n_t = (1 - \rho_t)(n_{t-1} + e_{t-1}v_{t-1}) \quad (35)$$

Since today's choice of  $v_t$  affects tomorrow's workforce, the firm faces an inter-temporal decision problem to maximize expected discounted profits. As firms are owned by Ricardian households, the firm's stochastic discount factor for real payoffs satisfies  $\Xi_{t,t+s}^R \equiv \beta^s (\varrho_{t+s}/\varrho_t) (\Lambda_{t+s}^R/\Lambda_t^R)$ , for  $s \geq 0$ . The wholesale firm chooses how much capital services and oil to use  $(K_t^S, X_t^O)$ , and how much labor to hire and fire  $(v_t, n_t, \bar{c}_t)$  subject to (32), (33), (34) and

(35). Hence, the firm's problem is

$$\begin{aligned}
& \max_{K_t^S, X_t^O, v_t, n_t, \bar{c}_t} E_t \sum_{s=0}^{\infty} \Xi_{t,t+s}^R \left[ \begin{aligned} & p_{t+s}^{\tilde{H}} Y_{t+s}^{\tilde{H}} - W_{t+s} n_{t+s} h_{t+s} - p_{t+s}^H H_{t+s}^C n_{t+s} \\ & - p_{t+s}^H \Omega_{t+s} v_{t+s} - r_{t+s}^K K_{t+s}^S - p_{t+s}^O X_{t+s}^O \end{aligned} \right] \\
& s.t. \quad Y_t^{\tilde{H}} = z_t \left[ (1 - o_O)^{\frac{1}{\eta_O}} \left( X_t^{\tilde{Z}} \right)^{\frac{\eta_O - 1}{\eta_O}} + o_O^{\frac{1}{\eta_O}} \left( X_t^O \right)^{\frac{\eta_O - 1}{\eta_O}} \right]^{\frac{\eta_O}{\eta_O - 1}} \\
& \quad X_t^{\tilde{Z}} = Y_t^{\tilde{Z}} = \left( \tilde{K}_t \right)^\alpha \left( A_t^H n_t h_t \right)^{1-\alpha} \\
& \quad \tilde{K}_t = \left[ (1 - o_{KG})^{\frac{1}{\eta_{KG}}} \left( K_t^S \right)^{\frac{\eta_{KG} - 1}{\eta_{KG}}} + o_{KG}^{\frac{1}{\eta_{KG}}} \left( K_{t-1}^G \right)^{\frac{\eta_{KG} - 1}{\eta_{KG}}} \right]^{\frac{\eta_{KG}}{\eta_{KG} - 1}} \\
& \quad n_t = (1 - \rho_t)(n_{t-1} + e_{t-1} v_{t-1})
\end{aligned}$$

Where  $p_t^{\tilde{H}}$  and  $p_t^O$  are the prices of  $Y_t^{\tilde{H}}$  and  $X_t^O$  in terms of the final consumption good, respectively. The second constraint follows from the fact that as the only use of  $Y_t^{\tilde{Z}}$  is to satisfy the demand from (32), the market clearing condition requires  $X_t^{\tilde{Z}} = Y_t^{\tilde{Z}}$ .

Given the constraints outlined above, the problem for the firm can be separated in two parts: the cost minimizing production of  $Y_t^{\tilde{Z}}$  (choosing  $n_t, v_t, \bar{c}_t$  and  $K_t^S$ ) and the profit maximizing production of  $Y_t^{\tilde{H}}$  (choosing  $Y_t^{\tilde{Z}}$  and  $X_t^O$ ).

In the first stage, the firm wants to minimize the expected discounted cost of production of  $Y_t^{\tilde{Z}}$  by solving

$$\begin{aligned}
& \min_{K_t^S, v_t, n_t, \bar{c}_t} E_t \sum_{s=0}^{\infty} \Xi_{t,t+s}^R [W_{t+s} n_{t+s} h_{t+s} + p_{t+s}^H H_{t+s}^C n_{t+s} + p_{t+s}^H \Omega_{t+s} v_{t+s} + r_{t+s}^K K_{t+s}^S] \\
& s.t. \quad Y_t^{\tilde{Z}} = \left( \tilde{K}_t \right)^\alpha \left( A_t^H n_t h_t \right)^{1-\alpha} \\
& \quad n_t = (1 - \rho_t)(n_{t-1} + e_{t-1} v_{t-1})
\end{aligned}$$

The Lagrangian for this minimization problem is

$$L_t^{Y^{\tilde{Z}}} = E_t \sum_{s=0}^{\infty} \Xi_{t,t+s}^R \left[ \begin{aligned} & W_{t+s} n_{t+s} h_{t+s} + p_{t+s}^H H_{t+s}^C n_{t+s} + p_{t+s}^H \Omega_{t+s} v_{t+s} + r_{t+s}^K K_{t+s}^S \\ & + mc_{t+s}^{\tilde{Z}} \left( Y_{t+s}^{\tilde{Z}} - \left( \tilde{K}_{t+s} \right)^\alpha \left( A_{t+s}^H n_{t+s} h_{t+s} \right)^{1-\alpha} \right) \\ & + \Upsilon_{t+s} (n_{t+s} - (1 - \rho_{t+s})(n_{t+s-1} + e_{t+s-1} v_{t+s-1})) \end{aligned} \right]$$

Where  $mc_t^{\tilde{Z}}$  denotes the multiplier on the technology constraint (i.e. real marginal cost of  $Y_t^{\tilde{Z}}$  in terms of the final

good), and  $\Upsilon_t$  denotes the multiplier on firm's workforce. The first-order conditions are

$$K_t^S : \tilde{K}_t = \alpha \left( \frac{r_t^{\tilde{K}}}{mc_t^{\tilde{Z}}} \right)^{-1} Y_t^{\tilde{Z}} \quad (36)$$

$$v_t : \frac{p_t^H \Omega_t}{e_t} = E_t \Xi_{t,t+1}^R (1 - \rho_{t+1}) \Upsilon_{t+1} \quad (37)$$

$$n_t : \Upsilon_t = mc_t^{\tilde{Z}} (1 - \alpha) \frac{Y_t^{\tilde{Z}}}{n_t} - W_t h_t - p_t^H H_t^C + E_t \Xi_{t,t+1}^R (1 - \rho_{t+1}) \Upsilon_{t+1} \quad (38)$$

$$\bar{c}_t : \frac{\Upsilon_t}{1 - \rho_t} \frac{\partial \rho_t}{\partial \bar{c}_t} = -h_t \frac{\partial W_t}{\partial \bar{c}_t} - \frac{\partial H_t^C}{\partial \bar{c}_t} p_t^H \quad (39)$$

Where  $r_t^{\tilde{K}}$ , the cost of acquiring an additional unit of  $\tilde{K}_t$ , is defined as

$$r_t^{\tilde{K}} = r_t^K \left( \frac{\partial \tilde{K}_t}{\partial K_t^S} \right)^{-1} = r_t^K \left( \frac{K_t^S}{(1 - o_{KG}) \tilde{K}_t} \right)^{\frac{1}{\eta_{KG}}}$$

Combining (37) and (38) yields the job creation condition:

$$\frac{p_t^H \Omega_t}{e_t} = E_t \Xi_{t,t+1}^R (1 - \rho_{t+1}) \left( mc_{t+1}^{\tilde{Z}} (1 - \alpha) \frac{Y_{t+1}^{\tilde{Z}}}{n_{t+1}} - W_{t+1} h_{t+1} - p_{t+1}^H H_{t+1}^C + \frac{p_{t+1}^H \Omega_{t+1}}{e_{t+1}} \right)$$

Firms post vacancies to expand employment until the effective cost of posting an additional vacancy ( $p_t^H \Omega_t / e_t$ ) equals the expected marginal product of an additional worker ( $mc_{t+1}^{\tilde{Z}} (1 - \alpha) Y_{t+1}^{\tilde{Z}} / n_{t+1}$ ) minus the wage payment to that worker ( $W_{t+1} h_{t+1}$ ) minus the average operating cost of the firm ( $p_{t+1}^H H_{t+1}^C$ ) plus its expected return of next periods reduction of vacancy posting costs ( $p_{t+1}^H \Omega_{t+1} / e_{t+1}$ ), conditional on the worker surviving job destruction in period  $t + 1$  with probability  $1 - \rho_{t+1}$ .

Combining (37), (38), (39), and using the fact that  $(1 - \rho_t^x) / (1 - \rho_t) = 1 / F(\bar{c}_t)$ , we can get the job destruction condition:<sup>10</sup>

$$p_t^H A_{t-1}^H \bar{c}_t = mc_t^{\tilde{Z}} (1 - \alpha) \frac{Y_t^{\tilde{Z}}}{n_t} - W_t h_t + \frac{p_t^H \Omega_t}{e_t}$$

This expression defines the critical threshold  $\bar{c}_t$  above which jobs are separated.

In the second stage, firms maximize the profits from producing  $Y_t^{\tilde{H}}$  as if  $Y_t^{\tilde{Z}}$  was produced by a vertically integrated subsidiary selling it at marginal cost. Note that there are no intertemporal decisions in this stage. The firm's problem is:

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<sup>10</sup>Derivatives  $\frac{\partial W_t}{\partial \bar{c}_t} = 0$ ,  $\frac{\partial \rho_t}{\partial \bar{c}_t} = -(1 - \rho_t^x) f(\bar{c}_t)$  and  $\frac{\partial H_t^C}{\partial \bar{c}_t} = A_{t-1}^H \left( \bar{c}_t - \frac{H_t^C}{A_{t-1}^H} \right) \frac{f(\bar{c}_t)}{F(\bar{c}_t)}$  were calculated using the Leibniz's rule for differentiation under the integral sign.

$$\max_{X_t^{\tilde{Z}}, X_t^O} p_t^{\tilde{H}} z_t \left[ (1 - o_O)^{\frac{1}{\eta_O}} \left( X_t^{\tilde{Z}} \right)^{\frac{\eta_O - 1}{\eta_O}} + o_O^{\frac{1}{\eta_O}} \left( X_t^O \right)^{\frac{\eta_O - 1}{\eta_O}} \right]^{\frac{\eta_O}{\eta_O - 1}} - p_t^O X_t^O - m c_t^{\tilde{Z}} X_t^{\tilde{Z}}$$

The optimal demands for  $X_t^{\tilde{Z}}$  and  $X_t^O$  are then given by

$$X_t^{\tilde{Z}} = (z_t)^{\eta_O - 1} (1 - o_O) \left( \frac{m c_t^{\tilde{Z}}}{p_t^{\tilde{H}}} \right)^{-\eta_O} Y_t^{\tilde{H}} \quad (40)$$

$$X_t^O = (z_t)^{\eta_O - 1} o_O \left( \frac{p_t^O}{p_t^{\tilde{H}}} \right)^{-\eta_O} Y_t^{\tilde{H}} \quad (41)$$

Substituting (40) and (41) into (32) yields the following expression for the price of  $Y_t^{\tilde{H}}$  in terms of the final consumption good:

$$p_t^{\tilde{H}} = \frac{1}{z_t} \left[ (1 - \alpha_O) \left( m c_t^{\tilde{Z}} \right)^{1 - \eta_O} + \alpha_O \left( p_t^O \right)^{1 - \eta_O} \right]^{\frac{1}{1 - \eta_O}} \quad (42)$$

### 2.3.5 Wages and Hours

The wages and hours bargaining process between the union and the representative firm begin after the endogenous separation process has finished. At the time the bargaining takes place, both the number of workers ( $n_t$ ) and the operating cost associated with each one of those workers ( $\tilde{c}_t^i$ ) is known. With a unique contract to be bargained for all workers, both the firm and the union consider an aggregate weighted surplus across all households.

As in Gertler et al. (2008) we assume the union and the firms agree to an efficient allocation of hours where the marginal value product of a worker-hour equals the marginal cost of work (in terms of consumption goods and adjusted by taxes) for an employed household member.

$$(1 - \omega^U) \frac{\partial \ell_t^R / \partial h_t^R}{\Lambda_t^R (1 - \tau_t^L)} + \omega^U \frac{\partial \ell_t^{NR} / \partial h_t^{NR}}{\Lambda_t^{NR} (1 - \tau_t^L)} = m c_t^{\tilde{Z}} \frac{\partial^2 Y_t^{\tilde{Z}}}{\partial h_t \partial n_t} \Rightarrow h_t = \left[ \frac{m c_t^{\tilde{Z}} (1 - \alpha)^2 \frac{Y_t^{\tilde{Z}}}{n_t}}{\frac{\Psi_t^U \kappa_t}{(1 - \tau_t^L)} (A_{t-1}^H)^{1 - \sigma}} \right]^{\frac{1}{1 + \phi}}$$

Where  $\Psi_t^U = (1 - \omega^U) \frac{\Theta_t^R}{\Lambda_t^R} + \omega^U \frac{\Theta_t^{NR}}{\Lambda_t^{NR}}$  and  $\omega^U$  is the weight given to the non Ricardian members by the union. To get to the expression to the right we use the fact that Ricardian and not Ricardian workers are indistinguishable to the firm and therefore demand the same labor intensity from Ricardian and non Ricardian workers.

Given the amount of hours per worker defined above, a notional contract specifying hourly wages ( $W_t^n$ ) is negotiated through Nash bargaining. The outcome of the bargaining process is a wage that maximizes a weighted average between the firm's and union's surpluses:

$$\max_{W_t^n} [\varphi^U \log \mathcal{S}_t^U + (1 - \varphi^U) \log \mathcal{S}_t^F]$$

where  $\mathcal{S}_t^U$  is the union's surplus,  $\mathcal{S}_t^F$  is the firm's surplus, and  $\varphi^U \in (0, 1)$  is the union's relative bargaining power.

The first-order condition are

$$W_t^n : \varphi^U \mathcal{S}_t^F \frac{\partial \mathcal{S}_t^U}{\partial W_t^n} = - (1 - \varphi^U) \mathcal{S}_t^U \frac{\partial \mathcal{S}_t^F}{\partial W_t^n} \quad (43)$$

On the union side, the union's surplus is a weighted average surplus of Ricardian and non-Ricardian households

$$\mathcal{S}_t^U = (1 - \omega^U) \mathcal{S}_t^{R,U} + \omega^U \mathcal{S}_t^{NR,U}$$

For a member of type- $i$  household, with  $i = \{R, NR\}$ , the union's surplus  $(\mathcal{S}_t^{i,U})$  is defined as the difference between the value of being employed ( $\mathcal{V}_t^{i,E}$ ) and the value of being unemployed ( $\mathcal{V}_t^{i,U}$ ). The value of being employed is equal to the current-period benefit from the job (after tax wage income minus disutility of work), plus the discounted continuation value of remaining employed next period plus the discounted continuation value of being separated:

$$\mathcal{V}_t^{i,E} = (1 - \tau_t^L) W_t^n h_t - \frac{\Theta_t^i \kappa_t (A_{t-1}^H)^{1-\sigma} (h_t)^{1+\phi}}{\Lambda_t^i} + E_t \Xi_{t,t+1}^i \left[ (1 - \rho_{t+1}) \mathcal{V}_{t+1}^{i,E} + \rho_{t+1} \mathcal{V}_{t+1}^{i,U} \right]$$

The value of being unemployed is equal to the current unemployed benefit which is paid out by the UFA, plus the discounted continuation value of being employed with probability  $s_t (1 - \rho_{t+1})$  plus the discounted continuation value of remaining unemployed:

$$\mathcal{V}_t^{i,U} = UB_t + E_t \Xi_{t,t+1}^i \left[ s_t (1 - \rho_{t+1}) \mathcal{V}_{t+1}^{i,E} + (1 - s_t (1 - \rho_{t+1})) \mathcal{V}_{t+1}^{i,U} \right]$$

Hence, the type- $i$  household's surplus is

$$\begin{aligned} \mathcal{S}_t^{i,U} &= \mathcal{V}_t^{i,E} - \mathcal{V}_t^{i,U} \\ &= (1 - \tau_t^L) W_t^n h_t - \frac{\Theta_t^i \kappa_t (A_{t-1}^H)^{1-\sigma} (h_t)^{1+\phi}}{\Lambda_t^i (1+\phi)} - UB_t + (1 - s_t) E_t \Xi_{t,t+1}^i (1 - \rho_{t+1}) \left[ \mathcal{V}_{t+1}^{i,E} - \mathcal{V}_{t+1}^{i,U} \right] \end{aligned}$$

Finally, the union's surplus is given by

$$\begin{aligned} \mathcal{S}_t^U &= (1 - \omega^U) \mathcal{S}_t^{R,U} + \omega^U \mathcal{S}_t^{NR,U} \\ &= (1 - \omega^U) \left( (1 - \tau_t^L) W_t^n h_t - \frac{\Theta_t^R \kappa_t (A_{t-1}^H)^{1-\sigma} (h_t^n)^{1+\phi}}{\Lambda_t^R (1+\phi)} - UB_t + (1 - s_t) E_t \Xi_{t,t+1}^R (1 - \rho_{t+1}) \left[ \mathcal{V}_{t+1}^{R,E} - \mathcal{V}_{t+1}^{R,U} \right] \right) \\ &\quad + \omega^U \left( (1 - \tau_t^L) W_t^n h_t - \frac{\Theta_t^{NR} \kappa_t (A_{t-1}^H)^{1-\sigma} (h_t^n)^{1+\phi}}{\Lambda_t^{NR} (1+\phi)} - UB_t + (1 - s_t) E_t \Xi_{t,t+1}^{NR} (1 - \rho_{t+1}) \left[ \mathcal{V}_{t+1}^{NR,E} - \mathcal{V}_{t+1}^{NR,U} \right] \right) \\ &= (1 - \tau_t^L) W_t^n h_t - \Psi_t^U \kappa_t (A_{t-1}^H)^{1-\sigma} \frac{(h_t^n)^{1+\phi}}{1+\phi} - UB_t + (1 - s_t) E_t \Xi_{t,t+1}^U (1 - \rho_{t+1}) \mathcal{S}_{t+1}^U \end{aligned}$$



Where  $\Xi_{t,t+s}^{NR} \equiv \beta^s (\varrho_{t+s}/\varrho_t)(\Lambda_{t+s}^{NR}/\Lambda_t^{NR})$  and the union's discount factor  $\Xi_{t,t+1}^U$  is implicitly defined by

$$\begin{aligned}\Sigma_t^U &= E_t \Xi_{t,t+1}^U (1 - \rho_{t+1}) \mathcal{S}_{t+1}^U = (1 - \omega^U) E_t \Xi_{t,t+1}^R (1 - \rho_{t+1}) [\mathcal{V}_{t+1}^{R,E} - \mathcal{V}_{t+1}^{R,U}] \\ &\quad + \omega^U E_t \Xi_{t,t+1}^{NR} (1 - \rho_{t+1}) [\mathcal{V}_{t+1}^{NR,E} - \mathcal{V}_{t+1}^{NR,U}].\end{aligned}$$

Where  $\Sigma_t^U = A_{t-1} \sigma_t^U$  corresponds to the union's expected surplus adjusted by the stochastic discount factor and the match continuation probability.

In the firm side, the firm's surplus is defined as the difference between the expected average value functions of a vacancy posting ( $\mathcal{V}_t^V$ ) and a filled job ( $\mathcal{V}_t^J$ ). The value of a filled job by a worker with known operational costs of  $\tilde{c}_t$  is equal to the current-period firm's profit from one worker (productivity of labor minus operational cost plus wage payment), plus the discounted continuation value of the job next period and losing the existing job:

$$\mathcal{V}_t^J(\tilde{c}_t) = m c_t^{\tilde{Z}} (1 - \alpha) \frac{Y_t^{\tilde{Z}}}{n_t} - W_t^n h_t - p_t^H A_{t-1}^H \tilde{c}_t + E_t \Xi_{t,t+1}^R [(1 - \rho_{t+1}) \mathcal{V}_{t+1}^J + \rho_{t+1} \mathcal{V}_{t+1}^V]$$

Integrating over the density function of  $\tilde{c}_t$  over the relevant interval we obtain the average value of a filled job  $\mathcal{V}_t^J$

$$\begin{aligned}\mathcal{V}_t^J &= \int_0^{\bar{c}_t} \mathcal{V}_t^J(\tilde{c}_t) \frac{dF(\tilde{c}_t)}{F(\bar{c}_t)} = m c_t^{\tilde{Z}} (1 - \alpha) \frac{Y_t^{\tilde{Z}}}{n_t} - W_t^n h_t - p_t^H A_{t-1}^H \int_0^{\bar{c}_t} \tilde{c}_t \frac{dF(\tilde{c}_t)}{F(\bar{c}_t)} + E_t \Xi_{t,t+1}^R [(1 - \rho_{t+1}) \mathcal{V}_{t+1}^J + \rho_{t+1} \mathcal{V}_{t+1}^V] \\ \mathcal{V}_t^J &= \int_0^{\bar{c}_t} \mathcal{V}_t^J(\tilde{c}_t) \frac{dF(\tilde{c}_t)}{F(\bar{c}_t)} = m c_t^{\tilde{Z}} (1 - \alpha) \frac{Y_t^{\tilde{Z}}}{n_t} - W_t^n h_t - p_t^H H_t^C + E_t \Xi_{t,t+1}^R [(1 - \rho_{t+1}) \mathcal{V}_{t+1}^J + \rho_{t+1} \mathcal{V}_{t+1}^V] = \mathcal{V}_t^J(H_t^C)\end{aligned}$$

The value of a vacancy posting is given by the current vacancy posting cost, plus the discounted continuation value of a filled job next period with probability  $e_t(1 - \rho_{t+1})$  and an open vacancy next period:

$$\mathcal{V}_t^V = -p_t^H \Omega_t + E_t \Xi_{t,t+1}^R [e_t(1 - \rho_{t+1}) \mathcal{V}_{t+1}^J + (1 - e_t(1 - \rho_{t+1})) \mathcal{V}_{t+1}^V]$$

A free entry condition implies for firms that  $\mathcal{V}_t^V = 0$  for all  $t$ , and thus the value of a vacancy posting produces

$$\frac{p_t^H \Omega_t}{e_t} = E_t \Xi_{t,t+1}^R (1 - \rho_{t+1}) \mathcal{V}_{t+1}^J$$

And the value of a filled job becomes

$$\mathcal{V}_t^J = m c_t^{\tilde{Z}} (1 - \alpha) \frac{Y_t^{\tilde{Z}}}{n_t} - W_t^n h_t^n - p_t^H H_t^C + \frac{p_t^H \Omega_t}{e_t}$$

Hence, the firm's surplus is given by

$$\mathcal{S}_t^F = \mathcal{V}_t^J - \mathcal{V}_t^V = \mathcal{V}_t^J = mc_t^{\tilde{Z}} (1 - \alpha) \frac{Y_t^{\tilde{Z}}}{n_t} - W_t^n h_t - p_t^H H_t^C + \frac{p_t^H \Omega_t}{e_t}$$

The first order condition (43) implies that

$$\varphi^U \mathcal{S}_t^F \frac{\partial \mathcal{S}_t^U}{\partial W_t^n} = - (1 - \varphi^U) \mathcal{S}_t^U \frac{\partial \mathcal{S}_t^F}{\partial W_t^n} \implies \frac{\mathcal{S}_t^U}{(1 - \tau_t^L)} = \frac{\varphi^U}{1 - \varphi^U} \mathcal{S}_t^F$$

Replacing the union's surplus and the firm's surplus in the previous relation and rearranging terms, yields the notional wage

$$\begin{aligned} W_t^n h_t^n = \varphi^U & \left( mc_t^{\tilde{Z}} (1 - \alpha) \frac{Y_t^{\tilde{Z}}}{n_t} - p_t^H H_t^C + \frac{p_t^H \Omega_t}{e_t} \right) \\ & + \frac{(1 - \varphi^U)}{(1 - \tau_t^L)} \left( \Psi_t^U \kappa_t (A_{t-1}^H)^{1-\sigma} \frac{(h_t^n)^{1+\phi}}{1+\phi} + UB_t - (1 - s_t) \Sigma_t^U \right) \end{aligned} \quad (44)$$

As in Hall (2005), we introduce wage stickiness by assuming the nominal wage paid to the individual worker ( $P_t W_t$ ) is a weighted average between the notional nominal wage ( $P_t W_t^n$ ) and the indexed nominal wage norm ( $\Gamma_{t-1}^W P_{t-1} W_{t-1}$ ):

$$P_t W_t = \varkappa_W \Gamma_{t-1}^W P_{t-1} W_{t-1} + (1 - \varkappa_W) P_t W_t^n, \quad \varkappa_W \in (0, 1)$$

where  $\Gamma_t^W$  is a wage indexation variable that satisfies  $\Gamma_t^W = (a_t^H)^{\alpha_W} (a)^{1-\alpha_W} \left[ (\pi_t)^{\vartheta_\pi} (\pi_t^Z)^{1-\vartheta_\pi} \right]^{\vartheta_W} \pi^{1-\vartheta_W}$ . Parameters  $\alpha_W, \vartheta_W \in (0, 1)$  define the indexation process: the former determines the relative influence of steady state and current productivity growth, and the latter between steady state and current inflation, both headline ( $\pi_t$ ) and core ( $\pi_t^Z$ ).

### 2.3.6 Commodity sector investment and output

Production in the commodity sector follows the framework described in Fornero and Kirchner (2018). As in Medina and Soto (2007), there is a representative firm in the commodity sector that produces an homogeneous commodity good. The entire production is exported. A fraction  $\chi^{Co}$  of the the firm's assets are owned by the government. The rest is owned by foreign investors. The cash flows generated in the commodity sector are shared accordingly, but the government also levies taxes on the profits that accrue to foreign investors.

The commodity firm's production function uses capital specific to the commodity sector,  $K_t^{Co}$ , at intensity  $\bar{u}_t^{Co}$ , and a fixed production factor,  $\bar{L}$ . The latter, which is thought to represent the mineral content of land, is subject to

a long-run technology trend denoted by  $A_t^{Co}$ :

$$Y_t^{Co} = z_t^{Co} (\bar{u}_t^{Co} K_{t-1}^{Co})^{\alpha_{Co}} (A_t^{Co} \bar{L})^{1-\alpha_{Co}} \quad (45)$$

where  $z_t^{Co}$  is a stationary technology shock specific to commodity production.<sup>11</sup> Capital utilization is subject to maintenance costs. These are paid in terms of investment goods, in amount  $\phi_{\bar{u}}^{Co} (\bar{u}_t^{Co})$  per unit of installed capital, with

$$\phi_{\bar{u}}^{Co} (\bar{u}_t^{Co}) \equiv \frac{r^{K,Co}}{\Phi_{\bar{u}}^{Co}} \left( e^{\Phi_{\bar{u}}^{Co} (\bar{u}_t^{Co} - 1)} - 1 \right)$$

where  $\Phi_{\bar{u}}^{Co} = \phi_{\bar{u}}^{Co''} (1) / \phi_{\bar{u}}^{Co'} (1) > 0$  and  $r^{K,Co}$  denotes the steady state gross real return on mining capital services.

The commodity sector's capital stock accumulates according to the following law of motion:

$$K_t^{Co} = (1 - \delta_{Co}) K_{t-1}^{Co} + \left( 1 - \phi_I^{Co} \left( \frac{I_{t-N_{Co}+1}^{ACo}}{I_{t-N_{Co}}^{ACo}} \right) \right) I_{t-N_{Co}+1}^{ACo} \varpi_{t-N_{Co}+1}^{Co}$$

Where  $I_{t-N_{Co}+1}^{ACo}$  are sector's investment projects authorized in period  $t - N_{Co} + 1$ ,  $N_{Co}$  denotes the number of periods it takes until these projects become productive and augment the capital stock,  $\phi_I^{Co} (I_t^{ACo} / I_{t-1}^{ACo}) \equiv (\Phi_I^{Co} / 2) (I_t^{ACo} / I_{t-1}^{ACo} - a)^2$  are convex investment adjustment costs with elasticity  $\Phi_I^{Co} = \phi_I^{Co''} (a) \geq 0$ , and  $\varpi_t^{Co}$  captures changes in the efficiency of the investment projects. The sector's total effective investment (not including maintenance costs) is distributed between new and old authorized projects according to

$$I_t^{Co} = \sum_{j=0}^{N_{Co}-1} \varphi_j^{Co} I_{t-j}^{ACo}, \quad (46)$$

Where  $\varphi_j^{Co}$  – the fraction of projects authorized in period  $t - j$  that is outlaid in period  $t$  – satisfy  $\sum_{j=0}^{N_{Co}-1} \varphi_j^{Co} = 1$  and  $\varphi_j^{Co} = \rho^{\varphi_{Co}} \varphi_{j-1}^{Co}$ .

Total spending in investment goods, including maintenance costs, is given by

$$I_t^{Co,f} \equiv I_t^{Co} + \phi_{\bar{u}}^{Co} (\bar{u}_t^{Co}) K_{t-1}^{Co}$$

Gross profits and before-tax cash flows of the firm, in units of final consumption goods, are respectively given by:

$$\Pi_t^{Co} = \text{re}r_t p_t^{Co*} Y_t^{Co}$$

$$CF_t^{Co} = \Pi_t^{Co} - p_t^{Co} I_t^{Co,f} \quad (47)$$

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<sup>11</sup> Given the small labor share in the Chilean mining sector, our specification considers a capital-driven commodity production and neglects labor inputs.

Where  $p_t^{Co*}$  is the international price of the commodity in terms of the foreign consumption good. The firm maximizes its cash flow subject to the tax  $\tau_t^{Co}$  on a fraction  $1 - \chi^{Co}$  of its gross profits, and by assumption discounts real cash flows at the same rate as the households  $\Xi_{t,t+s}^R$ .<sup>12</sup> The commodity producer's problem is then given by

$$\mathcal{L}_t^{Co} = E_t \sum_{s=0}^{\infty} \Xi_{t,t+s}^R \left\{ \begin{aligned} & [1 - \tau_t^{Co} (1 - \chi^{Co})] rert_{t+s} p_{t+s}^{Co*} Y_{t+s}^{Co} - p_{t+s}^{ICo} (I_{t+s}^{Co} + \phi_u^{Co} (\bar{u}_{t+s}^{Co}) K_{t+s-1}^{Co}) \\ & + \lambda_{t+s}^{Co} \left[ z_{t+s}^{Co} (\bar{u}_{t+s}^{Co} K_{t+s-1}^{Co})^{\alpha_{Co}} (A_{t+s}^{Co} \bar{L})^{1-\alpha_{Co}} - Y_{t+s}^{Co} \right] \\ & + q_{t+s}^{Co} [(1 - \delta_{Co}) K_{t+s-1}^{Co} + (1 - \phi_I^{Co} (I_{t+s-N_{Co}+1}^{ACo} / I_{t+s-N_{Co}}^{ACo})) I_{t+s-N_{Co}+1}^{ACo} \varpi_{t+s-N_{Co}+1}^{Co} - K_{t+s}^{Co}] \end{aligned} \right\}$$

Where  $\lambda_t^{Co}$  and  $q_t^{Co}$  denote the Lagrange multipliers associated with the technology constraint and the capital's law of motion.

The corresponding first order optimality conditions are

$$\begin{aligned} Y_t^{Co} : \quad & \lambda_t^{Co} = [1 - \tau_t^{Co} (1 - \chi^{Co})] rert_t p_t^{Co*} \\ K_t^{Co} : \quad & q_t^{Co} = E_t \left\{ \Xi_{t,t+1}^R \left[ \lambda_{t+1}^{Co} \alpha_{Co} \frac{Y_{t+1}^{Co}}{K_t^{Co}} + q_{t+1}^{Co} (1 - \delta_{Co}) - p_{t+1}^{ICo} \phi_u^{Co} (\bar{u}_{t+1}^{Co}) \right] \right\} \\ I_t^{ACo} : \quad & 0 = E_t \left\{ \frac{\sum_{j=0}^{N_{Co}-1} \Xi_{t,t+j}^R \varphi_j^{Co} p_{t+j}^{ICo}}{\Xi_{t,t+N_{Co}-1}^R q_{t+N_{Co}-1}^{Co}} \right\} \\ & - \left[ \left( 1 - \phi_I^{Co} \left( \frac{I_t^{ACo}}{I_{t-1}^{ACo}} \right) \right) - \Phi_I^{Co} \left( \frac{I_t^{ACo}}{I_{t-1}^{ACo}} - a \right) \frac{I_t^{ACo}}{I_{t-1}^{ACo}} \right] \varpi_t^{Co} \\ & - E_t \left\{ \frac{\Xi_{t,t+N_{Co}}^R}{\Xi_{t,t+N_{Co}-1}^R} \frac{q_{t+N_{Co}}^{Co}}{q_{t+N_{Co}-1}^{Co}} \Phi_I^{Co} \left( \frac{I_{t+1}^{ACo}}{I_t^{ACo}} - a \right) \left( \frac{I_{t+1}^{ACo}}{I_t^{ACo}} \right)^2 \varpi_{t+1}^{Co} \right\} \\ \bar{u}_t^{Co} : \quad & r_t^{K,Co} = p_t^{ICo} \phi_u^{Co'} (\bar{u}_t^{Co}) \end{aligned}$$

Where  $r_t^{K,Co}$  denotes the marginal return on utilized capital:

$$r_t^{K,Co} \equiv [1 - \tau_t^{Co} (1 - \chi^{Co})] rert_t p_t^{Co*} \alpha_{Co} \frac{Y_t^{Co}}{\bar{u}_t^{Co} K_{t-1}^{Co}}.$$

The optimal utilization rate is therefore given by

$$\bar{u}_t^{Co} = 1 + \frac{\log \left( \frac{r_t^{K,Co}}{r_t^{K,Co}} \right) - \log (p_t^{ICo})}{\Phi_{\bar{u}}^{Co}}.$$

<sup>12</sup>The stochastic discount factor for domestic currency payoffs of foreign investors is identical to the one of the Ricardian households if foreign investors have unrestricted access to domestic currency bonds.

## 2.4 Fiscal Policy

The government spends a stream of resources  $G_t$ , levies lump-sum and distortionary taxes, issues one-period bonds and receives a share of the income generated in the commodity sector. Aggregate spending is allocated to consumption of final goods ( $C_t^G$ ), investment in public goods ( $I_t^G$ ), transfers to households ( $TR_t^G$ ), and to finance a policy of domestic oil price stabilization ( $G_t^O$ ).

$$G_t = p_t^{CG} C_t^G + p_t^{IG} I_t^G + TR_t^G + G_t^O$$

### 2.4.1 Taxes

Part of the government spending is financed with time varying distortionary taxes, where  $\tau_t^C$ ,  $\tau_t^W$ ,  $\tau_t^K$ ,  $\tau_t^D$  and  $\tau_t^{Co}$  denote respectively the tax rates on consumption, labor income, capital income, dividend income and private commodity profits. Additionally, we assume lump-sum taxes to be a constant share of nominal GDP:<sup>13</sup>  $T_t = \alpha^T p_t^Y Y_t$ . Total tax revenue is then  $\Pi_t^T \equiv \tau_t A_{t-1} = \tau_t^C C_t + \tau_t^W W_t n_t h_t + \tau_t^K [r_t^K \bar{u}_t - p_t^I (\delta + \phi_{\bar{u}}(\bar{u}_t))] K_{t-1} + \tau_t^D D_t + \tau_t^{Co} (1 - \chi^{Co}) \Pi_t^{Co} + T_t$ . Lump-sum taxes are levied from non-Ricardian and Ricardian households with shares given respectively by  $\omega^G$  and  $1 - \omega^G$ . The taxes that each type of household has to pay to government therefore satisfy  $\omega T_t^{NR} = \omega^G T_t$  and  $(1 - \omega) T_t^R = (1 - \omega^G) T_t$ .

### 2.4.2 Government debt

In addition to issuing domestic currency denominated bonds, the government finances a share  $\alpha^D$  of its debt in foreign currency. The government asset position is determined by the budget constraint and the rule for the government asset's currency diversification:

$$B_t^G + rer_t B_t^{G*} = r_t^* rer_t B_{t-1}^{G*} + r_t B_{t-1}^G + \Pi_t^T + \chi^{Co} C F_t^{Co} - G_t \quad (48)$$

$$rer_t B_t^{G*} = \alpha^D (rer_t B_t^{G*} + B_t^G) \quad (49)$$

Where  $B_t^G$  and  $B_t^{G*}$  are the government's net asset position in domestic and foreign currency.

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<sup>13</sup>When government spending doesn't follow a structural balance rule (i.e  $I_{rule} = 0$ , see below), lump sum taxes are defined as  $\frac{T_t}{p_t^Y Y_t} = \alpha^T + \varepsilon^T \left( \frac{A_{t-1} (rer_t B_{t-1}^{G*} + B_{t-1}^G) - rer_t B_{t-1}^{G*} - B_{t-1}^G}{p_t^Y Y_t} \right)$ , where  $\varepsilon^T$  is a small constant that prevents indeterminacy of the steady state government debt level.

### 2.4.3 Spending Rule

The desired amount of government spending  $(\tilde{G}_t)$  follows either a structural balance rule  $(\tilde{G}_t^{rule})$  or an exogenous random path  $(\tilde{G}_t^{exo})$  :

$$\tilde{G}_t = \left(\tilde{G}_t^{rule}\right)^{I_{rule}} \left(\tilde{G}_t^{exo}\right)^{1-I_{rule}}$$

Where  $I_{rule}$  is an indicator function with value 1 if the government follows a rule and 0 otherwise.

The exogenous process for the desired level of government spending  $\tilde{G}_t^{exo}$  evolves with a law of motion given by

$$\tilde{G}_t^{exo} = \bar{G}_t \xi_t^G \quad (50)$$

Where  $\xi_t^G$  is an exogenous process with unconditional mean equal to one that captures deviations of desired government expenditure from the long term balanced growth path spending  $\bar{G}_t \equiv A_{t-1}g$ .

On the other hand,  $\tilde{G}_t^{rule}$  is determined through a structural balance fiscal rule, which is a simplified version of the rule described in Marcel et al. (2001) and Marcel et al. (2003), and similar to Medina and Soto (2007) and Kumhof and Laxton (2010). Let  $\tilde{B}_t^G + rer_t \tilde{B}_t^{G*}$  be the government asset position associated to the desired spending:

$$\tilde{B}_t^G + rer_t \tilde{B}_t^{G*} = r_t^* rer_t B_{t-1}^{G*} + r_t B_{t-1}^G + \Pi_t + \chi^{Co} C F_t^{Co} - \tilde{G}_t^{rule} \quad (51)$$

According to the rule, the deviation of the desired government surplus as a ratio of GDP from a structural balance target  $(\bar{s}_B)$ , depends on the deviation of tax revenue from potential and the deviation of government income from the commodity sector from a long-run reference value:

$$\frac{\tilde{B}_t^G + rer_t \tilde{B}_t^{G*} - B_{t-1}^G \pi_t^{-1} - rer_t B_{t-1}^{G*} (\pi_t^*)^{-1}}{p_t^Y Y_t} - \bar{s}_B = \frac{\gamma^D \left[ (\Pi_t^r - \tilde{\Pi}_t^r) + \chi^{Co} (C F_t^{Co} - \widetilde{C F}_t^{Co}) \right]}{p_t^Y Y_t} \quad (52)$$

Where  $\tilde{\Pi}_t^r$  denotes tax revenue at potential, i.e. current tax rates multiplied by the tax base in steady state:  $\tilde{\Pi}_t^r = \tilde{\tau}_t A_{t-1} = [\tau_t^C c + \tau_t^W w n h + \tau_t^K (r^K \bar{u} - p^I (\delta + \phi_{\bar{u}}(\bar{u})) k/a + \tau_t^D d + (1 - \chi^{Co}) \tau_t^{Co} (c f^{Co} + p^{ICo} i^{Co,f}) + t] A_{t-1}$ . Further,  $\widetilde{C F}_t^{Co} = rer_t \tilde{p}_t^{Co*} Y_t^{Co} - p_t^{ICo} I_t^{Co,f}$  denotes the commodity sector cash flows that would prevail with the long-run reference price  $\tilde{p}_t^{Co*} = E \left[ \prod_{j=1}^{40} p_{t+j}^{Co*} \right]^{\frac{1}{40}}$ , which is calculated as the forecast of the effective commodity price averaged over a 10 years horizon. The parameter  $\gamma^D$  governs the elasticity of the desired surplus to the cyclical part of government income. If  $\gamma^D < 1$ , the government spending (inclusive of interest payments) follows a procyclical pattern of higher spending in economic booms. A parameter equal to one is representative of a spending path that remains unaffected by cyclical fluctuations, while  $\gamma^D > 1$  corresponds to a government that actively tries to offset the economic fluctuations.<sup>14</sup>

<sup>14</sup>The exogenous stochastic process from (50) is equivalent to an acyclical path for the government spending *excluding interest payments*

Substituting out  $\tilde{B}_t^G + rer_t \tilde{B}_t^{G*}$  in (52) using (51) yields the rule for the desired government spending that follows a structural balance rule.

$$\frac{\tilde{G}_t^{rule}}{p_t^Y Y_t} = \frac{(R_{t-1} - 1)}{\pi_t} \frac{B_{t-1}^G}{p_t^Y Y_t} + \frac{(R_{t-1}^* \xi_{t-1} - 1)}{\pi_t^*} \frac{rer_t B_{t-1}^{G*}}{p_t^Y Y_t} + \frac{\Pi_t^\tau - \gamma^D \check{\Pi}_t^\tau}{p_t^Y Y_t} + \chi^{Co} \frac{CF_t^{Co} - \gamma^D \check{CF}_t^{Co}}{p_t^Y Y_t} - \bar{s}_B \quad (53)$$

Where  $\check{\Pi}_t^\tau = \Pi_t^\tau - \tilde{\Pi}_t^\tau$  and  $\check{CF}_t^{Co} = CF_t^{Co} - \tilde{CF}_t^{Co}$  are respectively the cyclical fluctuation of the tax base and the commodity sector's cash flows.

#### 2.4.4 Spending components

The individual expenditure components are assumed to be time-varying fractions of total desired expenditure, where  $\alpha_{CG}$ ,  $\alpha_{IG}$ , and  $1 - \alpha_{CG} - \alpha_{IG}$  denote respectively the long term shares for consumption, investment and transfers<sup>15</sup>. The terms  $\xi_t^{CG}$ ,  $\xi_t^{IG}$  and  $\xi_t^{TR}$  are shocks meant to capture deviations from such shares. Additionally, to avoid excessive volatility due to relative price variation, when modeling the budgetary planning for individual spending components we consider a price index constructed as a weighted average of current and steady state prices:  $\tilde{p}_t^J = (1 - \alpha_G) p_t^J + \alpha_G p^J$ , with  $J \in \{C^G, I^G\}$ .

Consumption and transfers are given by

$$\begin{aligned} \tilde{p}_t^{CG} C_t^G &= \alpha_{CG} \tilde{G}_t \xi_t^{CG} \\ TR_t^G &= (1 - \alpha_{CG} - \alpha_{IG} - \alpha_{UFA}) \tilde{G}_t \xi_t^{TR} + TR_t^{UFA} \end{aligned}$$

$TR_t^{UFA}$  are transfers from the government to the unemployment funds administrator (see below). In the long run, these transfers amount to a share  $\alpha_{UFA}$  of the total spending. The remainder transfers are received by non-Ricardian and Ricardian households with shares given by  $\omega^G$  and  $1 - \omega^G$ . The transfers that each type of household receive from the government therefore satisfy  $\omega TR_t^{NR} = \omega^G (TR_t^G - TR_t^{UFA})$  and  $(1 - \omega) TR_t^R = (1 - \omega^G) (TR_t^G - TR_t^{UFA})$ .

Regarding the government investment, we follow Kydland and Prescott (1982) and Leeper et al. (2010), where the stock of public capital accumulates according to the following law of motion:

$$K_t^G = (1 - \delta_G) K_{t-1}^G + I_{t-N^G+1}^{AG}, \quad \delta_G \in (0, 1], \quad (54)$$

Where  $I_{t-N^G+1}^{AG}$  are government investment projects authorized in period  $t - N^G + 1$ , and  $N^G$  denotes the number of periods it takes until these projects become productive and augment the public capital stock. The production of government investment goods is done by a representative firm as described in section (2.3.1), and bought by the

<sup>15</sup>Oil price stabilization policy is neutral to the the long term budget ( $G^O = 0$ ).

government at price  $p_t^{IG}$ . The investment goods acquired by the government are then distributed between new and old authorized projects according to

$$I_t^G = \sum_{j=0}^{N^G-1} \varphi_j I_{t-j}^{AG}, \quad (55)$$

Where  $\varphi_j$  – the fraction of projects authorized in period  $t-j$  that is outlaid in period  $t$ – satisfy  $\sum_{j=0}^{N^G-1} \varphi_j = 1$  and  $\varphi_j = \rho^\varphi \varphi_{j-1}$ .

The budget for government spending in public goods is set in terms of authorizations of new projects, taking the expenditure on previously authorized projects as given:

$$E_t \left[ \sum_{j=0}^{N^G-1} \varphi_j \tilde{p}_{t+j}^{IG} \right] I_t^{AG} = \alpha_{IG} E_t \left[ \sum_{j=0}^{N^G-1} \varphi_j \tilde{G}_{t+j} \right] \xi_t^{IG} \quad (56)$$

The price stabilization program, modeled as a simplified version of the MEPCO program<sup>16</sup>, forces firms and consumers to buy oil through the government. The engagement in the program then imposes a quarterly net government spending of

$$G_t^O = O_t (rer_t p_t^{O*} - p_t^O)$$

where  $O_t$  are total oil imports, and  $p_t^O = P_t^O / P_t$  and  $p_t^{O*} = P_t^{O*} / P_t^*$  are domestic and foreign real oil prices. The domestic price is set according to the following rule

$$p_t^O = \left( (p^O)^{1-\alpha_O} (p_{t-1}^O)^{\alpha_O} \right)^{\rho_O} \left( rer_t p_t^{O*} \right)^{1-\rho_O} \xi_t^O$$

Where  $\alpha_O$  and  $\rho_O$  are smoothing parameters, and  $\xi_t^O$  is an exogenous process with unconditional mean equal to one that captures deviations of the domestic oil price from the rule.

## 2.5 Monetary Policy

Monetary policy is carried out according to a Taylor rule of the form

$$R_t = (R_{t-1})^{\rho_R} \left[ \bar{R}_t \left( \frac{\tilde{\pi}_t}{\bar{\pi}_t} \right)^{\alpha_\pi} \left( \frac{Y_t^D / Y_{t-1}^D}{a_{t-1}} \right)^{\alpha_y} \right]^{1-\rho_R} e_t^R, \quad \rho_R \in (0, 1), \quad \alpha_\pi > 1, \quad \alpha_y \geq 0, \quad \bar{\pi} \geq 1,$$

Where  $Y_t^D \equiv Y_t - X_t^L - \phi_{\bar{u}}(\bar{u}_t) K_{t-1} - \phi_{\bar{u}}^{Co}(\bar{u}_t^{Co}) K_{t-1}^{Co}$  is GDP as measured by demand, which does not include operation, vacancy, and capital utilization costs,<sup>17</sup>  $e_t^R$  is an AR(1) exogenous process that captures deviations from

<sup>16</sup>The MEPCO program is a Chilean fiscal fund that acts as a buffer against the short term volatility of the foreign oil price.

<sup>17</sup>This is done as in as in Christiano et al. (2011, 2016), as typical GDP series analyzed by central banks are constructed by expenditure, which do not include this kind of costs.



the rule, and  $\tilde{\pi}_t$  is the inflation rate monitored by the central bank, an average between the present and expected total and core inflation rates:

$$\tilde{\pi}_t = \left[ (\pi_t^Z)^{\alpha_{\pi Z}} (\pi_t)^{1-\alpha_{\pi Z}} \right]^{1-\alpha_{\pi E}} \left[ (E_t \pi_{t+4}^Z)^{\alpha_{\pi Z}} (E_t \pi_{t+4})^{1-\alpha_{\pi Z}} \right]^{\alpha_{\pi E}}$$

Where  $\pi_t^Z = \frac{P_t^Z}{P_{t-1}^Z} \left( \frac{1+\tau_t^C}{1+\tau_{t-1}^C} \right)$  is the after tax core inflation rate.

Following Del Negro et al. (2015), the inflation targeted by the bank and the corresponding target nominal interest rate ( $\bar{\pi}_t$  and  $\bar{R}_t$ ) can potentially depart in the short run from their steady state values:

$$\log(\bar{\pi}_t/\bar{\pi}) = \rho_{\bar{\pi}} \log(\bar{\pi}_{t-1}/\bar{\pi}) + \varepsilon_t^{\bar{\pi}}$$

$$\log(\bar{R}_t/\bar{R}) = \rho_{\bar{R}} \log(\bar{R}_{t-1}/\bar{R}) + \varepsilon_t^{\bar{R}}$$

Where  $\varepsilon_t^{\bar{\pi}}$  is a normally distributed i.i.d shock with zero mean and standard deviation equal to  $\sigma_{\bar{\pi}}$  that affect the central bank's targets for the inflation level and the nominal interest rate.

## 2.6 Unemployment Funds Administrator

The unemployment funds administrator manages a domestic currency denominated fund. The UFA collects resources from employed households and pays to households currently unemployed. Besides, a lump sum transfer of  $TR_t^{UFA}$  is received each period from the government<sup>18</sup>. The UFA budget constraint is then given by

$$B_t^{UFA} - B_{t-1}^{UFA} = \tau_t^{UFA} W_t h_t n_t - (1 - n_t) U B_t + (r_t - 1) B_{t-1}^{UFA} + TR_t^{UFA}$$

## 2.7 The Rest of the World

Foreign agents demand home composite goods and buy the domestic commodity production. There are no transaction costs or other barriers to trade. The structure of the foreign economy is identical to the domestic economy, but the domestic economy is assumed to be small relative to the foreign economy. We also have the relation

$$\frac{rer_t}{rer_{t-1}} = \frac{\pi_t^S \pi_t^*}{\pi_t},$$

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<sup>18</sup>Lump sum transfers are given by  $TR_t^{UFA} = A_{t-1} \bar{tr}^{UFA} + \varepsilon^{UFA} (A_{t-1} b^{UFA} - B_t^{UFA})$ , where  $\varepsilon^{UFA}$  is a small constant that prevents indeterminacy of the steady state UFA net asset position, and  $\bar{tr}^{UFA}$  is a constant transfer from the government, calibrated to attain a long run balanced operational budget:  $\bar{tr}^{UFA} = (1 - n) ub - \tau^{UFA} whn$ .

Where  $\pi_t^S = S_t/S_{t-1}$ . Further, foreign demand for the exportable composite good  $X_t^{H*}$  is given by the reduced form schedule

$$X_t^{H*} = [a_{t-1}X_{t-1}^{H*}]^{\rho_{XH*}} \left[ o^* \left( \frac{P_t^{H*}}{P_t^*} \right)^{-\eta^*} Y_t^* \right]^{1-\rho_{XH*}} \xi_t^{XH*}, \quad o^* \in (0, 1), \quad \eta^* > 0,$$

Where  $\rho_{XH*}$  reflects some habit persistence in the foreign demand for domestic goods,  $\xi_t^{XH*}$  is an i.i.d. shock with mean one, and  $Y_t^*$  denotes foreign aggregate demand or GDP and is given by:

$$Y_t^* = A_t z_t^* \tag{57}$$

Where  $z_t^*$  follows an AR(1) process. Similar to Schmitt-Grohé and Uribe (2012),  $A_t^J$  for  $J \in \{H, Co\}$  (with  $a_t^J \equiv A_t^J/A_{t-1}^J$ ) cointegrate with the global productivity  $A_t$  according to:

$$A_t^J = (aA_{t-1}^J)^{1-\Gamma^J} (A_t)^{\Gamma^J},$$

Where the parameters  $\Gamma^J \in [0, 1]$  govern the speed of convergence towards the global productivity level. Defining  $\nabla_t^J \equiv A_t^J/A_t$  as the wedges with respect to the global productivity levels, we obtain the following relation:

$$\begin{aligned} \nabla_t^J &= \left( \frac{a}{a_t} \nabla_{t-1}^J \right)^{1-\Gamma^J}. \\ \frac{A_t^J}{A_{t-1}^J} &\equiv a_t^J = \frac{\nabla_t^J}{\nabla_{t-1}^J} a_t \end{aligned}$$

This setup nests the common specification with  $A_t^H = A_t^{Co} = A_t$  when  $\Gamma^H = \Gamma^{Co} = 1$ .

Furthermore, as in García-Schmidt and García-Cicco (2017), the international price levels for exported commodities, oil, the home import basket, and the foreign CPI are allowed to co-integrate with a common trend  $F_t^*$  according to

$$P_t^J = (\pi^* P_{t-1}^J)^{1-\Gamma^J} (F_t^*)^{\Gamma^J} \xi_t^J,$$

for  $J \in \{Co*, M*, O*, *\}$ , where  $P_t^J$  (with  $\pi_t^J \equiv P_t^J/P_{t-1}^J$ ) are the respective non-stationary price levels, the parameters  $\Gamma^J \in (0, 1]$  govern the speed of convergence towards the common trend, and the  $\xi_t^J$  are exogenous processes. The growth rate of the common trend  $\pi_t^{F*} \equiv F_t^*/F_{t-1}^*$  also evolves exogenously. Defining  $f_t^* \equiv F_t^*/P_t^*$  and the relative prices with respect to the foreign CPI  $p_t^J \equiv P_t^J/P_t^*$  (such that  $p_t^* = 1$ ), we can re-write the above equations in terms of stationary variables:

$$p_t^J = \left( \frac{\pi^*}{\pi_t^*} p_{t-1}^J \right)^{1-\Gamma^J} (f_t^*)^{\Gamma^J} \xi_t^J,$$

with  $\pi_t^{F*} = (f_t^*/f_{t-1}^*) \pi_t^*$ . This setup nests the common specification where  $F_t^* = P_t^*$  and where  $p_t^{Co*}, p_t^{M*}, p_t^{O*}$  and  $\pi_t^*$  evolve as independent exogenous processes when  $\Gamma^{Co*} = \Gamma^{M*} = \Gamma^{O*} = \Gamma^* = \xi^* = 1$  and  $var(\xi_t^*) = 0$ .

## 2.8 Aggregation and Market Clearing

### 2.8.1 Aggregation across households

Aggregate variables add up the per-capita amounts from non-Ricardian and Ricardian households considering their respective demographic mass  $\omega$  and  $1 - \omega$ :

$$C_t = \omega C_t^{NR} + (1 - \omega) C_t^R \quad (58)$$

$$TR_t^G - TR_t^{UFA} = \omega TR_t^{NR} + (1 - \omega) TR_t^R \quad (59)$$

$$T_t = \omega T_t^{NR} + (1 - \omega) T_t^R \quad (60)$$

$$K_t = (1 - \omega) K_t^R \quad (61)$$

$$K_t^S = (1 - \omega) K_t^{S,R} \quad (62)$$

$$I_t = (1 - \omega) I_t^R \quad (63)$$

$$B_t^{Pr} = (1 - \omega) B_t^R \quad (64)$$

$$B_t^{Pr*} = (1 - \omega) B_t^{R*} \quad (65)$$

$$D_t = (1 - \omega) D_t^R \quad (66)$$

### 2.8.2 Goods market clearing

Defining labor costs in terms of home goods  $X_t^L \equiv H_t^C n_t + \Omega_t v_t$ , the market clearing conditions for the different composite goods varieties are

$$Y_t^H = X_t^H = X_t^{Z,H} + X_t^{A,H} + X_t^{CG,H} + X_t^{I,H} + X_t^{ICo,H} + X_t^{IG,H} + X_t^L \quad (67)$$

$$Y_t^F = X_t^F = X_t^{Z,F} + X_t^{A,F} + X_t^{CG,F} + X_t^{I,F} + X_t^{ICo,F} + X_t^{IG,F} \quad (68)$$

$$Y_t^{H*} = X_t^{H*} \quad (69)$$

And for the corresponding varieties:

$$Y_t^H(j) = X_t^H(j), \quad Y_t^F(j) = X_t^F(j), \quad Y_t^{H*}(j) = X_t^{H*}(j).$$

The market clearing condition for oil is

$$O_t = C_t^O + X_t^O. \quad (70)$$

Aggregate output of home wholesale goods is then given by

$$\begin{aligned} Y_t^{\tilde{H}} &= X_t^{\tilde{H}} + X_t^{\tilde{H}*} = \int_0^1 Y_t^H(j) dj + \int_0^1 Y_t^{H*}(j) dj = \int_0^1 X_t^H(j) dj + \int_0^1 X_t^{H*}(j) dj \\ &= Y_t^H \int_0^1 \left( \frac{P_t^H(j)}{P_t^H} \right)^{-\epsilon_H} dj + Y_t^{H*} \int_0^1 \left( \frac{P_t^{H*}(j)}{P_t^{H*}} \right)^{-\epsilon_{H*}} dj = Y_t^H \Delta_t^H + Y_t^{H*} \Delta_t^{H*}, \end{aligned}$$

while for imported goods we have

$$M_t^* = \int_0^1 Y_t^F(j) dj = \int_0^1 X_t^F(j) dj = Y_t^F \int_0^1 \left( \frac{P_t^F(j)}{P_t^F} \right)^{-\epsilon_F} dj = Y_t^F \Delta_t^F,$$

where  $\Delta_t^H$ ,  $\Delta_t^{H*}$  and  $\Delta_t^F$  are price dispersion terms satisfying

$$\begin{aligned} \Delta_t^H &= \int_0^1 \left( \frac{P_t^H(j)}{P_t^H} \right)^{-\epsilon_H} dj = (1 - \theta_H) (\tilde{p}_t^H)^{-\epsilon_H} + \theta_H \left( \frac{p_{t-1}^H}{p_t^H} \frac{g_{t-1}^{\Gamma_H}}{\pi_t} \frac{(1 + \tau_t^C)}{(1 + \tau_{t-1}^C)} \right)^{-\epsilon_H} \Delta_{t-1}^H, \\ \Delta_t^{H*} &= \int_0^1 \left( \frac{P_t^{H*}(j)}{P_t^{H*}} \right)^{-\epsilon_{H*}} dj = (1 - \theta_{H*}) (\tilde{p}_t^{H*})^{-\epsilon_{H*}} + \theta_{H*} \left( \frac{p_{t-1}^{H*}}{p_t^{H*}} \frac{g_{t-1}^{\Gamma_{H*}}}{\pi_t^*} \right)^{-\epsilon_{H*}} \Delta_{t-1}^{H*}, \\ \Delta_t^F &= \int_0^1 \left( \frac{P_t^F(j)}{P_t^F} \right)^{-\epsilon_F} dj = (1 - \theta_F) (\tilde{p}_t^F)^{-\epsilon_F} + \theta_F \left( \frac{p_{t-1}^F}{p_t^F} \frac{g_{t-1}^{\Gamma_F}}{\pi_t} \frac{(1 + \tau_t^C)}{(1 + \tau_{t-1}^C)} \right)^{-\epsilon_F} \Delta_{t-1}^F. \end{aligned}$$

### 2.8.3 Aggregate demand

Aggregate demand or GDP is defined as the sum of domestic absorption ( $Y_t^C$ ) and the trade balance ( $TB_t$ ). In units of the final consumption good, those components are given by

$$Y_t^C = C_t + p_t^{CG} C_t^G + p_t^I I_t^f + p_t^{ICo} I_t^{Co,f} + p_t^{IG} I_t^G + p_t^H X_t^L, \quad (71)$$

$$TB_t = rer_t \left( p_t^{H*} Y_t^{H*} + p_t^{Co*} Y_t^{Co} - p_t^{M*} M_t^* - p_t^{O*} O_t \right). \quad (72)$$

We define real GDP as follows:

$$Y_t \equiv C_t + C_t^G + I_t^f + I_t^{Co,f} + I_t^G + X_t^L + Y_t^{H*} + Y_t^{Co} - M_t^* - O_t.$$

Then, the GDP deflator ( $p_t^Y$ , expressed as a relative price in terms of the final consumption good) is implicitly defined as

$$p_t^Y Y_t = Y_t^C + TB_t. \quad (73)$$

#### 2.8.4 Aggregate profits

Aggregate profits of the household owned firms ( $\Pi_t^{HHOF}$ ), in units of final goods, are given by

$$\begin{aligned} \Pi_t^{HHOF} &= \underbrace{Y_t^C - p_t^H X_t^H - p_t^F X_t^F - p_t^O C_t^O}_{\Pi_t^C + \Pi_t^Z + \Pi_t^A + \Pi_t^{CG} + \Pi_t^I + \Pi_t^{IG} + \Pi_t^{Co}} \\ &\quad + \underbrace{p_t^H Y_t^H - \int_0^1 X_t^H(j) [p_t^H p_t^H(j)] dj}_{\Pi_t^H} + \underbrace{\int_0^1 Y_t^H(j) [p_t^H p_t^H(j) - p_t^{\tilde{H}}] dj}_{\int_0^1 \Pi_t^H(j) dj} \\ &\quad + \underbrace{p_t^F Y_t^F - \int_0^1 X_t^F(j) [p_t^F p_t^F(j)] dj}_{\Pi_t^F} + \underbrace{\int_0^1 Y_t^F(j) [p_t^F p_t^F(j) - rer_t p_t^{M*}] dj}_{\int_0^1 \Pi_t^F(j) dj} \\ &\quad + \underbrace{rer_t p_t^{H*} Y_t^{H*} - \int_0^1 rer_t X_t^{H*}(j) [p_t^{H*} p_t^{H*}(j)] dj}_{\Pi_t^{H*}} + \underbrace{\int_0^1 Y_t^{H*}(j) [rer_t p_t^{H*} p_t^{H*}(j) - p_t^{\tilde{H}}] dj}_{\int_0^1 \Pi_t^{H*}(j) dj} \\ &\quad + \underbrace{p_t^{\tilde{H}} Y_t^{\tilde{H}} - r_t^K K_t^S - W_t h_t n_t - p_t^H X_t^L - p_t^O X_t^O}_{\Pi_t^{\tilde{H}}} \\ &= Y_t^C + rer_t p_t^{H*} Y_t^{H*} - rer_t p_t^{M*} M_t^* - p_t^O O_t - r_t^K K_t^S - W_t h_t n_t - p_t^H X_t^L \\ &= p_t^Y Y_t - rer_t p_t^{Co*} Y_t^{Co} + (rer_t p_t^{O*} - p_t^O) O_t - r_t^K K_t^S - W_t h_t n_t - p_t^H X_t^L \end{aligned} \quad (74)$$

At the end of each period, all profits are returned to the Ricardian households in the form of dividends:

$$D_t = \Pi_t^{HHOF}.$$

#### 2.8.5 Domestic bonds

Participating agents in the domestic bond market are the Ricardian households, the government, and the UFA.

Their aggregate net holdings are in zero net supply:

$$B_t^{Pr} + B_t^G + B_t^{UFA} = 0$$

### 2.8.6 Foreign asset position

Summing over the Ricardian and non-Ricardian households budgets from (5) and (14) by using the aggregation conditions (58)-(66) yields the aggregate household budget:

$$\begin{aligned}
(1 + \tau_t^C)C_t + p_t^I I_t^f + B_t^{Pr} + rer_t B_t^{Pr*} + T_t = & rer_t (1 - \omega) REN_t^{R*} + (1 - \tau_t^W)W_t h_t n_t + (1 - n_t)UB_t \\
& + K_{t-1} [r_t^K \bar{u}_t (1 - \tau_t^K) + \tau_t^K p_t^I (\delta + \phi_{\bar{u}}(\bar{u}_t))] \\
& + (1 - \tau_t^D)D_t + (TR_t^G - TR_t^{UFA}) + r_t B_{t-1}^{Pr} + r_t^* rer_t B_{t-1}^{Pr*}
\end{aligned} \tag{75}$$

Combined with the commodity profits, the government asset position, the UFA budget, and the private firms profits given by (47), (48) and (74), the current account, or the change in the net foreign asset position, can be expressed as the sum of the net asset transfers from the rest of the world due to interest on debt, trade of goods, and rents:

$$rer_t \left( B_t^* - \frac{B_{t-1}^*}{\pi_t^*} \right) = rer_t \frac{B_{t-1}^*}{\pi_t^*} (R_{t-1}^* \xi_{t-1} - 1) + TB_t + rer_t REN_t^*$$

Where  $REN_t^* = (1 - \omega) REN_t^{R*} - (1 - \chi^{Co}) \frac{CF_t^{Co} - \tau_t^{Co}(\Pi_t^{Co})}{rer_t}$  are the aggregate net rents denominated in foreign currency.

## 3 Parameterization strategy and estimation results

Most of the model parameters are calibrated and estimated. Some other parameters are endogenously determined in order to match some exogenous steady state moment. The calibrated parameters include those characterizing exogenous processes for which we have a data counterpart, those that are drawn from related studies for Chile or other countries, and those that are chosen to match sample averages or long-run ratios for the Chilean economy. The estimated parameters are obtained by means of Bayesian techniques as discussed below. We now describe the details of data sources and values of the calibrated and estimated parameters.

### 3.1 Calibrated parameters

Table 1 presents the values of those parameters that are either chosen to match observed statistics and available evidence for Chile, or following related studies for other countries. The parameters  $\sigma$ ,  $\omega$ ,  $\delta$ ,  $\alpha$ ,  $o_{CG}$ ,  $o_O$ ,  $\epsilon_H$ ,  $\epsilon_F$  and  $\epsilon_{H*}$  are set as in Medina and Soto (2007). We assume capital depreciates at the same rate in all three sectors ( $\delta_G = \delta_{Co} = \delta$ ). Mining sector parameters  $N^{Co}$ ,  $\varphi_j^{Co}$ , and  $o_{Co}$  are set as in Fornero and Kirchner (2018). Fiscal parameters  $o_{\hat{C}}$  and  $o_{KG}$  are set as in Coenen et al. (2013) to equalize the marginal utility between public and households investment and consumption levels. Nash bargaining power  $\varphi^U$  is set to 0.5 as in Mortensen and

Pissarides (1994) and most of the search and matching literature. We assume the central bank gives equal weight to present and expected inflation, then  $\alpha_{\pi E} = 0.5$ . We also assume the government spending does not react to cyclical fluctuations, then  $\gamma^D = 1$ , and that the government considers steady state prices when determining component expenditure. As in Medina and Soto (2007), the government debt is financed totally in foreign currency ( $\alpha^D = 1$ ). The shares of foreign goods in core consumption,  $o_Z$ , and investment in the domestic goods sector,  $o_I$ , are set to 21% and 33%, respectively, based on input-output tables from national accounts between 2008 and 2016. We assume complete home bias in government consumption and investment ( $o_{CG} = o_I = 0$ ), and the same home bias in agricultural goods as in core consumption ( $o_A = 0.21$ ). The share of agricultural goods and energy consumption in the household's consumption basket,  $\kappa_A$  and  $\kappa_O$ , are chosen to match their weight in the Chilean CPI. For simplicity we assume that the shares  $\omega^U$ ,  $\omega^G$  are equal to the relative size of Non-Ricardian households, calibrated at 50% ( $\omega = 0.5$ ). In the same spirit, wage indexation depends purely on steady state (instead of current) productivity, as in  $\alpha^W = 0$ , and there is no habit persistence in the foreign demand for domestic goods,  $\rho_{XH*} = 0$ . Finally, we assume one period time-to-build for public capital, then  $N^G$  is set to one.

Table 1: Calibrated deep parameters.

Parameter	Description	Value	Source
$\sigma$	Inverse elasticity of intertemporal substitution	1	Medina and Soto (2007)
$\omega$	Share of non-Ricardian households	0.5	Medina and Soto (2007)
$\omega^U, \omega^G$	Weights of non-Ricardians in union and government's decisions	0.5	Equal to $\omega$
$\delta$	Quarterly depreciation rate	0.01	Adolfson et al. (2007)
$\delta_G$	Quarterly depreciation rate of public and comm. capital	0.01	Equal to $\delta$
$\alpha$	Share of labor in wholesale domestic goods	0.34	Medina and Soto (2007)
$\alpha_{\pi E}$	Taylor rule expected inflation weight	0.5	Normalization
$\gamma^D$	Gov. spending reaction to cyclical fluctuations	1	Normalization
$\alpha^D$	Share of gov. debt in foreign currency	1	Normalization
$\alpha^W$	Wage indexation to current productivity	0	Normalization
$\alpha_G$	Share of SS prices in fiscal component expenditure	1	Normalization
$\rho_{XH*}$	Persistence in foreign demand for domestic goods	0	Normalization
$\varphi^U$	Nash bargaining power of union	0.5	Mortensen and Pissarides (1994)
$N^G$	Time to build (quarters), public sector	1	Normalization
$N^{Co}$	Time to build (quarters), commodity sector	6	Fornero and Kirchner (2018)
$\varphi_j^{Co}$	Financing profile of comm. invest. projects	1/6	Fornero and Kirchner (2018)
$o_Z$	Share of foreign goods in core consumption	0.21	Average (2008-2016)
$o_I$	Share of foreign goods in investment	0.33	Average (2008-2016)
$o_{CG}$	Share of foreign goods in gov. consumption	0	Medina and Soto (2007)
$o_{IG}$	Share of foreign goods in gov. investment	0	Coenen et al. (2013)
$o_{Co}$	Share of foreign goods in comm. investment	0.41	Fornero and Kirchner (2018)
$o_A$	Share of foreign goods in agricultural goods	0.21	Equal to $o_Z$
$o_O$	Share of oil in home good production	0.01	Medina and Soto (2007)
$\kappa_A$	Share of agricultural goods in consumption	0.19	CPI: 2013 weighting factor
$o_{\hat{C}}$	Share of gov. consumption in $\hat{C}$	0.34	Coenen et al. (2013)
$o_{KG}$	Share of public capital in $\tilde{k}_t$	0.16	Coenen et al. (2013)
$\epsilon_H$	Elast. of substitution among domestic varieties	11	Medina and Soto (2007)
$\epsilon_F$	Elast. of substitution among imported varieties	11	Medina and Soto (2007)
$\epsilon_{H*}$	Elast. of substitution among exported varieties	11	Medina and Soto (2007)

Table 2 shows the parameters that are chosen to match some long-run trend data in the Chilean economy. We assume a steady state labor productivity growth rate,  $a$ , of 1.49% on an annual basis.<sup>19</sup> The steady state inflation target,  $\pi$ , is set to the central bank's CPI inflation target of 3% since 2001. From den Haan et al. (2000), we draw  $e$  and  $s^{\rho_x}$ , while  $\rho = p^{E,U} / (1 - p^{U,E})$  is estimated by Jones and Naudon (2009). The household's subjective discount factor,  $\beta$ , is equal to 0.99997 to match a steady state real interest rate of 1.5%, in line with existing estimates of the neutral real interest rate for Chile from Ceballos et al. (2017). The steady state nominal exchange rate is assumed constant, in line with CLP/USD dynamics during the sample period. The steady state values of  $\bar{L}$ ,  $p^H$ ,  $p^O$  and  $p^{Co}$  are normalized to one, while  $h$  is set to 0.3 as its common in the literature. We shut down capital utilization in the commodity sector by setting  $\Phi_u^{Co} = (10)^5$ , in order to better match the response of commodity production to its price. The share of oil to total consumption,  $s^{OC}$ , is drawn from the 2013 CPI weighting factor for fuel items. The share of physical capital to quarterly output in the commodity sector,  $s^{k^{Co}, y^{Co}}$ , is set to 12 as in Fornero and Kirchner (2018). We restrict the frictional labor market costs to be a small fraction of GDP. In particular, we calibrate the share  $s^{Hc}$  so that the ratio of administrative costs to GDP is 0.1% on steady state. The government share in the commodity sector,  $\chi^{Co}$ , is set to 0.33, consistent with the average share of production of the state-owned copper mining company (Codelco) relative to total copper production since 2001 to 2016. The fiscal-deficit-to-GDP ratio,  $s^{def}$  is set to 0, consistent with a structural balance of fiscal accounts. The unemployment rate( $u$ ), country premium( $\xi$ ) and steady state shares with respect to nominal GDP for trade balance( $s^{tb}$ ), government spending in investment( $s^{iG}$ ), consumption( $s^{cG}$ ) and transfers( $s^{tr}$ ), and commodity investment( $s^{iCo}$ ) and output( $s^{Co}$ ) are set to match the corresponding data averages between 2001 and 2016. The current account-to-GDP ratio,  $s^{CA}$ , is set to -0.5% in order to match a steady state net foreign asset position of 14% of annual GDP, the average between 2003-2016. The tax rate on consumption,  $\tau^C$ , is set to 19%.<sup>20</sup> The tax rates on capital and dividends,  $\tau^K$  and  $\tau^D$ , are set to 20%.<sup>21</sup> The government tax rate on wages,  $\tau^W$ , is set to 7%, while the UFA tax rate on wages,  $\tau^{UFA}$ , is set to 3%.<sup>22</sup> Finally, the tax rate on the foreign mining profits,  $\tau^{Co}$ , is set to 35% as in Fornero and Kirchner (2018).

### 3.2 Estimation, prior distributions and posterior estimates

The model is solved by a linear approximation around the non-stochastic steady state. The model is then estimated by Bayesian methods, as described in An and Schorfheide (2007). We now briefly describe the estimation strategy before discussing the details of the data, prior distributions, and posterior results.

The whole set of the linearized equations of the model forms a linear rational expectation system whose solution

<sup>19</sup>This is consistent with an observed long run GDP growth of approximately 3.3% and labor force growth of around 1.8% for Chile.

<sup>20</sup>See <http://www.oecd.org/tax/tax-policy/Table-4.1-VAT-GST-Rates-June-2014.xlsx>.

<sup>21</sup>See [http://www.oecd.org/tax/tax-policy/tax-database.htm#C\\_CorporateCapital](http://www.oecd.org/tax/tax-policy/tax-database.htm#C_CorporateCapital).

<sup>22</sup>See <http://www.oecd.org/ctp/tax-policy/taxing-wages-tax-burden-trends-latest-year.htm> and <https://www.afc.cl/empleadores-afiliacion/cotizaciones/> respectively.



Table 2: Targeted steady state values.

Parameter	Description	Value
$(a)^4$	Annual balanced growth path	1.015
$(\pi)^4$	Annual inflation target	1.03
$u$	Unemployment rate	0.08
$e$	Quarterly vacancy filling probability	0.8
$\rho$	Quarterly job destruction probability	0.04
$\beta$	Quarterly subjective discount factor	0.999
$\pi^S$	Nominal exchange rate depreciation	1
$\xi$	Country premium, annual base	1.015
$\bar{L}$	Commodity fixed factor	1
$\Phi_u^{Co}$	Commodity capital utilization parameter	(10) <sup>5</sup>
$p^H$	Home good price	1
$p^O$	Domestic oil price	1
$p^{Co}$	Domestic commodity price	1
$h$	Hours per worker	0.3
$\chi^{Co}$	Government share in mining sector	0.33
$s^{def}$	Fiscal deficit to GDP	0
$s^{tb}$	Trade balance to GDP	0.05
$s^{CA}$	Current account to GDP	-0.005
$s^{iG}$	Government investment to GDP	0.04
$s^{tr}$	Government transfers to GDP	0.11
$s^{cG}$	Government consumption to GDP	0.12
$s^{Co}$	Commodity GDP to GDP	0.12
$s^{iCo}$	Commodity investment to GDP	0.04
$s^{Hc}$	Workers administrative costs to GDP	0.001
$s^{\rho x}$	Exogenous separations to total	0.667
$s^{OC}$	Oil to total consumption	0.06
$s^{k^{Co}, y^{Co}}$	Mining capital to Mining GDP	12
$\tau^C$	Tax rate on consumption	0.19
$\tau^K, \tau^D$	Tax rate on capital and dividends	0.20
$\tau^W$	Tax rate on wages, government	0.07
$\tau^{UFA}$	Tax rate on wages, UFA	0.03
$\tau^{Co}$	Tax rate on foreign foreign profits	0.35

can be expressed as

$$x_t = A(\theta)x_{t-1} + B(\theta)\varepsilon_t, \quad \varepsilon_t \sim N(0, \Sigma_\varepsilon), \quad (76)$$

where  $x_t$  contains the model's variables,  $\theta$  collects the structural parameters of the model to be estimated, and  $\varepsilon_t$  contains white noise innovations to the exogenous shocks of the model. The state matrix  $A$  and the input matrix  $B$  are non-linear functions of  $\theta$ . Equation (76) is called the transition equation. Let  $x_t^{obs}$  be a vector of several time series to estimate the model, which are referred to as observable variables<sup>23</sup>. This vector is related to the model's variables through as

$$x_t^{obs} = Hx_t + u_t, \quad u_t \sim N(0, \Sigma_u), \quad (77)$$

<sup>23</sup>Adequately transformed to map them to the model.

where  $H$  is called the output matrix that selects elements from  $x_t$ , and  $u_t$  are measurement errors which are included to avoid stochastic singularity. Equation (77) is called the measurement equation. Note that the state equation (76) and observation equation (77) constitute a linear state-space representation for the dynamic of  $x_t^{obs}$ . Let  $P(\theta)$  a prior density on the structural parameters and  $L(Y^T|\theta)$  the conditional likelihood function for the observed data  $Y^T = [x_1^{obs}, \dots, x_T^{obs}]'$ . Using Bayes theorem, the joint posterior distribution,  $P(\theta|Y^T)$ , is defined as

$$P(\theta|Y^T) = \frac{L(Y^T|\theta) \times P(\theta)}{\int L(Y^T|\theta) \times P(\theta) d\theta}. \quad (78)$$

We use central tendency measures (in particular the mean) of the distribution function given by (78) as estimates of  $\theta$ . We now describe the details of  $Y^T$  and  $P(\theta)$ .

Our data  $Y^T$  consists of 23 macroeconomic variables covering the period between 2001Q3 and 2017Q2.<sup>24</sup> We choose the following Chilean and foreign quarterly data: mining and non mining GDP, an indicator of export-weighted real GDP of Chile's main trading partners as a proxy for foreign aggregate demand, private and government consumption, aggregate, government and commodity related investment, government transfers, total employment as a fraction of the labor force, total hours per employee, nominal wages, core, food, and energy components of CPI, an external price index, price of West Texas Intermediate crude oil in dollars per barrel, London Metal Exchange price of refined copper in dollars per metric pound, the imports deflator, short-term central bank target rate, London Interbank Offered Rate as a proxy for the foreign interest rate, real exchange rate ( $rer_t$ ), J.P. Morgan Emerging Market Bond Index Global (EMBIG) spread for Chile as a proxy for the country premium, and the trade balance to total GDP ( $tb_t/y_t$ ). With the exception of the interest rates the risk spread, the real exchange rate and trade balance, all variables are log-differentiated with respect to the previous quarter. All variables are demeaned. Our estimation strategy also includes i.i.d. measurement errors for all local observables with the exception of the interest rate. Additionally we incorporate observed news shocks on the tax reform of 2014<sup>25</sup>. The variance of the measurement errors is calibrated to be 10% of the variance of the corresponding observable.

The posterior estimates are obtained from a random walk Metropolis–Hasting chain with 500,000 draws after a burn-in of another 500,000 draws. As in Christiano et al. (2011), we scale the parameters, in particular the shocks standard deviations, to have similar order of magnitude to facilitate optimization.

For the prior selection, we follow the endogenous prior strategy used in Christiano et al. (2011) and Coenen et al. (2013), where the joint prior distribution of the estimated parameters  $P(\theta)$  is computed as the product of the initial prior distribution and the likelihood that the model generated standard deviations match the volatility of the observed variables. For the choice of the initial priors  $P(\theta^{ini})$ , we specify independent univariate prior distributions

<sup>24</sup>The starting point of our sample is set at the time the Chilean Central Bank started conducting monetary policy by using a nominal reference interest rate.

<sup>25</sup>The reform was approved on September, 2014, and specified a time-table for a staggered rise of the corporate tax to be completed over 4 years.

for  $\theta^{ini} = \theta^S \cup \theta^{exo}$  with  $\theta^S$  containing the structural parameters of the model and  $\theta^{exo}$  the parameter governing the law of motion of the exogenous processes. The prior distributions are documented in column 3 of Tables 3 and 4. The types of the priors are chosen according to the support on which the individual parameters are defined, while the means and standard deviations of the priors are selected according to our beliefs on plausible regions for the parameters or were set to match the priors of related papers for the Chilean economy and international literature. These values are presented in columns 4 and 5 of Tables 3 and 4.

Table 3: Prior and posterior distributions. Structural parameters,  $\theta^S$ .

Parameter	Description	Initial Prior			Posterior		
		distr.	mean	s.d.	mean	pct. 5	pct. 95
$\varsigma$	Habit formation	B	0.75	0.1	0.61	0.51	0.72
$\nu$	Preferences endogenous shifter	B	0.5	0.2	0.06	0.02	0.12
$\phi$	Inverse Frisch elasticity	G	5.0	1.0	1.51	1.05	2.15
$\mu$	Match elasticity parameter	B	0.5	0.2	0.91	0.85	0.96
$\sigma_{\tilde{C}}$	Worker's adm. costs dispersion	IG	0.25	Inf	5.80	4.93	6.96
$100\psi$	Country premium debt elast.	IG	1.0	Inf	0.24	0.18	0.30
$\rho_R$	Taylor rule smoothing parameter	B	0.85	0.025	0.74	0.71	0.77
$\alpha_\pi$	Taylor rule response to total inflation	N	1.7	0.1	1.95	1.81	2.09
$\alpha_Y$	Taylor rule response to GDP growth	N	0.125	0.05	0.13	0.06	0.20
$\alpha_{\pi^z}$	Taylor rule response to core inflation	B	0.75	0.1	0.71	0.55	0.86
$\eta_Z$	Elast. of subst. H/F in core cons.	G	1.5	0.25	1.76	1.35	2.21
$\eta^*$	Elasticity of foreign demand	G	0.25	0.05	0.34	0.24	0.45
$\eta_A$	Elast. of subst. H/F in agriculture	G	1.0	0.25	1.07	0.67	1.54
$\eta_O$	Elast. of subst. Z,O in H prod.	G	0.5	0.25	0.54	0.17	1.02
$\eta_C$	Elast. of subst. CZ,O,A goods	G	1.0	0.25	0.66	0.42	0.94
$\eta_I$	Elast. of subst. H/F in investment	G	1.0	0.25	1.18	0.76	1.68
$\eta_{Co}$	Elast. of subst. H/F in comm. inv.	G	1.0	0.25	1.03	0.64	1.50
$\eta_{KG}$	Elast. of subst. priv. and pub. capital	G	1.0	0.5	0.60	0.26	1.11
$\eta_{\hat{C}}$	Elast. of subst. priv. and pub. cons.	G	1.0	0.5	2.24	1.37	3.30
$\rho_O$	Oil price smoothing param. 1	B	0.5	0.2	0.70	0.66	0.74
$\alpha_O$	Oil price smoothing param. 2	B	0.5	0.2	0.43	0.24	0.62
$\vartheta_W$	Indexation wages	B	0.25	0.075	0.31	0.19	0.45
$\varkappa_W$	Wage Smoothing	B	0.75	0.025	0.83	0.79	0.87
$\theta_H$	Calvo probability domestic prices	B	0.75	0.025	0.82	0.80	0.85
$\vartheta_H$	Indexation domestic prices	B	0.25	0.075	0.21	0.12	0.30
$\theta_F$	Calvo probability import prices	B	0.75	0.05	0.73	0.70	0.77
$\vartheta_F$	Indexation import prices	B	0.25	0.075	0.25	0.13	0.38
$\theta_{H^*}$	Calvo probability export prices	B	0.75	0.05	0.73	0.64	0.81
$\vartheta_{H^*}$	Indexation export prices	B	0.25	0.075	0.26	0.14	0.39
$\vartheta_\pi$	Indexation CPI over core	B	0.25	0.075	0.27	0.14	0.41
$\Phi_{\bar{u}}$	Capital utilization cost, non-mining	G	1.5	0.25	1.07	0.76	1.43
$\Phi_I$	Inv. adjustment cost elast.	G	5.0	1.0	3.09	1.97	4.50
$\Phi_{ICo}$	Inv. adjustment cost elast., mining	G	0.5	0.25	0.49	0.28	0.79
$\Gamma^{Co}$	Global pass through, mining prod.	B	0.5	0.2	0.50	0.17	0.83
$\Gamma^H$	Global pass through, home prod.	B	0.5	0.2	0.57	0.28	0.84
$\Gamma^{Co*}$	Global pass through, copper price.	B	0.5	0.2	0.52	0.33	0.70
$\Gamma^{O*}$	Global pass through, oil price.	B	0.5	0.2	0.77	0.54	0.93
$\Gamma^*$	Global pass through, foreign prices.	B	0.5	0.2	0.75	0.64	0.88
$\Gamma^{M*}$	Global pass through, imports prices.	B	0.5	0.2	0.34	0.25	0.44

Note: The prior distributions are: beta distribution (B) on the open interval  $(0, 1)$ , inverse gamma distribution (IG) on  $\mathbb{R}^+$ , gamma distribution (G) on  $\mathbb{R}_0^+$ , normal distribution (N) on  $\mathbb{R}$ .

Table 4: Prior and posterior distributions. Exogenous processes parameters,  $\theta^{exo}$ .

Parameter	Description	Initial Prior			Posterior		
		distribution	mean	s.d.	mean	pct. 5	pct. 95
AR(1) coefficient							
$\rho_\varrho$	Preference shock	B	0.5	0.2	0.81	0.67	0.91
$\rho_{\varpi}$	Inv. tech. shock, non-mining	B	0.75	0.075	0.45	0.35	0.55
$\rho_{\varpi Co}$	Inv. tech. shock, mining	B	0.5	0.2	0.11	0.03	0.22
$\rho_z$	Transitory tech. shock, non-mining	B	0.85	0.075	0.73	0.60	0.87
$\rho_{z Co}$	Transitory tech. shock, mining	B	0.85	0.075	0.78	0.64	0.89
$\rho_{z*}$	Transitory tech. shock, foreign	B	0.85	0.075	0.89	0.81	0.96
$\rho_{zA}$	Transitory tech. shock, agriculture	B	0.75	0.075	0.90	0.85	0.94
$\rho_a$	Global unit root tech. shock	B	0.5	0.2	0.57	0.32	0.78
$\rho_{\zeta^o}$	Obs. country premium shock	B	0.75	0.075	0.74	0.67	0.81
$\rho_{\zeta^u}$	Unobs. country premium shock	B	0.75	0.075	0.71	0.62	0.80
$\rho_{\xi CG}$	Public consumption shock	B	0.75	0.075	0.77	0.66	0.87
$\rho_{\xi TR}$	Public transfer shock	B	0.75	0.075	0.79	0.68	0.88
$\rho_{\xi IG}$	Public investment shock	B	0.5	0.2	0.22	0.06	0.41
$\rho_{\kappa}$	Labor supply shock	B	0.5	0.2	0.73	0.45	0.93
$\rho_{\rho_x}$	Job separation shock	B	0.75	0.075	0.71	0.61	0.81
$\rho_{\xi O}$	Domestic oil price shock	B	0.75	0.075	0.72	0.57	0.84
$\rho_{eR}$	Monetary policy shock	B	0.5	0.2	0.27	0.14	0.40
$\rho_{\pi f}$	Price global factor shock	B	0.5	0.2	0.17	0.06	0.28
$\rho_{\xi Co*}$	Copper price shock	B	0.5	0.2	0.71	0.57	0.80
$\rho_{\xi O*}$	Oil price shock	B	0.5	0.2	0.66	0.40	0.85
$\rho_{\xi M*}$	Imports price shock	B	0.5	0.2	0.84	0.76	0.91
$\rho_{\xi*}$	Foreign economy price shock	B	0.5	0.2	0.51	0.17	0.83
$\rho_{R*}$	Foreign interest rate shock	B	0.5	0.2	0.88	0.84	0.91
Innovation s.d.							
$100\sigma_\varrho$	Preference shock	IG	0.5	Inf	2.52	2.04	3.10
$100\sigma_{\varpi}$	Inv. tech. shock, non-mining	IG	0.5	Inf	8.14	4.81	12.49
$100\sigma_{\varpi Co}$	Inv. tech. shock, mining	IG	0.5	Inf	11.51	6.44	18.38
$100\sigma_z$	Transitory tech. shock, non-mining	IG	0.5	Inf	0.62	0.54	0.71
$100\sigma_{z Co}$	Transitory tech. shock, mining	IG	0.5	Inf	2.81	2.41	3.22
$100\sigma_{z*}$	Transitory tech. shock, foreign	IG	0.5	Inf	0.51	0.43	0.59
$100\sigma_{zA}$	Transitory tech. shock, agriculture	IG	0.5	Inf	1.28	1.09	1.47
$100\sigma_a$	Global unit root tech. shock	IG	0.5	Inf	0.24	0.15	0.33
$100\sigma_{\zeta^o}$	Obs. country premium shock	IG	0.5	Inf	0.08	0.07	0.09
$100\sigma_{\zeta^u}$	Unobs. country premium shock	IG	0.5	Inf	0.60	0.38	0.84
$100\sigma_{\xi CG}$	Public consumption shock	IG	0.5	Inf	1.09	0.97	1.21
$100\sigma_{\xi TR}$	Public transfer shock	IG	0.5	Inf	3.16	2.72	3.63
$100\sigma_{\xi IG}$	Public investment shock	IG	0.5	Inf	10.07	8.91	11.30
$100\sigma_{\kappa}$	Labor supply shock	IG	0.5	Inf	2.35	1.56	3.42
$100\sigma_{\rho_x}$	Job separation shock	IG	0.5	Inf	0.28	0.24	0.31
$100\sigma_{\xi O}$	Domestic oil price shock	IG	0.5	Inf	2.03	1.43	2.65
$100\sigma_{eR}$	Monetary policy shock	IG	0.5	Inf	0.14	0.12	0.16
$100\sigma_{\pi f}$	Price global factor shock	IG	5	Inf	3.31	2.78	3.86
$100\sigma_{\xi Co*}$	Copper price shock	IG	0.25	Inf	11.46	10.14	12.81
$100\sigma_{\xi O*}$	Oil price shock	IG	0.25	Inf	13.58	12.15	14.98
$100\sigma_{\xi M*}$	Imports price shock	IG	0.25	Inf	1.52	1.17	1.90
$100\sigma_{\xi*}$	Foreign economy price shock	IG	0.25	Inf	0.19	0.08	0.40
$100\sigma_{R*}$	Foreign interest rate shock	IG	0.5	Inf	0.12	0.10	0.14

Note: The prior distributions are: beta distribution (B) on the open interval  $(0, 1)$ , inverse gamma distribution (IG) on  $\mathbb{R}^+$ , gamma distribution (G) on  $\mathbb{R}_0^+$ , normal distribution (N) on  $\mathbb{R}$ . Exogenous processes not mentioned in this table are calibrated to have zero variance.

Table (5) reports the standard deviations, the correlation with non-commodity GDP and the first-order auto-correlation coefficients of selected domestic variables implied by the posterior mean of the parameters, and compares these statistics with the corresponding empirical moments. The model does a good job matching the unconditional volatility of most variables, but overestimate the observed volatility of nominal wages and individual hours. In terms of the business cycle correlations, the table shows that the model captures most of the cyclicalities observed in the data. The variables auto-correlations are mostly well matched, with the exception of non-mining output which shows lower auto-correlation than the data, even if individual demand components seems to be well matched. Overall, we find that the model performs reasonable well in terms of fitting second moments of the data.

Table 5: Second Moments.

	Description	s.d. (%)		Corr. with $\Delta \log Y^{NCo}$		AC order 1	
		data	XMAS	data	XMAS	data	XMAS
$\Delta \log Y$	GDP growth*	0.98	0.96	0.92	0.92	0.31	0.00
$\Delta \log Y^{NCo}$	Non-Mining GDP growth	1.07	0.99	1.00	1.00	0.29	0.02
$\Delta \log Y^{Co}$	Mining GDP growth	3.04	3.03	-0.05	0.07	-0.14	-0.08
$\Delta \log C$	Private consumption growth	1.11	1.17	0.74	0.62	0.41	0.26
$\Delta \log C^G$	Gov. consumption growth	1.35	1.45	-0.12	0.16	-0.19	-0.00
$\Delta \log TR^G$	Gov. real transfers growth	3.17	3.15	-0.08	0.13	-0.43	-0.09
$\Delta \log I$	Total investment growth	3.75	3.71	0.55	0.82	0.36	0.27
$\Delta \log I^G$	Gov. investment growth	13.6	12.95	-0.18	0.63	-0.46	-0.39
$\Delta \log I^{Co}$	Mining investment growth	8.80	8.60	0.22	0.13	0.42	0.81
$TB/Y$	Nom. trade balance/GDP	5.17	3.32	0.37	-0.06	0.78	0.88
$\Delta \log N$	Employment growth	0.42	0.37	0.46	0.41	0.25	0.35
$\Delta \log H$	Hours per employee growth	1.35	1.68	0.34	0.76	-0.63	-0.13
$\Delta \log HN$	Total Hours growth*	1.37	1.81	0.47	0.80	-0.56	-0.07
$\Delta \log WN$	Nominal wage growth	0.38	0.76	-0.11	0.27	0.52	0.67
$\Delta \log W$	Real wage growth*	0.63	0.59	-0.08	0.25	0.43	0.36
$\pi$	Headline inflation*	0.67	0.73	-0.19	0.07	0.59	0.53
$\pi^Z$	Core inflation	0.49	0.57	-0.19	0.13	0.59	0.77
$\pi^A$	Food inflation	1.39	1.44	-0.24	-0.07	0.53	0.09
$\pi^O$	Fuel inflation	5.37	5.49	0.32	0.05	0.08	0.24
$R$	Nominal interest rate	0.40	0.45	-0.26	-0.09	0.88	0.91
$rer$	Real exchange rate	5.01	5.85	-0.22	0.02	0.75	0.85
$\pi^S$	Nominal depreciation*	5.12	4.94	-0.27	0.07	0.22	-0.03

Note: The model moments are the theoretical moments at the posterior mean.

\*: Not observed in XMAS

## 4 XMAS as an extended version of Medina and Soto (2007)

In this section we describe some of the channels that are present in the XMAS model but not in Medina and Soto (2007). They allow for added flexibility in several dimensions: the interaction between the external sector, the

commodity sector and the rest of the economy; the interaction between fiscal and private spending in consumption and investment goods; the response of capital use intensity to economic shocks; the relationship between the extensive and intensive margins of the labor sector and the rest of the economy; the relationship between domestic and foreign oil prices; the relationship between domestic, commodity and foreign technology disturbances; and the relationship between the foreign, imports, oil and commodity prices.<sup>26</sup>

Subsections 4.1 to 4.5 describe the individual channels. In subsection 4.6 we present a forecasting comparison between the baseline specification and one analogous to Medina and Soto (2007), which we will refer as the MAS model.

## 4.1 Endogenous commodity sector

The mining sector is an important part of the Chilean economy. Mining production accounts for roughly 10% of GDP and copper for 40% of exports. Besides, close to 20% of total investment corresponds to mining specific projects. Following Fornero and Kirchner (2018), we endogenize the mining investment decision by making mining output depend on the amount of sector specific capital, in a time to built investment framework that reflects the dependence of the sector on large scale projects. Modeling an endogenous mining sector allows for additional channels through which domestic and foreign shocks (in particular shocks to the price of copper) may affect the economy. Under the proposed framework, a shock to the international price of the commodity affects the sector's optimal investment decision. This has implications not only for future mining production; it also affects the rest of the economy by increasing the demand for the input factors needed to produce the investment goods. In a different dimension, by introducing time to build in the mining sector, we increase the importance of persistent shocks over temporary fluctuations. Finally, the introduction of royalties, specific taxes to the profits of the foreign owned mining firms, further increase the impact of commodity prices in the economy. By easing the fiscal budget, they allow for higher government spending. Figure 2, shows the effects of a 50% shock to the price of the exported commodity, both in the baseline specification and in 3 counterfactuals: one with a simpler commodity sector, akin to MAS ( $\alpha_{Co} = s_{ICo} = 0$  and  $\Phi_{ICo} = 10^5$ ), a second one with no time to build in the commodity sector ( $N_{CO} = 1$  instead of 6), and a third with no sector specific taxes on the commodity profits ( $\tau_{Co} = 0$ ). The introduction of time to build has first order effect on the simulated dynamics. The specification without the mechanism shows a reaction of investment an order of magnitude bigger than the baseline specification. The added investment also affect the rest of the economy through greater investment input demand. The introduction of a tax on foreign profits, on the other hand, generates a bigger domestic impact as it increases the shocks influence on the government budget.

Compared with a model with homogeneous investment, a framework with endogenous commodity production

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<sup>26</sup>The impulse response functions shown in this section measure the percent deviation from steady state of the specified variable responding to a given shock. In the case of inflation variables, the nominal interest rate  $R$ , and the unemployment rate, these are level deviations from steady state, measured in percent. Inflation and interest rates are annualized quarter over quarter variations.

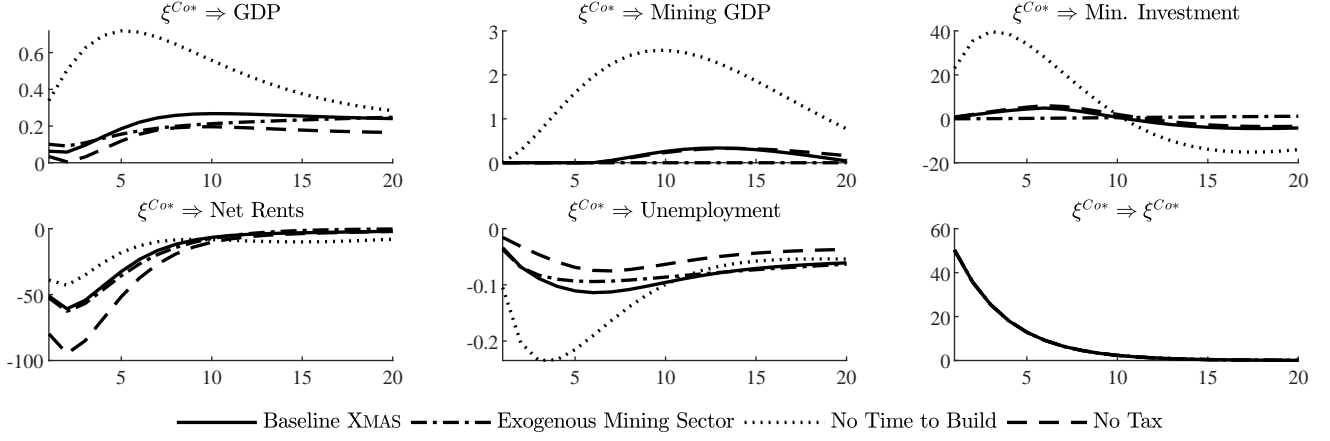


Figure 2: Commodity price shock.

allows for greater insight over observed aggregate investment fluctuations, as the propagation mechanisms of mining and non mining investment are not equal. Compared with the non-mining sector, the mining sector has lower labor participation, and its ownership is shared between the government and foreign investors, not households. In figure 3 we compare shocks for the mining and non mining investment of similar magnitude.

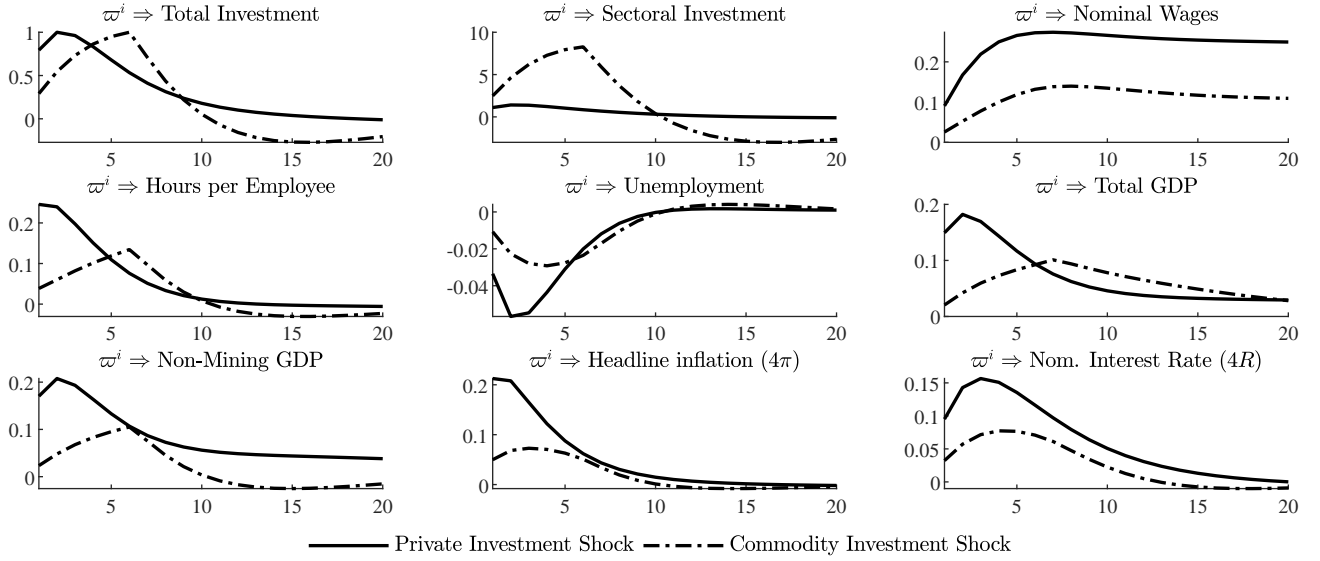


Figure 3: Effects of a non-commodity private investment shock, and a commodity investment shock

Even with a similar impact on aggregate investment, due to the mining sector's low labor intensity, a shock in commodity investment has weaker effects on hours worked, unemployment and wages. The propagation to the rest of the economy is then reduced, with smaller effects on inflation, interest rates and wages.



## 4.2 Augmented Fiscal Policy

Government spending on consumption goods accounts for only 46% of total spending. More than half of the aggregate spending goes to investment and direct transfers. In addition, theoretical and empirical literature find that different spending components have different effects and transmission mechanism (see, for example, Ilzetzki et al. 2013, Leeper et al. 2010, and Giambattista and Pennings 2017). Following Coenen et al. (2012, 2013), we introduce valuable government consumption and investment plus direct government transfers. We find that the source of the fiscal spending matters, both for output and for inflation dynamics, and that a correct assessment of the specific fiscal shock has important implications for the prescribed monetary policy response.

The introduction of valuable government consumption allows for more flexibility when modeling the co-movement between government and private consumption by directly influencing the level of crowding out(in) following a change on government consumption spending. The degree of influence that government consumption can have on private consumption is given by  $\eta_{\hat{C}}$ , the elasticity of substitution between private and government consumption in the final consumption good bundle. When private and government consumption are complements, everything else equal, higher government consumption increases the household's willingness to spend in private consumption goods. On the other hand, if they are substitutes, an increase in government consumption decreases the desire to consume. The change in the households willingness to consume has material implications only for Ricardian households. Consumption of non-Ricardians is only affected by the government spending general equilibrium effects on prices, employment and wages.

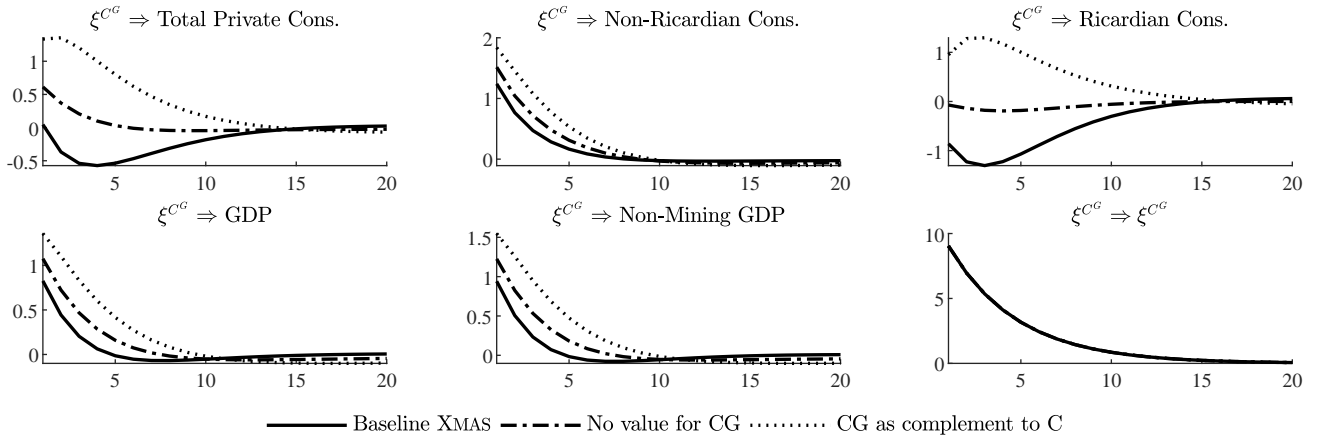


Figure 4: Government consumption shock.

Figure 4 shows the effects of a transitory 10% increase in government consumption spending. The model estimated elasticity of 2.2 suggest that the average fiscal spending in consumption goods tend to act as a substitute to private consumption, decreasing the overall effect on GDP that were to be present if both goods acted as complements (the dotted line, where the parameter  $\eta_{\hat{C}}$  is set as the inverse of the estimated value). After the shock, disregarding

the elasticity of substitution, Non-Ricardian households always increase their consumption, as the additional fiscal stimulus eases their budget constraint. On the other hand, the response of Ricardian households depends crucially on the elasticity of substitution. In the case where government consumption is not valued, Ricardian households do not respond to the shock and the overall consumption response will only reflect the spending effect on the non-Ricardian budget constraints. But if consumption is valued, the effect of a shock to government consumption will depend if the goods are considered complements or substitutes. In the first case Ricardian private consumption will increase. If goods are found to be substitutes, the shock will induce a drop in their consumption.

We now turn to the relationship between public and private investment dynamics. Similar to the consumption case, the model framework allows for different degrees of substitutability between public and private capital in the production of the wholesale domestic goods. Figure 4 compares the propagation of private and government investment shocks for the baseline specification. Both shocks are calibrated to increase total investment by 1% on impact.

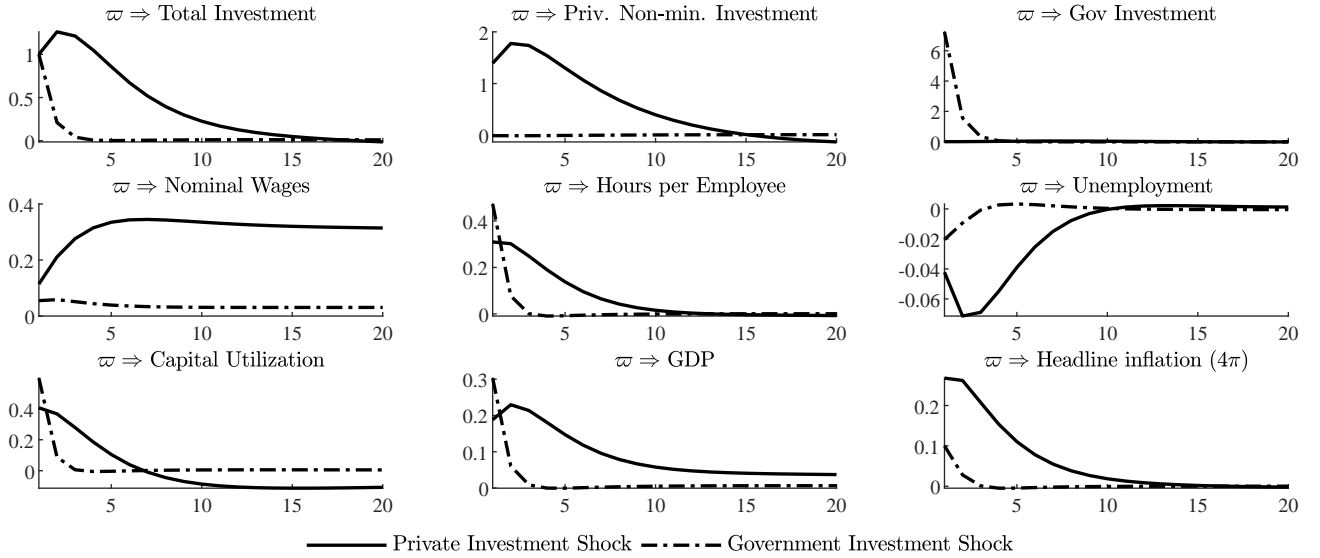


Figure 5: Private vs government investment shock.

Private and public capital are estimated to be complements, with  $\eta_{KG} < 1$ . However, an exogenous increase in government investment does not trigger a significant increase in private investment. The increase in private capital services comes mainly through the intensive margin, with a higher rate of capital utilization. The labor market also adjust mainly through the intensive margin(hours), with relatively small changes in the extensive margin(employment). Forward looking variables like wages and inflation show modest fluctuations.

On the other hand, a similar shock, but to the marginal productivity of private investment, has markedly different effects than the government shock. The relatively higher estimated persistence of the private investment shock generates larger responses from almost all variables, with an emphasis on the extensive(capital stock accumulation

and employment) rather than the intensive(capital utilization and hours per worker) margins.

Figure 4 show the response to a government investment shock both in the baseline parameterization and three additional cases: first assuming assuming these shocks are just as persistent as the estimated government consumption shocks. A second case assumes higher substitutability, with  $\eta_{KG}$  set as the inverse of the estimated value. The third case combine the previous modifications.

The marginal effect of the private/public capital elasticity of substitution  $\eta_{KG}$  is similar to the consumption case. Facing a government investment shock, a parameterization with low elasticity results in higher private investment than the alternative with a high degree of substitutability. However, even in parameterizations where both kind of capital stocks are complements, higher government investment lead to a decrease in the short term private investment rate. The explanation comes from the monetary policy reaction. Higher government investment lead to higher domestic demand and higher inflation. The central bank then raises interest rates, lowering the present value of new investment projects. The interest rate effect dominates the capital complementarity channel, particularly in the cases where the investment shock is expected to last longer, with higher inflationary pressures and stronger monetary responses.

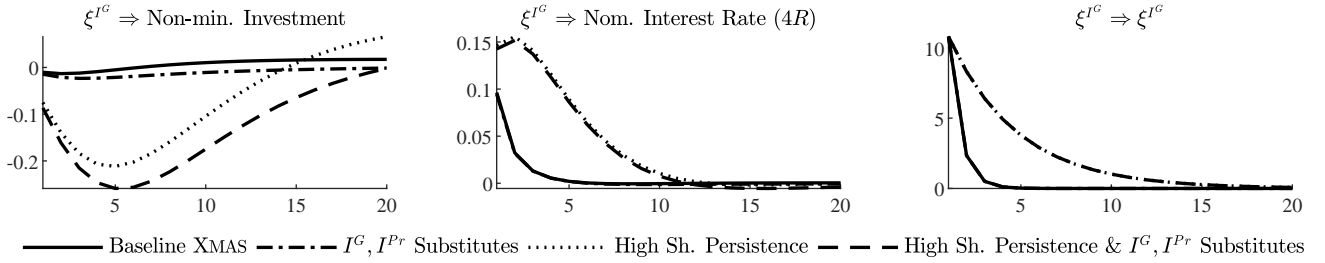
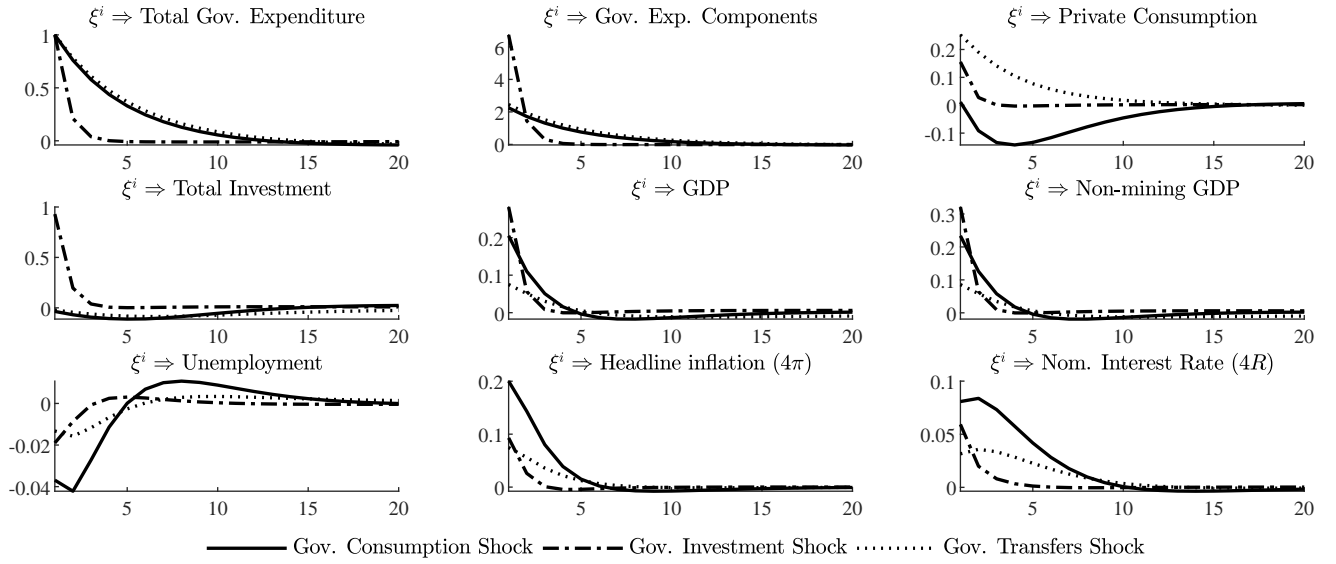


Figure 6: Government investment shock.

Finally, the decomposition of government expenditure into consumption, investment and transfers is useful in itself to better understand the impact of expenditure changes. Figure 7 shows the effects of similar expenditure shocks, arising from each of the three components.



Note: The figure displays the response of the corresponding variables to three different government expenditure shocks. The size of each shock  $\xi^i$ , with  $i \in \{CG, IG, TR\}$ , is calibrated to achieve a one percent increase in total government expenditure.

Figure 7: Government expenditure shocks.

The size of all three shocks is calibrated to produce the same effect on aggregate government expenditure on impact, although we allow for heterogeneity in the persistence of the shocks as derived from the model estimation.

Direct transfers have the smaller impact on GDP, as a significant part of such transfers are saved and not spent by the Ricardian households, dampening the aggregate demand effect. Investment spending has the higher GDP effect, as the higher capital stock increases the production capacity of the economy. Consumption spending generate more inflation due to an increased domestic demand that is not accompanied by higher production capacity, pushing marginal costs. Overall, facing similar spending shocks, the model prescribes the stronger monetary policy response when facing government consumption shocks. The weaker response is prescribed after a change in government transfers.

## 4.3 Real and Nominal rigidities

### 4.3.1 Variable capital utilization

As noted by Christiano et al. (2005), by allowing the capital services to respond contemporaneously to shocks, the introduction of variable capital utilization reduce the volatility of the rental rate of capital. As their argument goes, the implications for monetary policy are straight-forward. After a monetary shock, by allowing the services of capital to react, the introduction of this mechanism dampen the large rise in the rental rate of capital that would otherwise occur. The effects on marginal costs, and therefore inflation, are then predicted to be smaller.

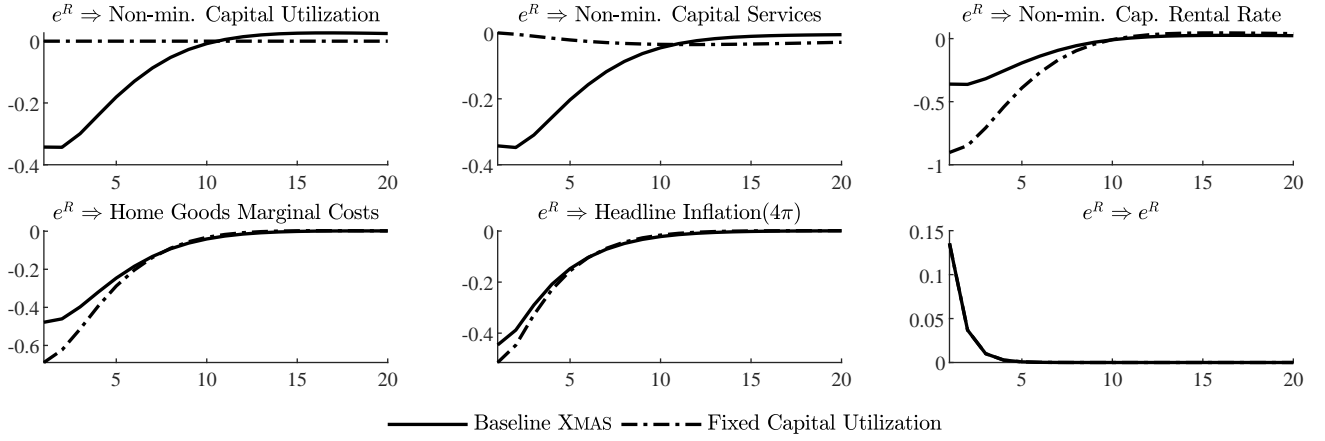


Figure 8: Monetary shock with variable capital utilization.

As figure 8 shows, similar dynamics occur in the XMAS model. After a monetary shock, a parameterization that doesn't allow for variable capital utilization generates smaller responses in capital, and greater fluctuations in the rental rate of capital, marginal costs and inflation.

#### 4.3.2 Non core inflation

The model introduces both agricultural goods and oil related goods as part of the consumption bundle. Empirically, they exhibit significantly different price behavior than the rest of the consumption basket. In particular, agricultural and oil prices are highly dependent on the specific supply and demand conditions in their spot markets. A significant share of their volatility is unrelated to the domestic business cycle.

In the model, the agricultural sector is exposed to idiosyncratic productivity shocks, uncorrelated to the domestic economic conditions. The shocks create a wedge between the sector's marginal costs (and prices) and the marginal costs (and prices) of the rest of the home produced goods.

The determination of fuel prices, on the other hand, depends on the international price of oil, the exchange rate, and a government smoothing policy. The last component is introduced in order to match the volatility differential between the domestic fuel price and the international oil price in domestic currency (the latter being much more volatile than the former). Its implementation mimics the MEPCO program, a Chilean fiscal fund that acts as a buffer against the short term volatility of the foreign oil price. The introduction of this channel reduces the unconditional standard deviation of the core inflation rate from 0.58% to 0.57% , and for the total inflation rate from 1.14% to 0.73%, closer to their empirical moments of 0.51% and 0.69%.

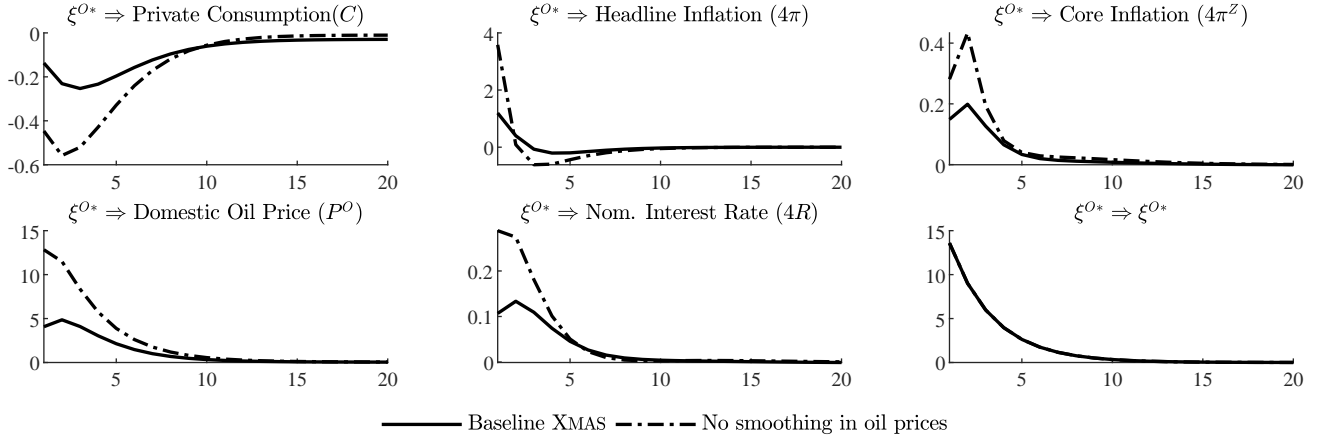


Figure 9: International oil price shock.

As shown in figure 9, the implementation of the government smoothing policy has relevant implications on the domestic propagation of oil price shocks, not only to inflation, but also to real variables. With the policy, consumption and inflation, and therefore monetary policy, exhibit smaller responses.

Table 6: Annual inflation variance decomposition

	Agricultural Shock ( $z^A$ )	Oil Shocks ( $\xi^O, \xi^{O*}$ )	Other Shocks
$P_t/P_{t-4}$	6.37%	14.61%	79.02%
$E[P_{t+1}/P_{t-3}]$	5.14%	13.20%	81.66%
$E[P_{t+2}/P_{t-2}]$	4.08%	10.74%	85.18%
$E[P_{t+4}/P_t]$	1.09%	7.55%	91.36%

Table 6 presents the contribution of non-core price shocks to aggregate inflation volatility. In the estimated model, given the assumed structure for the agricultural and oil sectors, the importance of non-core shocks as drivers of inflation volatility is relevant in the short term, but decreasing over time. While they account for more than 20% of the short term volatility, less than 10% of the variation of the one year ahead expected annual inflation can be attributed to those shocks.

#### 4.4 Delayed pass through of foreign price and productivity shocks

We introduce a potentially delayed pass through from a global price factor to foreign currency denominated prices (oil, copper, imports, and foreign CPI) and from global technology towards domestic mining and non-mining productivity. While maintaining a long term cointegration process, we avoid excessive propagation of short term foreign volatility into the domestic economy. By estimating the idiosyncratic pass-through for each process, we can account, in a reduced form specification, for a variety of non-modeled frictions that may exist in the real economy.

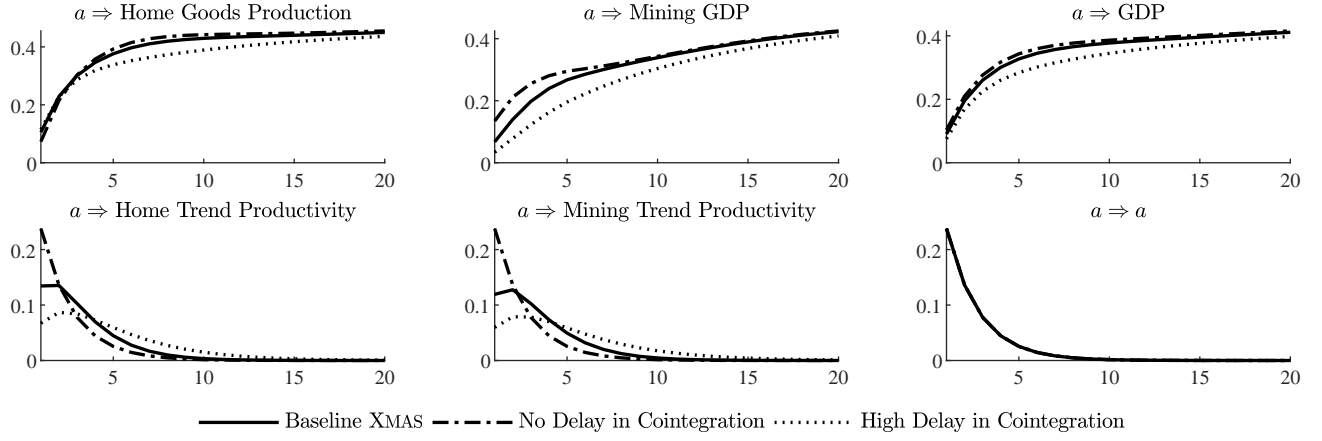


Figure 10: Global productivity shock.

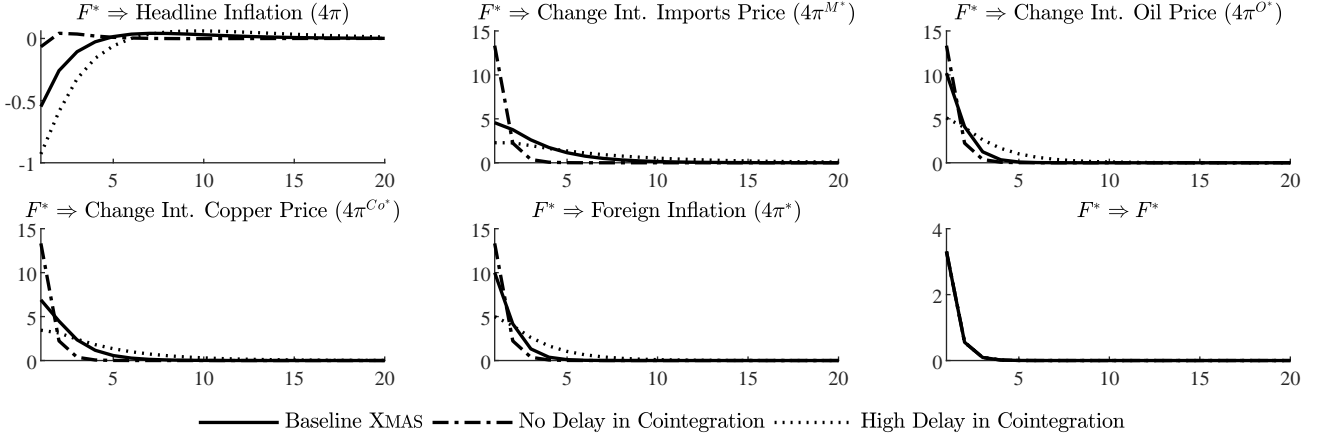


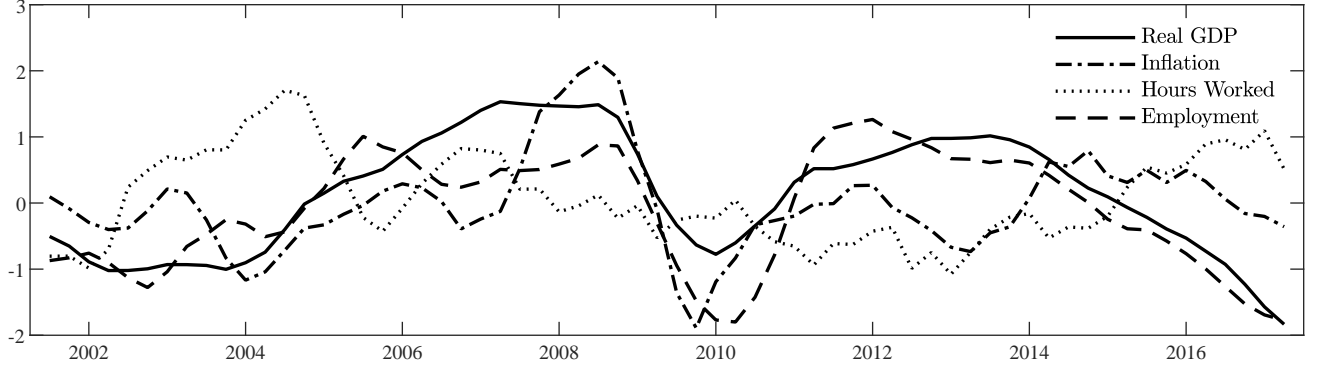
Figure 11: Global price shock.

Figures 10 and 11 show the effect of shocks to global productivity and to the global price factor. We compare the baseline parameterization with two alternative parameterizations. One with instantaneous pass-through ( $\Gamma^H = \Gamma^{Co} = \Gamma^{pCo} = \Gamma^{pM} = \Gamma^{pO} = \Gamma^* = 1$ ) and a second with an increased delay (with  $\Gamma^H, \Gamma^{Co}, \Gamma^{pCo}, \Gamma^{pM}, \Gamma^{pO}$  and  $\Gamma^*$  set to half their posterior estimates). For the case of productivity shocks, the estimated delayed pass-through doesn't appear to have first order effects, specially for the non-mining sector. On the other hand, the introduction of the delayed pass-through mechanism for foreign prices does change the inflationary consequences of global price shocks in a significant manner. In the estimated model, the effect comes mainly by dampening the global price factor influence on copper and non-oil imports price dynamics.

#### 4.5 Labor market with search and matching

The introduction of search and matching in the labor market is a significant departure from Medina and Soto (2007). The specification enables the analysis of the extensive margin of work (unemployment vs employment) as well as the

intensive margin (hours worked). This is shown to be important as the extensive margin accounts for a significant part of the aggregate labor supply volatility. Furthermore, as shown in figure 12 and table 7, they don't seem to follow the same trajectories across the business cycle: the extensive margin follows output and inflation more closely than the intensive one. For this reason, observing the evolution of employment can give a less noisy signal about the state of the economy than total worked hours.



Note: Level deviation (%) from a log linear trend for GDP, hours and employment. Inflation is the CPI demeaned quarterly log-variation. All variables are smoothed with a four period moving average, and normalized with respect to their sample standard deviation.

Figure 12: Labor market and the business cycle

Table 7: Correlation between labor variables and business cycle variables

	Real GDP	Inflation
Hours worked	-0.170	-0.081
Employment	0.822	0.365

Note: Level deviation (%) from a log linear trend for GDP, hours and employment. Inflation is the CPI demeaned quarterly log-variation.

We compare the baseline specification with one with Calvo-type frictions in the labor market. In the alternative specification, the extensive margin is assumed to be absent, with every household actively participating in the production of goods ( $n_t = n = 1$ ). In this case, the aggregate labor supply is entirely driven by fluctuation of the intensive margin.<sup>27</sup> In table 8 we compare, for both specifications, the model's theoretical second moments for hours worked and employment with their data counterparts<sup>28</sup>.

Table 8: Volatility of intensive and extensive margins

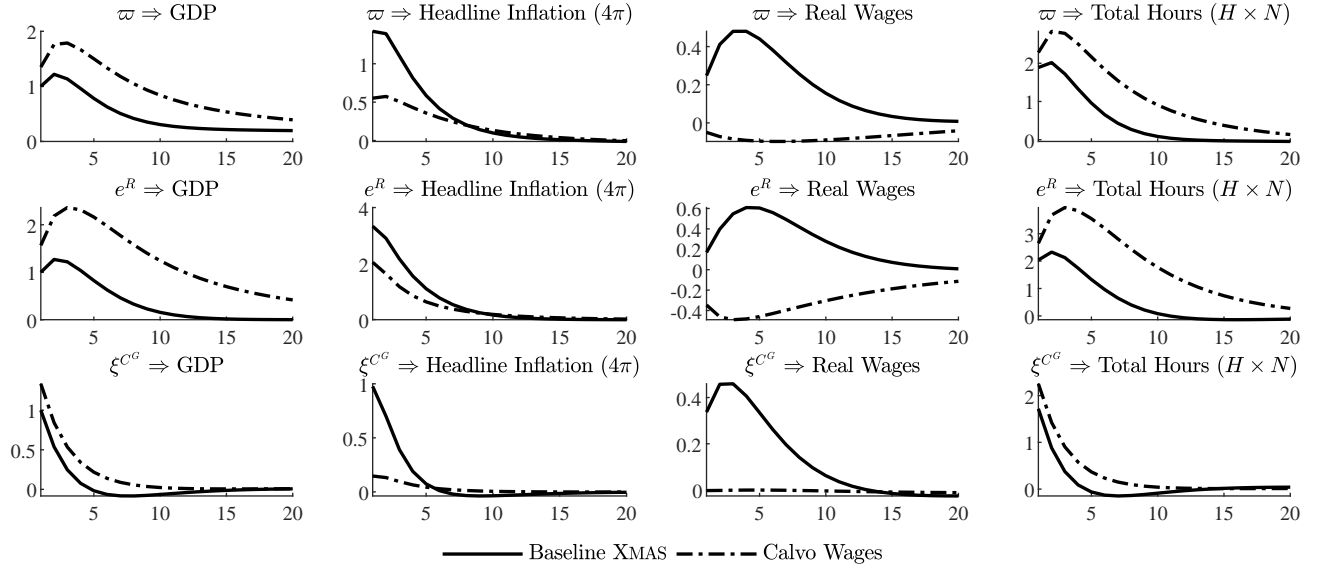
	Data	Baseline Model	Calvo Wages
$\sigma_{\log(h)}$	1.12	2.43	4.37
$\sigma_{\log(n)}$	0.85	0.83	0
$\sigma_{\log(h \times n)}$	1.32	2.83	4.37

<sup>27</sup>A complete description of the model with Calvo type wages is given in the appendix A. For the following exercises, we calibrate the parameter  $\theta_W$  to the posterior estimate of  $\pi_W = 0.83$  in order to generate comparable wage inertia across both specifications. Following Medina and Soto (2007) the elasticity of substitution among labor varieties is set as  $\epsilon_W = \epsilon_H = \epsilon_F = \epsilon_{H*} = 11$ . Finally, we set  $\omega^U = \omega = 0.5$  assuming unbiased unions.

<sup>28</sup>The empirical moments are computed in terms of log-deviations from a linear trend.



The introduction of search and matching significantly closes the gap between the model and the data second moments, particularly for the extensive margin. It also allows for additional insights on the mechanisms at play in the relationship between the labor market and the rest of the economy. We simulate the response to demand shocks for both the baseline specification, and an alternative with a centralized labor market and Calvo wage contracts. The baseline scenario, due to the additional frictions, shows a weaker adjustment of output, and a stronger response of wages and inflation. In the Calvo wages case, real wages fall in some cases due to prices adjusting faster than nominal wages.



Note: The figure displays the response of the corresponding variables to three different demand shocks: investment efficiency ( $\varpi$ ), monetary policy ( $e^R$ ), and government consumption ( $\xi^{CG}$ ). The size of each shock is calibrated to achieve a one percent increase in total GDP in the baseline specification.

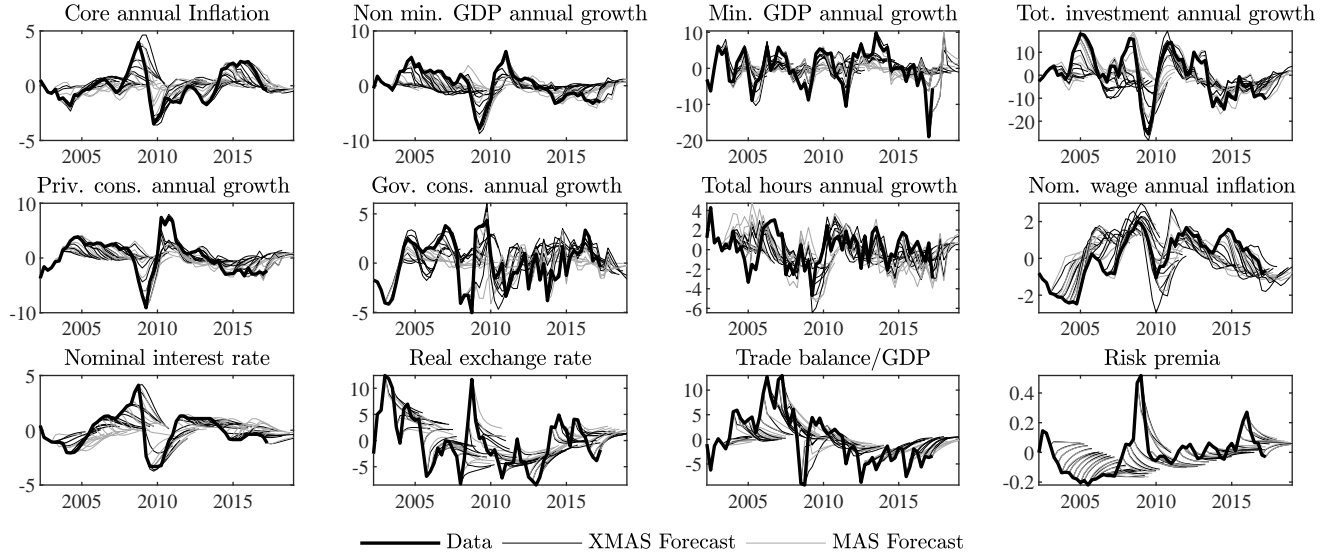
Figure 13: Demand shocks and the labor market

## 4.6 Model Forecast

We now compare the baseline model with the MAS specification in terms of forecast accuracy. We do in-sample forecasting, where all the variables are dynamically forecasted at different horizons, but always utilizing the full sample posterior parameters.<sup>29</sup> Figures 14 and 16 show respectively the models forecasts and forecast errors for the endogenous variables that both specifications observe. Despite the significantly added complexity of the XMAS specification, its forecast accuracy is fairly comparable to the simpler specification, even outperforming the MAS specification in some dimensions. In particular, XMAS does a much better job projecting total hours worked, thanks to the introduction of a search and matching framework. In addition, as shown in figures 15 and 17, the structure of

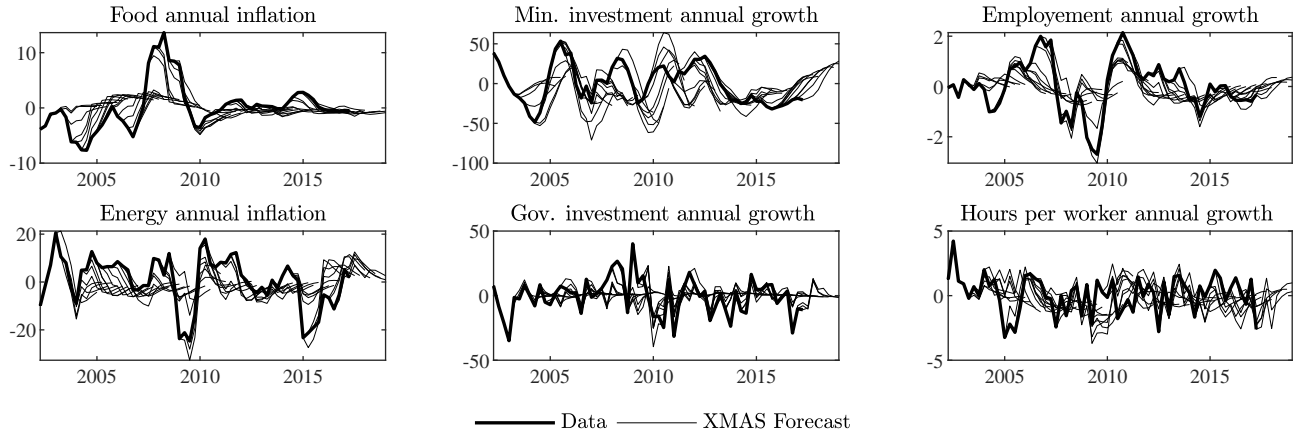
<sup>29</sup> Given our relatively short available data, a full out of sample forecast comparison with meaningful number of forecast evaluations would require the use of short samples for the initial estimations. Given the size of the model and the number of parameters to be estimated, the use of shorter samples would require increasingly tight priors in order to guarantee sensible results. The issue is even greater with the utilization of the endogenous priors approach, due to the mid-sample fluctuations in overall volatility generated in the aftermath of the 2008 financial crisis. For those reasons, we abstain to attempt full recursive estimation of the models.

XMAS allows for an assessment over individual components of investment, inflation, and labor market variables. It is reassuring that the increased granularity of the model does not come at the expense of a decrease in the precision of its forecasts.



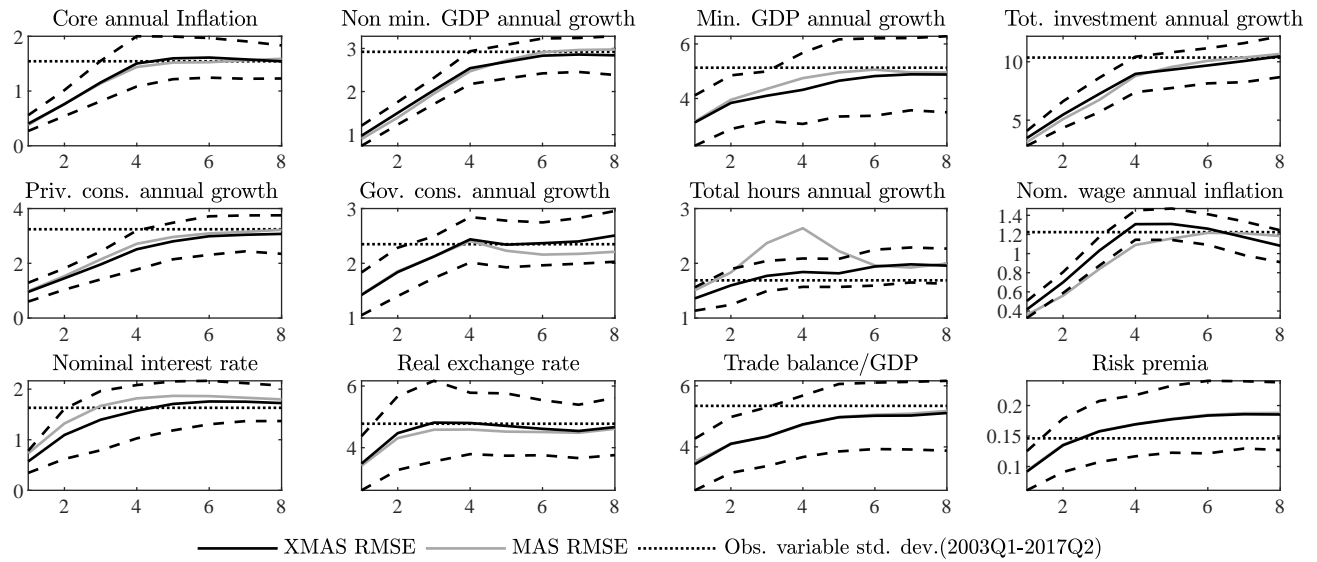
Note: All variables in deviation from sample mean.

Figure 14: Model forecasts of variables present on both XMAS and MAS specifications.



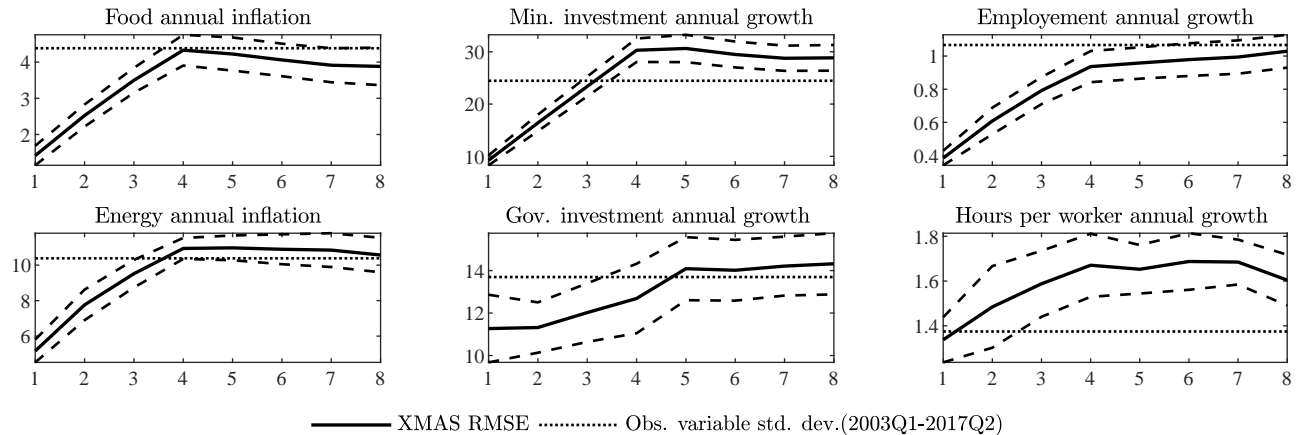
Note: All variables in deviation from sample mean.

Figure 15: Model forecasts of variables only present on XMAS specification..



Note: Dashed lines denote the 95% confidence interval of the XMAS root mean square errors computed with bootstrapping methods.

Figure 16: Root mean square error 1 to 8 periods ahead for variables observed on both XMAS and MAS specifications.



Note: Dashed lines denote the 95% confidence interval of the XMAS root mean square errors computed with bootstrapping methods.

Figure 17: Root mean square error 1 to 8 periods ahead for variables observed only on the XMAS specification.

## 5 Concluding Remarks

We present XMAS, a DSGE model for monetary policy analysis and macroeconomic projections that, building on Medina and Soto (2007), incorporates a range of new features, motivated by recent advances in the literature and the experience of commodity-exporting emerging economies in general, and Chile in particular. The improvements over the base model include a commodity sector with endogenous production and investment, a labor market with search and matching frictions that allows for labor variation on both the intensive and extensive margins, an augmented fiscal block, as well as additional shocks and other real and nominal frictions. We show that despite the significantly added complexity of Xmas, its empirical fit and forecast accuracy is comparable or better compared to the base

model. The main dimensions where Xmas outperforms the base model are consumption, nominal interest rates, and labor intensity.

Directions for future work include the introduction of an endogenous productivity fluctuation channel through on the job search and inter-firm labor transitions, the inclusion of an optimal monetary policy framework instead of the Taylor rule approach currently in place, the addition of financial frictions and a banking sector<sup>30</sup>, and the exploration of different expectational frameworks that may permit the modeling of anticipated monetary shocks with realistic outcomes, minimizing the forward guidance puzzle effect as described by Del Negro et al. (2015).

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<sup>30</sup>After the global financial crisis, models with extended financial-real connections or financial frictions have been developed (for a review, see Taylor and Uhlig, 2016). However, most of these models, such as Christiano et al. (2015), have been developed for economically and financially advanced economies. It is therefore not obvious that the financial frictions embedded in those models are also useful in the context of emerging economies with significant amounts of funding from abroad, for instance, to better understand the transmission of foreign shocks (see García-Cicco et al., 2015).

# Appendix

## A Calvo wages in the XMAS

In a standard New Keynesian model with Calvo wages, since the extensive margin is non-existent,  $n_t = 1$  and  $u_t = 0$  at all times. Since there is no unemployment, there is no role for the UFA, therefore we set  $B_t^{UFA} = TR_t^{UFA} = \tau_t^{UFA} = 0$ . Finally, there is no matching function, no exogenous or endogenous separations, and no vacancy postings, allowing us to dispense of vacancy and operating costs, setting  $X_t^L = 0$ .

Wages and hours are not determined by Nash bargaining. Instead both Ricardian and non-Ricardian households supply differentiated labor services to a continuum of unions which act as wage setters on behalf of the households in monopolistically competitive markets. The unions pool the wage income of all households and then distribute the aggregate wage income in equal proportions among the latter.<sup>31</sup> Once wages are set, the unions satisfy all labor demand at that wage.

Labor demand is given by the wholesale goods firm's cost minimization problem, which becomes much simpler:

$$\min_{\tilde{h}_t^d, K_t^S} L_t^{Y^{\tilde{Z}}} = W_t \tilde{h}_t^d + r_t^K K_t^S + mc_t^{\tilde{Z}} \left[ Y_t^{\tilde{Z}} - \left( \tilde{K}_t \right)^\alpha \left( A_t^H \tilde{h}_t^d \right)^{1-\alpha} \right] \quad (79)$$

Where  $\tilde{h}_t^d$  denotes the demand for units of composite labor. The optimal labor demand is given by

$$\tilde{h}_t^d = (1 - \alpha) \left( \frac{W_t}{mc_t^{\tilde{Z}}} \right)^{-1} Y_t^{\tilde{Z}} \quad (80)$$

This demand is satisfied by perfectly competitive packing firms which demand all varieties  $j \in [0, 1]$  of labor services in amounts  $h^d(j)$  and combines them in order to produce composite labor services ( $h$ ), much like the firms in 2.3.2, with the production function, variety  $j$  demand, and aggregate nominal wage respectively given by:

$$\tilde{h}_t = \left[ \int_0^1 h_t^d(j)^{\frac{\epsilon_W - 1}{\epsilon_W}} dj \right]^{\frac{\epsilon_W}{\epsilon_W - 1}}, \quad \epsilon_W > 0. \quad (81)$$

$$h_t^d(j) = \left( \frac{W_t^n(j)}{W_t^n} \right)^{-\epsilon_W} \tilde{h}_t \quad (82)$$

$$W_t^n = \left[ \int_0^1 W_t^n(j)^{1-\epsilon_W} dj \right]^{\frac{1}{1-\epsilon_W}}. \quad (83)$$

Regarding the supply of differentiated labor, following Erceg et al. (2000) and closely following the structure of the firms in 2.3.3 there is a continuum of monopolistically competitive unions indexed by  $i \in [0, 1]$ , which act as

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<sup>31</sup>Hence, households are insured against variations in household-specific wage income.

wage setters for the differentiated labor services supplied by households. The union supplying variety  $j$  satisfies the demand given by (82) but it has monopoly power for its variety. Wage setting is subject to a Calvo-type problem, whereby each period a union can set its nominal wage optimally with probability  $1 - \theta_W$ , and if it cannot optimally change its wage, it indexes its past wage according to a weighted product of past and steady state inflation with weights  $\vartheta_W \in [0, 1]$  and  $1 - \vartheta_W$ .<sup>32</sup> A union reoptimizing in period  $t$  is assumed to choose the wage  $\tilde{W}_t^n$  (equal for Ricardian and non Ricardian households) that maximizes the households lifetime utility until it can reoptimize.<sup>33</sup> All considered, taking the aggregate nominal wage as given, the union's  $i$  maximization problem can be expressed as

$$\begin{aligned} \max_{\tilde{W}_t^n(i)} E_t \sum_{s=0}^{\infty} (\beta \theta_W)^s \varrho_{t+s} & \left[ \omega^U \left( \Lambda_{t+s}^{NR} (1 - \tau_{t+s}^W) \frac{\tilde{W}_t^n \Gamma_{t,s}^W}{P_{t+s}} h_{t+s}(i) - \Theta_{t+s}^{NR} \kappa_{t+s} (A_{t+s-1}^H)^{1-\sigma} \frac{h_{t+s}^{1+\phi}(i)}{1+\phi} \right) \right. \\ & \left. + (1 - \omega^U) \left( \Lambda_{t+s}^R (1 - \tau_{t+s}^W) \frac{\tilde{W}_t^n \Gamma_{t,s}^W}{P_{t+s}} h_{t+s}(i) - \Theta_{t+s}^R \kappa_{t+s} (A_{t+s-1}^H)^{1-\sigma} \frac{h_{t+s}^{1+\phi}(i)}{1+\phi} \right) \right], \\ \text{s.t. } h_{t+s}(i) &= \left( \frac{\tilde{W}_t^n \Gamma_{t,s}^W}{W_{t+s}^n} \right)^{-\epsilon_W} \tilde{h}_{t+s}, \end{aligned}$$

A similar derivation than the one presented in section (2.3.3) yields<sup>34</sup>

$$\begin{aligned} f_t^W &= mc_t^W \tilde{w}_t^{-\epsilon_W(1+\phi)} \tilde{h}_t + \beta \theta_W E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\Lambda_{t+1}^U}{\Lambda_t^U} \frac{(1 - \tau_{t+1}^W)}{(1 - \tau_t^W)} \frac{\pi_{t+1}^W}{\pi_t^W} \left( \frac{g_t^{\Gamma^W}}{\pi_{t+1}^W} \right)^{-\epsilon_W(1+\phi)} \left( \frac{\tilde{w}_t}{\tilde{w}_{t+1}} \right)^{-\epsilon_W(1+\phi)} f_{t+1}^W \right\} \\ f_t^W &= \tilde{w}_t^{1-\epsilon_W} \tilde{h}_t \left( \frac{\epsilon_W - 1}{\epsilon_W} \right) + \beta \theta_W E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\Lambda_{t+1}^U}{\Lambda_t^U} \frac{(1 - \tau_{t+1}^W)}{(1 - \tau_t^W)} \left( \frac{\pi_{t+1}^W}{\pi_t^W} \right)^{\epsilon_W} \left( \frac{g_t^{\Gamma^W}}{\pi_{t+1}^W} \right)^{1-\epsilon_W} \left( \frac{\tilde{w}_t}{\tilde{w}_{t+1}} \right)^{1-\epsilon_W} f_{t+1}^W \right\}, \end{aligned}$$

and

$$1 = (1 - \theta_W) \tilde{w}_t^{1-\epsilon_W} + \theta_W \left( \frac{g_t^{\Gamma^W}}{\pi_t^W} \right)^{1-\epsilon_W}.$$

Finally, the clearing condition for the labor market is

$$h_t = \int_0^1 h_t(j) dj = \int_0^1 h_t^d(j) dj = \tilde{h}_t \int_0^1 w_t(j)^{-\epsilon_F} dj = \tilde{h}_t \Delta_t^W = \tilde{h}_t^d \Delta_t^W,$$

<sup>32</sup>As in section 2.3.3,  $g_t^{\Gamma^W} \equiv [(\pi_t)^{\vartheta_W} (\pi_t^Z)^{1-\vartheta_W}]^{\vartheta_W} \pi_t^{1-\vartheta_W}$  is the gross growth rate of the indexation variable.

<sup>33</sup>The union weights the benefits of wage income by considering the agents' marginal utility of consumption – which will usually differ between Ricardian and non-Ricardian households – and a subjective weight on their welfare. The unions take into account the fact that firms allocate their labor demand uniformly across different kind of workers, and therefore  $h_t^R(i) = h_t^{NR}(i) = h_t(i) \forall i, t$ .

<sup>34</sup>Where  $\Lambda_{t+s}^U \equiv \omega^U \Lambda_{t+s}^{NR} + (1 - \omega^U) \Lambda_{t+s}^R$  is the weighted marginal utility of consumption relevant for the union's decision,  $\tilde{w}_t = \tilde{W}_t^n / W_t^n$  denotes the optimal nominal wage relative to the aggregate nominal wage index,  $\pi_t^W = W_t^n / W_{t-1}^n$  is the wage inflation, and  $mc_t^W = \frac{-U_H^U / U_C}{(1 - \tau_t^W) W_t^n / P_t} = \frac{\Theta_t^U \kappa_t (A_{t-1}^H)^{1-\sigma} (h_t)^\phi / \Lambda_t^U}{(1 - \tau_t^W) W_t^n}$  denotes the gap with the efficient allocation when wages are flexible.  $\Theta_{t+s}^U \equiv \omega^U \Theta_{t+s}^{NR} + (1 - \omega^U) \Theta_{t+s}^R$  is the weighted endogenous shifter.

Where  $\Delta_t^W$  is a wage dispersion term that satisfies

$$\Delta_t^W = (1 - \theta_W) \tilde{w}_t^{-\epsilon_W} + \theta_W \left( \frac{g_{t-1}^W}{\pi_t^W} \right)^{-\epsilon_W} \Delta_{t-1}^W,$$

## B Equilibrium and Steady State equations

### B.1 Equilibrium Conditions

The variables in uppercase that are not prices contain a unit root in equilibrium due to the presence of the non-stationary productivity shock  $A_t$ . We need to transform these variables to have a stationary version of the model. To do this, with the exceptions we enumerate below, lowercase variables denote the uppercase variable divided by  $A_{t-1}$  (e.g.  $c_t \equiv \frac{C_t}{A_{t-1}}$ ). There are two exceptions: first is the Lagrange multiplier  $\Lambda_t$  that is multiplied by  $A_{t-1}^\sigma$  (i.e.  $\lambda_t \equiv \Lambda_t A_{t-1}^\sigma$ ), for it decreases along the balanced growth path. Second, we need to define the parameter  $\psi_t^U = \Psi_t^U / A_{t-1}^\sigma$  in order to define a stationary equilibrium in the labor market.

The rational expectations equilibrium of the stationary version of the model is the set of sequences for the endogenous variables such that for given initial values and exogenous variables and assuming

$$\tilde{c}_t \sim \log N(\mu_{\tilde{c}}, \sigma_{\tilde{c}}^2)$$

the following conditions are satisfied:

from Households (2.1):

$$\hat{c}_t^R = \left[ (1 - o_{\hat{C}})^{\frac{1}{\eta_{\hat{C}}}} (c_t^R - \varsigma c_{t-1}^R / a_{t-1})^{\frac{\eta_{\hat{C}} - 1}{\eta_{\hat{C}}}} + o_{\hat{C}}^{\frac{1}{\eta_{\hat{C}}}} (c_t^G)^{\frac{\eta_{\hat{C}} - 1}{\eta_{\hat{C}}}} \right]^{\frac{\eta_{\hat{C}}}{\eta_{\hat{C}} - 1}} \quad (\text{EE.1})$$

$$\hat{c}_t^{NR} = \left[ (1 - o_{\hat{C}})^{\frac{1}{\eta_{\hat{C}}}} (c_t^{NR} - \varsigma c_{t-1}^{NR} / a_{t-1})^{\frac{\eta_{\hat{C}} - 1}{\eta_{\hat{C}}}} + o_{\hat{C}}^{\frac{1}{\eta_{\hat{C}}}} (c_t^G)^{\frac{\eta_{\hat{C}} - 1}{\eta_{\hat{C}}}} \right]^{\frac{\eta_{\hat{C}}}{\eta_{\hat{C}} - 1}} \quad (\text{EE.2})$$

$$\tau_t^L = \tau_t^{UFA} + \tau_t^W \quad (\text{EE.3})$$

$$k_t^{S,R} = \bar{u}_t \frac{k_{t-1}^R}{a_{t-1}} \quad (\text{EE.4})$$

$$\phi_{\bar{u}}(\bar{u}_t) = \frac{r^k}{\Phi_{\bar{u}}} \left( e^{\Phi_{\bar{u}}(\bar{u}_t - 1)} - 1 \right) \quad (\text{EE.5})$$

$$k_t^R = (1 - \delta) \frac{k_{t-1}^R}{a_{t-1}} + \left( 1 - \frac{\Phi_I}{2} \left( \frac{i_t^R}{i_{t-1}^R} a_{t-1} - a \right)^2 \right) \varpi_t i_t^R \quad (\text{EE.6})$$

$$(1 + \tau_t^C) \lambda_t^R = (\hat{c}_t^R)^{-\sigma} \left( \frac{(1 - o_{\hat{C}}) \hat{c}_t^R}{c_t^R - \varsigma c_{t-1}^R / a_{t-1}} \right)^{\frac{1}{\eta_{\hat{C}}}} \quad (\text{EE.7})$$

$$\lambda_t^R = \frac{\beta}{a_t^\sigma} R_t E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\pi_{t+1}} \right\} \quad (\text{EE.8})$$

$$\lambda_t^R = \frac{\beta}{a_t^\sigma} R_t^* \xi_t E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\pi_{t+1}^S \lambda_{t+1}^R}{\pi_{t+1}} \right\} \quad (\text{EE.9})$$

$$q_t = \frac{\beta}{a_t^\sigma} E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} \left[ \begin{array}{l} r_{t+1}^K \bar{u}_{t+1} (1 - \tau_{t+1}^K) + q_{t+1} (1 - \delta) \\ + p_{t+1}^I [\tau_{t+1}^K \delta - \phi_{\bar{u}}(\bar{u}_{t+1}) (1 - \tau_{t+1}^K)] \end{array} \right] \right\} \quad (\text{EE.10})$$

$$\begin{aligned} \frac{p_t^I}{q_t} &= \left[ \left( 1 - \frac{\Phi_I}{2} \left( \frac{i_t^R}{i_{t-1}^R} a_{t-1} - a \right)^2 \right) - \Phi_I \left( \frac{i_t^R}{i_{t-1}^R} a_{t-1} - a \right) \frac{i_t^R}{i_{t-1}^R} a_{t-1} \right] \varpi_t \\ &+ \frac{\beta}{a_t^\sigma} E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} \frac{q_{t+1}}{q_t} \Phi_I \left( \frac{i_{t+1}^R}{i_t^R} a_t - a \right) \left( \frac{i_{t+1}^R}{i_t^R} a_t \right)^2 \varpi_{t+1} \right\} \end{aligned} \quad (\text{EE.11})$$

$$\bar{u}_t = 1 + \frac{\log(r_t^K / r^K) - \log(p_t^I)}{\Phi_{\bar{u}}} \quad (\text{EE.12})$$

$$\xi_t = \bar{\xi} \exp \left[ -\psi \left( \frac{rer_t b_t^*}{p_t^Y y_t} - \frac{rer b^*}{p^Y y} \right) + \frac{\zeta_t^O - \zeta^O}{\zeta^O} + \frac{\zeta_t^U - \zeta^U}{\zeta^U} \right] \quad (\text{EE.13})$$

$$b_t^* = b_t^{Pr^*} + b_t^{G^*} \quad (\text{EE.14})$$

$$(1 + \tau_t^C) \lambda_t^{NR} = (\hat{c}_t^{NR})^{-\sigma} \left( \frac{(1 - o_{\hat{C}}) \hat{c}_t^{NR}}{c_t^{NR} - \varsigma c_{t-1}^{NR} / a_{t-1}} \right)^{\frac{1}{\eta_{\hat{C}}}} \quad (\text{EE.15})$$

$$(1 + \tau_t^C) c_t^{NR} = (1 - \tau_t^L) w_t n_t h_t + u_t u b + t r_t^{NR} - t_t^{NR} \quad (\text{EE.16})$$

$$\Theta_t^R = \tilde{\chi}_t^R (\nabla_{t-1}^H)^\sigma (\hat{c} (c_t^R - \varsigma c_{t-1}^R / a_{t-1}, c^G))^{-\sigma} \quad (\text{EE.17})$$

$$\Theta_t^{NR} = \tilde{\chi}_t^{NR} (\nabla_{t-1}^H)^\sigma (\hat{c} (c_t^{NR} - \varsigma c_{t-1}^{NR} / a_{t-1}, c^G))^{-\sigma} \quad (\text{EE.18})$$

$$\tilde{\chi}_t^R = (\tilde{\chi}_{t-1}^R)^{1-\nu} (\nabla_{t-1}^H)^{-\sigma\nu} (\hat{c} (c_t^R - \varsigma c_{t-1}^R / a_{t-1}, c^G))^{\sigma\nu} \quad (\text{EE.19})$$

$$\tilde{\chi}_t^{NR} = (\tilde{\chi}_{t-1}^{NR})^{1-\nu} (\nabla_{t-1}^H)^{-\sigma\nu} (\hat{c} (c_t^{NR} - \varsigma c_{t-1}^{NR} / a_{t-1}, c^G))^{\sigma\nu} \quad (\text{EE.20})$$

from Labor Market (2.2):

$$n_t = (1 - \rho_t) \left( n_{t-1} + m_{t-1} v_{t-1}^{1-\mu} u_{t-1}^\mu \right) \quad (\text{EE.21})$$

$$u_t = 1 - n_t \quad (\text{EE.22})$$



$$s_t = m_t \left( \frac{v_t}{u_t} \right)^{1-\mu} \quad (\text{EE.23})$$

$$e_t = m_t \left( \frac{v_t}{u_t} \right)^{-\mu} \quad (\text{EE.24})$$

$$\rho_t = \rho_t^x + (1 - \rho_t^x) \rho_t^n \quad (\text{EE.25})$$

$$\rho_t^n = 1 - F(\bar{c}_t) = 1 - \Phi \left( \frac{\ln \bar{c}_t - \mu_{\bar{c}}}{\sigma_{\bar{c}}} \right) \quad (\text{EE.26})$$

where  $\Phi$  is the standard normal c.d.f.

from Final Goods (2.3.1):

$$c_t = \left[ (1 - \kappa_O - \kappa_A)^{\frac{1}{\eta_C}} (c_t^Z)^{\frac{\eta_C - 1}{\eta_C}} + \kappa_O^{\frac{1}{\eta_C}} (c_t^O)^{\frac{\eta_C - 1}{\eta_C}} + \kappa_A^{\frac{1}{\eta_C}} (c_t^A)^{\frac{\eta_C - 1}{\eta_C}} \right]^{\frac{\eta_C}{\eta_C - 1}} \quad (\text{EE.27})$$

$$c_t^Z = (1 - \kappa_O - \kappa_A) (p_t^Z)^{-\eta_C} c_t \quad (\text{EE.28})$$

$$c_t^O = \kappa_O (p_t^O)^{-\eta_C} c_t \quad (\text{EE.29})$$

$$c_t^A = \kappa_A (p_t^A)^{-\eta_C} c_t \quad (\text{EE.30})$$

$$c_t^Z = \left[ (1 - o_Z)^{\frac{1}{\eta_Z}} (x_t^{Z,H})^{\frac{\eta_Z - 1}{\eta_Z}} + o_Z^{\frac{1}{\eta_Z}} (x_t^{Z,F})^{\frac{\eta_Z - 1}{\eta_Z}} \right]^{\frac{\eta_Z}{\eta_Z - 1}} \quad (\text{EE.31})$$

$$x_t^{Z,F} = o_Z (p_t^F / p_t^Z)^{-\eta_Z} c_t^Z \quad (\text{EE.32})$$

$$x_t^{Z,H} = (1 - o_Z) (p_t^H / p_t^Z)^{-\eta_Z} c_t^Z \quad (\text{EE.33})$$

$$c_t^A = z_t^A \left[ (1 - o_A)^{\frac{1}{\eta_A}} (x_t^{A,H})^{\frac{\eta_A - 1}{\eta_A}} + o_A^{\frac{1}{\eta_A}} (x_t^{A,F})^{\frac{\eta_A - 1}{\eta_A}} \right]^{\frac{\eta_A}{\eta_A - 1}} \quad (\text{EE.34})$$

$$x_t^{A,F} = (z_t^A)^{\eta_A - 1} o_A (p_t^F / p_t^A)^{-\eta_A} c_t^A \quad (\text{EE.35})$$

$$x_t^{A,H} = (z_t^A)^{\eta_A - 1} (1 - o_A) (p_t^H / p_t^A)^{-\eta_A} c_t^A \quad (\text{EE.36})$$

$$c_t^G = \left[ (1 - o_{CG})^{\frac{1}{\eta_{CG}}} (x_t^{CG,H})^{\frac{\eta_{CG} - 1}{\eta_{CG}}} + o_{CG}^{\frac{1}{\eta_{CG}}} (x_t^{CG,F})^{\frac{\eta_{CG} - 1}{\eta_{CG}}} \right]^{\frac{\eta_{CG}}{\eta_{CG} - 1}} \quad (\text{EE.37})$$

$$x_t^{CG,F} = o_{CG} (p_t^F / p_t^{CG})^{-\eta_{CG}} c_t^G \quad (\text{EE.38})$$

$$x_t^{CG,H} = (1 - o_{CG}) (p_t^H / p_t^{CG})^{-\eta_{CG}} c_t^G \quad (\text{EE.39})$$

$$i_t^f = \left[ (1 - o_I)^{\frac{1}{\eta_I}} (x_t^{I,H})^{\frac{\eta_I - 1}{\eta_I}} + o_I^{\frac{1}{\eta_I}} (x_t^{I,F})^{\frac{\eta_I - 1}{\eta_I}} \right]^{\frac{\eta_I}{\eta_I - 1}} \quad (\text{EE.40})$$

$$x_t^{I,F} = o_I (p_t^F / p_t^I)^{-\eta_I} i_t^f \quad (\text{EE.41})$$

$$x_t^{I,H} = (1 - o_I) (p_t^H / p_t^I)^{-\eta_I} i_t^f \quad (\text{EE.42})$$

$$i_t^f = i_t + \phi_{\bar{u}}(\bar{u}_t) \frac{k_{t-1}}{a_{t-1}} \quad (\text{EE.43})$$

$$i_t^{Co,f} = \left[ (1 - o_{Co})^{\frac{1}{\eta_{Co}}} \left( x_t^{Co,H} \right)^{\frac{\eta_{Co}-1}{\eta_{Co}}} + o_{Co}^{\frac{1}{\eta_{Co}}} \left( x_t^{Co,F} \right)^{\frac{\eta_{Co}-1}{\eta_{Co}}} \right]^{\frac{\eta_{Co}}{\eta_{Co}-1}} \quad (\text{EE.44})$$

$$x_t^{Co,F} = o_{Co} (p_t^F / p_t^{ICo})^{-\eta_{Co}} i_t^{Co,f} \quad (\text{EE.45})$$

$$x_t^{Co,H} = (1 - o_{Co}) (p_t^H / p_t^{ICo})^{-\eta_{Co}} i_t^{Co,f} \quad (\text{EE.46})$$

$$i_t^G = \left[ (1 - o_{IG})^{\frac{1}{\eta_{IG}}} \left( x_t^{IG,H} \right)^{\frac{\eta_{IG}-1}{\eta_{IG}}} + o_{IG}^{\frac{1}{\eta_{IG}}} \left( x_t^{IG,F} \right)^{\frac{\eta_{IG}-1}{\eta_{IG}}} \right]^{\frac{\eta_{IG}}{\eta_{IG}-1}} \quad (\text{EE.47})$$

$$x_t^{IG,F} = o_{IG} (p_t^F / p_t^{IG})^{-\eta_{IG}} i_t^G \quad (\text{EE.48})$$

$$x_t^{IG,H} = (1 - o_{IG}) (p_t^H / p_t^{IG})^{-\eta_{IG}} i_t^G \quad (\text{EE.49})$$

from Differentiated Varieties (2.3.3):

$$\begin{aligned} f_t^H &= (\tilde{p}_t^H)^{-\epsilon_H} y_t^H m c_t^H + \frac{\beta}{a_t^{\sigma-1}} \theta_H \\ &\times E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} \left( \frac{g_t^{\Gamma^H}}{\pi_{t+1}} \frac{\tilde{p}_t^H}{\tilde{p}_{t+1}^H} \right)^{-\epsilon_H} \left( \frac{p_t^H}{p_{t+1}^H} \frac{(1 + \tau_{t+1}^C)}{(1 + \tau_t^C)} \right)^{-1-\epsilon_H} f_{t+1}^H \right\} \end{aligned} \quad (\text{EE.50})$$

$$\begin{aligned} f_t^H &= (\tilde{p}_t^H)^{1-\epsilon_H} y_t^H \left( \frac{\epsilon_H - 1}{\epsilon_H} \right) + \frac{\beta}{a_t^{\sigma-1}} \theta_H \\ &\times E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} \left( \frac{g_t^{\Gamma^H}}{\pi_{t+1}} \frac{\tilde{p}_t^H}{\tilde{p}_{t+1}^H} \right)^{1-\epsilon_H} \left( \frac{p_t^H}{p_{t+1}^H} \frac{(1 + \tau_{t+1}^C)}{(1 + \tau_t^C)} \right)^{-\epsilon_H} f_{t+1}^H \right\} \end{aligned} \quad (\text{EE.51})$$

$$1 = (1 - \theta_H) (\tilde{p}_t^H)^{1-\epsilon_H} + \theta_H \left( \frac{p_{t-1}^H}{p_t^H} \frac{g_{t-1}^{\Gamma^H}}{\pi_t} \frac{(1 + \tau_t^C)}{(1 + \tau_{t-1}^C)} \right)^{1-\epsilon_H} \quad (\text{EE.52})$$

$$m c_t^H = \frac{p_t^{\tilde{H}}}{p_t^H} \quad (\text{EE.53})$$

$$g_t^{\Gamma^H} = \left[ (\pi_t)^{\vartheta_\pi} (\pi_t^Z)^{1-\vartheta_\pi} \right]^{\vartheta_H} \pi^{1-\vartheta_H} \quad (\text{EE.54})$$

$$\begin{aligned}
f_t^F &= (\tilde{p}_t^F)^{-\epsilon_F} y_t^F m c_t^F + \frac{\beta}{a_t^{\sigma-1}} \theta_F \\
&\times E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} \left( \frac{g_t^{\Gamma^F}}{\pi_{t+1}} \frac{\tilde{p}_t^F}{\tilde{p}_{t+1}^F} \right)^{-\epsilon_F} \left( \frac{p_t^F}{p_{t+1}^F} \frac{(1 + \tau_{t+1}^C)}{(1 + \tau_t^C)} \right)^{-1-\epsilon_F} f_{t+1}^F \right\}
\end{aligned} \tag{EE.55}$$

$$\begin{aligned}
f_t^F &= (\tilde{p}_t^F)^{1-\epsilon_F} y_t^F \left( \frac{\epsilon_F - 1}{\epsilon_F} \right) + \frac{\beta}{a_t^{\sigma-1}} \theta_F \\
&\times E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} \left( \frac{g_t^{\Gamma^F}}{\pi_{t+1}} \frac{\tilde{p}_t^F}{\tilde{p}_{t+1}^F} \right)^{1-\epsilon_F} \left( \frac{p_t^F}{p_{t+1}^F} \frac{(1 + \tau_{t+1}^C)}{(1 + \tau_t^C)} \right)^{-\epsilon_F} f_{t+1}^F \right\}
\end{aligned} \tag{EE.56}$$

$$1 = (1 - \theta_F) (\tilde{p}_t^F)^{1-\epsilon_F} + \theta_F \left( \frac{p_{t-1}^F}{p_t^F} \frac{g_{t-1}^{\Gamma^F}}{\pi_t} \frac{(1 + \tau_t^C)}{(1 + \tau_{t-1}^C)} \right)^{1-\epsilon_F} \tag{EE.57}$$

$$m c_t^F = \frac{p^{M*} r e r_t}{p_t^F} \tag{EE.58}$$

$$g_t^{\Gamma^F} = \left[ (\pi_t)^{\vartheta_\pi} (\pi_t^Z)^{1-\vartheta_\pi} \right]^{\vartheta_F} \pi^{1-\vartheta_F} \tag{EE.59}$$

$$\begin{aligned}
f_t^{H*} &= (\tilde{p}_t^{H*})^{-\epsilon_{H*}} y_t^{H*} m c_t^{H*} + \frac{\beta}{a_t^{\sigma-1}} \theta_{H*} \\
&\times E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} \frac{r e r_{t+1}}{r e r_t} \left( \frac{g_t^{\Gamma^{H*}}}{\pi_{t+1}^*} \frac{\tilde{p}_t^{H*}}{\tilde{p}_{t+1}^{H*}} \right)^{-\epsilon_{H*}} \left( \frac{p_t^{H*}}{p_{t+1}^{H*}} \right)^{-1-\epsilon_{H*}} f_{t+1}^{H*} \right\}
\end{aligned} \tag{EE.60}$$

$$\begin{aligned}
f_t^{H*} &= (\tilde{p}_t^{H*})^{1-\epsilon_{H*}} y_t^{H*} \left( \frac{\epsilon_{H*} - 1}{\epsilon_{H*}} \right) + \frac{\beta}{a_t^{\sigma-1}} \theta_{H*} \\
&\times E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} \frac{r e r_{t+1}}{r e r_t} \left( \frac{g_t^{\Gamma^{H*}}}{\pi_{t+1}^*} \frac{\tilde{p}_t^{H*}}{\tilde{p}_{t+1}^{H*}} \right)^{1-\epsilon_{H*}} \left( \frac{p_t^{H*}}{p_{t+1}^{H*}} \right)^{-\epsilon_{H*}} f_{t+1}^{H*} \right\}
\end{aligned} \tag{EE.61}$$

$$1 = (1 - \theta_{H*}) (\tilde{p}_t^{H*})^{1-\epsilon_{H*}} + \theta_{H*} \left( \frac{p_{t-1}^{H*}}{p_t^{H*}} \frac{g_{t-1}^{\Gamma^{H*}}}{\pi_t^*} \right)^{1-\epsilon_{H*}} \tag{EE.62}$$

$$m c_t^{H*} = \frac{\tilde{p}_t^{\tilde{H}}}{r e r_t p_t^{H*}} \tag{EE.63}$$

$$g_t^{\Gamma^{H*}} = (\pi_t^*)^{\vartheta_{H*}} (\pi^*)^{1-\vartheta_{H*}} \tag{EE.64}$$

from Wholesale Domestic Goods (2.3.4):

$$y_t^{\tilde{H}} = z_t \left[ (1 - o_O)^{\frac{1}{\eta_O}} \left( x_t^{\tilde{Z}} \right)^{\frac{\eta_O-1}{\eta_O}} + o_O^{\frac{1}{\eta_O}} \left( x_t^O \right)^{\frac{\eta_O-1}{\eta_O}} \right]^{\frac{\eta_O}{\eta_O-1}} \tag{EE.65}$$

$$x_t^{\tilde{Z}} = (z_t)^{\eta_O - 1} (1 - o_O) \left( \frac{mc_t^{\tilde{Z}}}{p_t^{\tilde{H}}} \right)^{-\eta_O} y_t^{\tilde{H}} \quad (\text{EE.66})$$

$$x_t^O = (z_t)^{\eta_O - 1} o_O \left( \frac{p_t^O}{p_t^{\tilde{H}}} \right)^{-\eta_O} y_t^{\tilde{H}} \quad (\text{EE.67})$$

$$y_t^{\tilde{Z}} = (\tilde{k}_t)^\alpha (a_t \nabla_t^H n_t h_t)^{1-\alpha} \quad (\text{EE.68})$$

$$\tilde{k}_t = \alpha \left( \frac{r_t^{\tilde{K}}}{mc_t^{\tilde{Z}}} \right)^{-1} y_t^{\tilde{Z}} \quad (\text{EE.69})$$

$$\tilde{k}_t = \left[ (1 - o_{KG})^{\frac{1}{\eta_{KG}}} (k_t^S)^{\frac{\eta_{KG}-1}{\eta_{KG}}} + o_{KG}^{\frac{1}{\eta_{KG}}} \left( \frac{k_{t-1}^G}{a_{t-1}} \right)^{\frac{\eta_{KG}-1}{\eta_{KG}}} \right]^{\frac{\eta_{KG}}{\eta_{KG}-1}} \quad (\text{EE.70})$$

$$k_t^S = (1 - o_{KG}) \left( \frac{r_t^K}{r_t^{\tilde{K}}} \right)^{-\eta_{KG}} \tilde{k}_t \quad (\text{EE.71})$$

$$\frac{\nabla_{t-1}^H p_t^H \Omega_v}{e_t} = \frac{\beta}{a_t^{\sigma-1}} E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} (1 - \rho_{t+1}) \begin{pmatrix} mc_{t+1}^{\tilde{Z}} (1 - \alpha) \frac{y_{t+1}^{\tilde{Z}}}{n_{t+1}} - w_{t+1} h_{t+1} \\ -p_{t+1}^H h_{t+1}^C + \frac{\nabla_t^H p_{t+1}^H \Omega_v}{e_{t+1}} \end{pmatrix} \right\} \quad (\text{EE.72})$$

$$\nabla_{t-1}^H p_t^H \bar{c}_t = mc_t^{\tilde{Z}} (1 - \alpha) \frac{y_t^{\tilde{Z}}}{n_t} - w_t h_t + \frac{\nabla_{t-1}^H p_t^H \Omega_v}{e_t} \quad (\text{EE.73})$$

$$h_t^C = \nabla_{t-1}^H \frac{\exp\left(\mu_{\bar{c}} + \frac{\sigma_{\bar{c}}^2}{2}\right) \Phi\left(\frac{\ln \bar{c}_t - \mu_{\bar{c}} - \sigma_{\bar{c}}^2}{\sigma_{\bar{c}}}\right)}{1 - \rho_t^n} \quad (\text{EE.74})$$

from Wages and Hours (2.3.5):

$$h_t = \left[ \frac{mc_t^{\tilde{Z}} (1 - \alpha)^2 \frac{y_t^{\tilde{Z}}}{n_t}}{\frac{\psi_t^U \kappa_t}{(1 - \tau_t^L)} (\nabla_{t-1}^H)^{1-\sigma}} \right]^{\frac{1}{1+\phi}} \quad (\text{EE.75})$$

$$\begin{aligned} w_t^n h_t &= \varphi^U \left[ mc_t^{\tilde{Z}} (1 - \alpha) \frac{y_t^{\tilde{Z}}}{n_t} - p_t^H h_t^C + \nabla_{t-1}^H \frac{p_t^H \Omega_v}{e_t} \right] \\ &+ \frac{(1 - \varphi^U)}{(1 - \tau_t^L)} \left[ ub + \psi_t^U \kappa_t (\nabla_{t-1}^H)^{1-\sigma} \frac{h_t^{1+\phi}}{1 + \phi} - (1 - s_t) \sigma_t^U \right] \end{aligned} \quad (\text{EE.76})$$

$$\sigma_t^U = (1 - \omega^U) E_t \left\{ \frac{\beta}{a_t^\sigma} \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} (1 - \rho_{t+1}) s_{t+1}^{R,U} \right\} + \omega^U E_t \left\{ \frac{\beta}{a_t^\sigma} \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^{NR}}{\lambda_t^{NR}} (1 - \rho_{t+1}) s_{t+1}^{NR,U} \right\} \quad (\text{EE.77})$$

$$s_t^{R,U} = (1 - \tau_t^L) w_t^n h_t - \frac{\Theta_t^R \kappa_t (\nabla_{t-1}^H)^{1-\sigma} \frac{h_t^{1+\phi}}{1+\phi}}{\lambda_t^R} - ub + (1 - s_t) E_t \left\{ \frac{\beta}{a_t^\sigma} \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} (1 - \rho_{t+1}) s_{t+1}^{R,U} \right\} \quad (\text{EE.78})$$

$$s_t^{NR,U} = (1 - \tau_t^L) w_t^n h_t - \frac{\Theta_t^{NR} \kappa_t (\nabla_{t-1}^H)^{1-\sigma} h_t^{1+\phi}}{\lambda_t^{NR}} - ub + (1 - s_t) E_t \left\{ \frac{\beta}{a_t^\sigma} \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^{NR}}{\lambda_t^{NR}} (1 - \rho_{t+1}) s_{t+1}^{NR,U} \right\} \quad (\text{EE.79})$$

$$\pi_t w_t = \varkappa_W \Gamma_{t-1}^W \frac{w_{t-1}}{a_{t-1}} \frac{(1 + \tau_t^C)}{(1 + \tau_{t-1}^C)} + (1 - \varkappa_W) \pi_t w_t^n \quad (\text{EE.80})$$

$$\Gamma_t^W = \left( a_t \frac{\nabla_t^H}{\nabla_{t-1}^H} \right)^{\alpha_W} (a)^{1-\alpha_W} \left[ (\pi_t)^{\vartheta_\pi} (\pi_t^Z)^{1-\vartheta_\pi} \right]^{\vartheta_W} \pi^{1-\vartheta_W} \quad (\text{EE.81})$$

$$\psi_t^U = (1 - \omega^U) \frac{\Theta_t^R}{\lambda_t^R} + \omega^U \frac{\Theta_t^{NR}}{\lambda_t^{NR}} \quad (\text{EE.82})$$

from Commodity sector investment and output (2.3.6):

$$y_t^{Co} = z_t^{Co} \left( \bar{u}_t^{Co} \frac{k_{t-1}^{Co}}{a_{t-1}} \right)^{\alpha_{Co}} (a_t \nabla_t^{Co} \bar{L})^{1-\alpha_{Co}} \quad (\text{EE.83})$$

$$k_t^{Co} = (1 - \delta_{Co}) \frac{k_{t-1}^{Co}}{a_{t-1}} + \left( 1 - \frac{\Phi_I^{Co}}{2} \left( \frac{i_{t-N_{Co}+1}^{ACo}}{i_{t-N_{Co}}^{ACo}} a_{t-N_{Co}} - a \right)^2 \right) \frac{i_{t-N_{Co}+1}^{ACo} a_t}{\prod_{i=1}^{N_{Co}} a_{t+1-i}} \varpi_{t-N_{Co}+1}^{Co} \quad (\text{EE.84})$$

$$i_t^{Co} = \varphi_0^{Co} i_t^{ACo} + \frac{\varphi_1^{Co} i_{t-1}^{ACo}}{a_{t-1}} + \frac{\varphi_2^{Co} i_{t-2}^{ACo}}{a_{t-1} a_{t-2}} + \dots + \frac{\varphi_{N_{Co}-1}^{Co} i_{t-N_{Co}+1}^{ACo}}{a_{t-1} a_{t-2} \dots a_{t-N_{Co}+1}} \quad (\text{EE.85})$$

$$\phi_{\bar{u}}^{Co} (\bar{u}_t^{Co}) \equiv \frac{r^{K,Co}}{\Phi_{\bar{u}}^{Co}} \left( e^{\Phi_{\bar{u}}^{Co} (\bar{u}_t^{Co} - 1)} - 1 \right) \quad (\text{EE.86})$$

$$i_t^{Co,f} = i_t^{Co} + \phi_{\bar{u}}^{Co} (\bar{u}_t^{Co}) \frac{k_{t-1}^{Co}}{a_{t-1}} \quad (\text{EE.87})$$

$$cf_t^{Co} = rer_t p_t^{Co*} y_t^{Co} - p_t^{ICo} i_t^{Co,f} \quad (\text{EE.88})$$

$$\lambda_t^{Co} = [1 - \tau_t^{Co} (1 - \chi^{Co})] rer_t p_t^{Co*} \quad (\text{EE.89})$$

$$q_t^{Co} = E_t \left\{ \frac{\beta}{a_t^\sigma} \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^R}{\lambda_t^R} \left[ \lambda_{t+1}^{Co} \alpha^{Co} \frac{y_{t+1}^{Co}}{k_t^{Co}} a_t + q_{t+1}^{Co} (1 - \delta_{Co}) - p_{t+1}^{ICo} \phi_{\bar{u}}^{Co} (\bar{u}_{t+1}^{Co}) \right] \right\} \quad (\text{EE.90})$$

$$\begin{aligned} 0 = & E_t \left\{ \frac{\sum_{j=0}^{N_{Co}-1} \beta^j \frac{\varrho_{t+j}}{\varrho_t} \frac{\lambda_{t+j}^R}{\lambda_t^R} \left( \frac{a_{t-1}}{\prod_{i=0}^j a_{t+i-1}} \right)^\sigma \varphi_j^{Co} p_{t+j}^{ICo}}{\left( \beta^{N_{Co}-1} \right) \frac{\varrho_{t+N_{Co}-1}}{\varrho_t} \frac{\lambda_{t+N_{Co}-1}^R}{\lambda_t^R} \left( \frac{a_{t-1}}{\prod_{i=0}^{N_{Co}-1} a_{t+i-1}} \right)^\sigma q_{t+N_{Co}-1}^{Co}} \right\} \\ & - \left[ \left( 1 - \frac{\Phi_I^{Co}}{2} \left( \frac{i_t^{ACo}}{i_{t-1}^{ACo}} a_{t-1} - a \right)^2 \right) - \Phi_I^{Co} \left( \frac{i_t^{ACo}}{i_{t-1}^{ACo}} a_{t-1} - a \right) \frac{i_t^{ACo}}{i_{t-1}^{ACo}} a_{t-1} \right] \varpi_t^{Co} \\ & - E_t \left\{ \beta \frac{\varrho_{t+N_{Co}}}{\varrho_{t+N_{Co}-1}} \frac{\lambda_{t+N_{Co}}^R}{a_{t+N_{Co}}^\sigma \lambda_{t+N_{Co}-1}^R} \frac{q_{t+N_{Co}}^{Co}}{q_{t+N_{Co}-1}^{Co}} \right. \\ & \left. \times \Phi_I^{Co} \left( \frac{i_{t+1}^{ACo}}{i_t^{ACo}} a_t - a \right) \left( \frac{i_{t+1}^{ACo}}{i_t^{ACo}} a_t \right)^2 \varpi_{t+1}^{Co} \right\} \end{aligned} \quad (\text{EE.91})$$

$$r_t^{K,Co} = \lambda_t^{Co} \alpha^{Co} \frac{y_t^{Co}}{\bar{u}_t^{Co} k_{t-1}^{Co}} a_{t-1} \quad (\text{EE.92})$$

$$\bar{u}_t^{Co} = 1 + \frac{\log(r_t^{K,Co}/r^{K,Co}) - \log(p_t^{ICo})}{\Phi_{\bar{u}}^{Co}} \quad (\text{EE.93})$$

from Fiscal Policy (2.4):

$$g_t = p_t^{CG} c_t^G + p_t^{IG} i_t^G + tr_t^G + (rer_t p_t^{O*} - p^O) o_t \quad (\text{EE.94})$$

$$t_t = \alpha^T p_t^Y y + (1 - I_{rule}) \varepsilon^T \left( rer_t b_t^{G*} + b^G - rer_t b_t^{G*} - b_t^G \right) \quad (\text{EE.95})$$

$$\omega t_t^{NR} = \omega_G t_t \quad (\text{EE.96})$$

$$(1 - \omega) t_t^R = (1 - \omega_G) t_t \quad (\text{EE.97})$$

$$\begin{aligned} \tau_t = & \tau_t^C c_t + \tau_t^W w_t n_t h_t + \tau_t^K [r_t^K \bar{u}_t - p_t^I (\delta + \phi_{\bar{u}}(\bar{u}_t))] \frac{k_{t-1}}{a_{t-1}} \\ & + \tau_t^D d_t + (1 - \chi^{Co}) \tau_t^{Co} (cf_t^{Co} + p_t^{ICo} i_t^{Co,f}) + t_t \end{aligned} \quad (\text{EE.98})$$

$$b_t^G + rer_t b_t^{G*} = R_{t-1} \frac{b_{t-1}^G}{\pi_t a_{t-1}} + R_{t-1}^* \xi_{t-1} \frac{rer_t b_{t-1}^{G*}}{\pi_t^* a_{t-1}} + \tau_t + \chi^{Co} cf_t^{Co} - g_t \quad (\text{EE.99})$$

$$rer_t b_t^{G*} = \alpha^D \left( rer_t b_t^{G*} + b_t^G \right) \quad (\text{EE.100})$$

$$\tilde{g}_t = (\tilde{g}_t^{rule})^{I_{rule}} (\tilde{g}_t^{exo})^{1-I_{rule}} \quad (\text{EE.101})$$

$$\tilde{g}_t^{exo} = g \xi_t^G \quad (\text{EE.102})$$

$$\begin{aligned} \tilde{g}_t^{rule} = & \frac{(R_{t-1} - 1) b_{t-1}^G}{\pi_t a_{t-1}} + \frac{(R_{t-1}^* \xi_{t-1} - 1) rer_t b_{t-1}^{G*}}{\pi_t^* a_{t-1}} + \tau_t \\ & - \gamma^D \check{\tau}_t + \chi^{Co} \left( cf_t^{Co} - \gamma^D \check{cf}_t^{Co} \right) - \bar{s}_{BP} p_t^Y y_t \end{aligned} \quad (\text{EE.103})$$

$$\check{\tau}_t = \tau_t - \tilde{\tau}_t \quad (\text{EE.104})$$

$$\begin{aligned} \tilde{\tau}_t = & \tau_t^C c + \tau_t^W w n h + \tau_t^K (r^K \bar{u} - p^I (\delta + \phi_{\bar{u}}(\bar{u}))) k/a \\ & + \tau_t^D d + (1 - \chi^{Co}) \tau_t^{Co} (cf_t^{Co} + p_t^{ICo} i_t^{Co,f}) + t \end{aligned} \quad (\text{EE.105})$$

$$\check{cf}_t^{Co} = cf_t^{Co} - \widetilde{cf}_t^{Co} \quad (\text{EE.106})$$

$$\widetilde{cf}_t^{Co} = rer_t \tilde{p}_t^{Co*} y_t^{Co} - p_t^{ICo} i_t^{Co,f} \quad (\text{EE.107})$$

$$\log(\tilde{p}_t^{Co*}) = \frac{1}{40} E_t \sum_{i=1}^{40} \log(p_{t+i}^{Co*}) \quad (\text{EE.108})$$

$$[(1 - \alpha_G) p_t^{CG} + \alpha_G p^{CG}] = \alpha_{CG} \tilde{g}_t \xi_t^{CG} \quad (\text{EE.109})$$

$$tr_t^G = \left(1 - \alpha_{CG} - \alpha_{IG} - \frac{tr^{UFA}}{g}\right) \tilde{g}_t \xi_t^{TR} + tr_t^{UFA} \quad (\text{EE.110})$$

$$\omega tr_t^{NR} = \omega_G (tr_t^G - tr_t^{UFA}) \quad (\text{EE.111})$$

$$(1 - \omega) tr_t^R = (1 - \omega_G) (tr_t^G - tr_t^{UFA}) \quad (\text{EE.112})$$

$$k_t^G = (1 - \delta_G) \frac{k_{t-1}^G}{a_{t-1}} + \frac{i_{t-N^G+1}^{AG} a_t}{\prod_{i=1}^{N^G} a_{t+1-i}} \quad (\text{EE.113})$$

$$i_t^G = \varphi_0 i_t^{AG} + \frac{\varphi_1 i_{t-1}^{AG}}{a_{t-1}} + \frac{\varphi_2 i_{t-2}^{AG}}{a_{t-1} a_{t-2}} + \dots + \frac{\varphi_{N^G-1} i_{t-N^G+1}^{AG}}{a_{t-1} a_{t-2} \dots a_{t-N^G+1}} \quad (\text{EE.114})$$

$$\left( (1 - \alpha_G) E_t \left[ \sum_{j=0}^{N^G-1} \varphi_j p_{t+j}^{IG} \right] + \alpha_G p^{IG} \right) i_t^{AG} = \alpha_{IG} E_t \left[ \sum_{j=0}^{N^G-1} \varphi_j \frac{\tilde{g}_{t+j} \prod_{i=0}^j a_{t+i-1}}{a_{t-1}} \right] \xi_t^{IG} \quad (\text{EE.115})$$

$$p_t^O = \left( (p^O)^{1-\alpha_O} (p_{t-1}^O)^{\alpha_O} \right)^{\rho_O} \left( rer_t p_t^{O*} \right)^{1-\rho_O} \xi_t^O \quad (\text{EE.116})$$

from Monetary Policy (2.5):

$$R_t = (R_{t-1})^{\rho_R} \left[ \bar{R}_t \left( \frac{\tilde{\pi}_t}{\bar{\pi}_t} \right)^{\alpha_\pi} \left( \frac{y_t^D}{y_{t-1}^D} \right)^{\alpha_y} \right]^{1-\rho_R} e_t^R \quad (\text{EE.117})$$

$$\tilde{\pi}_t = \left[ (\pi_t^Z)^{\alpha_{\pi Z}} (\pi_t)^{1-\alpha_{\pi Z}} \right]^{1-\alpha_{\pi E}} \left[ (E_t \pi_{t+4}^Z)^{\alpha_{\pi Z}} (E_t \pi_{t+4})^{1-\alpha_{\pi Z}} \right]^{\alpha_{\pi E}} \quad (\text{EE.118})$$

$$y_t^D = y_t - x_t^L - \phi_{\bar{u}}(\bar{u}_t) \frac{k_{t-1}}{a_{t-1}} - \phi_{\bar{u}}^{Co}(\bar{u}_t^{Co}) \frac{k_{t-1}^{Co}}{a_{t-1}} \quad (\text{EE.119})$$

$$\pi_t^Z = \frac{p_t^Z}{p_{t-1}^Z} \pi_t \quad (\text{EE.120})$$

from Unemployment Funds Administrator (2.6):

$$b_t^{UFA} = \tau_t^{UFA} w_t h_t n_t - (1 - n_t) ub + tr_t^{UFA} + R_{t-1} \frac{b_{t-1}^{UFA}}{\pi_t a_{t-1}} \quad (\text{EE.121})$$

$$tr_t^{UFA} = \bar{tr}^{UFA} + \varepsilon^{UFA} (b^{UFA} - b_t^{UFA}) \quad (\text{EE.122})$$

from The Rest of the World (2.7):

$$\frac{rer_t}{rer_{t-1}} = \frac{\pi_t^S \pi_t^*}{\pi_t}, \quad (\text{EE.123})$$

$$x_t^{H*} = [x_{t-1}^{H*}]^{\rho_{XH*}} \left[ o^* (p_t^{H*})^{-\eta^*} y_t^* \right]^{1-\rho_{XH*}} \xi_t^{XH*} \quad (\text{EE.124})$$

$$y_t^* = a_t z_t^* \quad (\text{EE.125})$$

$$\nabla_t^H = \left( \frac{a}{a_t} \nabla_{t-1}^H \right)^{1-\Gamma^H} \quad (\text{EE.126})$$

$$\nabla_t^{Co} = \left( \frac{a}{a_t} \nabla_{t-1}^{Co} \right)^{1-\Gamma^{Co}} \quad (\text{EE.127})$$

$$\pi_t^{F*} = \frac{f_t^*}{f_{t-1}^*} \pi_t^* \quad (\text{EE.128})$$

$$1 = \left( \frac{\pi^*}{\pi_t^*} \right)^{1-\Gamma^*} (f_t^*)^{\Gamma^*} \xi_t^* \quad (\text{EE.129})$$

$$p_t^{Co*} = \left( \frac{\pi^*}{\pi_t^*} p_{t-1}^{Co*} \right)^{1-\Gamma^{Co*}} (f_t^*)^{\Gamma^{Co*}} \xi_t^{Co*} \quad (\text{EE.130})$$

$$p_t^{O*} = \left( \frac{\pi^*}{\pi_t^*} p_{t-1}^{O*} \right)^{1-\Gamma^{O*}} (f_t^*)^{\Gamma^{O*}} \xi_t^{O*} \quad (\text{EE.131})$$

$$p_t^{M*} = \left( \frac{\pi^*}{\pi_t^*} p_{t-1}^{M*} \right)^{1-\Gamma^{M*}} (f_t^*)^{\Gamma^{M*}} \xi_t^{M*} \quad (\text{EE.132})$$

$$\pi_t^{Co*} = \frac{p_t^{Co*}}{p_{t-1}^{Co*}} \pi_t^* \quad (\text{EE.133})$$

$$\pi_t^{O*} = \frac{p_t^{O*}}{p_{t-1}^{O*}} \pi_t^* \quad (\text{EE.134})$$

$$\pi_t^{M*} = \frac{p_t^{M*}}{p_{t-1}^{M*}} \pi_t^* \quad (\text{EE.135})$$

from Aggregation and Market Clearing (2.8):

$$c_t = \omega c_t^{NR} + (1 - \omega) c_t^R \quad (\text{EE.136})$$

$$k_t = (1 - \omega) k_t^R \quad (\text{EE.137})$$

$$k_t^S = (1 - \omega) k_t^{S,R} \quad (\text{EE.138})$$

$$i_t = (1 - \omega) i_t^R \quad (\text{EE.139})$$

$$b_t^{Pr} = (1 - \omega) b_t^R \quad (\text{EE.140})$$

$$b_t^{Pr*} = (1 - \omega) b_t^{R*} \quad (\text{EE.141})$$

$$d_t = (1 - \omega) d_t^R \quad (\text{EE.142})$$



$$y_t^H = x_t^H \quad (\text{EE.143})$$

$$x_t^H = x_t^{Z,H} + x_t^{A,H} + x_t^{CG,H} + x_t^{I,H} + x_t^{ICo,H} + x_t^{IG,H} + x_t^L, \quad (\text{EE.144})$$

$$y_t^F = x_t^F \quad (\text{EE.145})$$

$$x_t^F = x_t^{Z,F} + x_t^{A,F} + x_t^{CG,F} + x_t^{I,F} + x_t^{ICo,F} + x_t^{IG,F}, \quad (\text{EE.146})$$

$$y_t^{H*} = x_t^{H*} \quad (\text{EE.147})$$

$$x_t^L = h_t^C n_t + \nabla_{t-1}^H \Omega_v v_t \quad (\text{EE.148})$$

$$y_t^{\tilde{H}} = y_t^H \Delta_t^H + y_t^{H*} \Delta_t^{H*} \quad (\text{EE.149})$$

$$m_t^* = y_t^F \Delta_t^F \quad (\text{EE.150})$$

$$\Delta_t^H = (1 - \theta_H) (\tilde{p}_t^H)^{-\epsilon_H} + \theta_H \left( \frac{p_{t-1}^H}{p_t^H} \frac{g_{t-1}^H}{\pi_t} \frac{(1 + \tau_t^C)}{(1 + \tau_{t-1}^C)} \right)^{-\epsilon_H} \Delta_{t-1}^H \quad (\text{EE.151})$$

$$\Delta_t^F = (1 - \theta_F) (\tilde{p}_t^F)^{-\epsilon_F} + \theta_F \left( \frac{p_{t-1}^F}{p_t^F} \frac{g_{t-1}^F}{\pi_t} \frac{(1 + \tau_t^C)}{(1 + \tau_{t-1}^C)} \right)^{-\epsilon_F} \Delta_{t-1}^F \quad (\text{EE.152})$$

$$\Delta_t^{H*} = (1 - \theta_{H*}) (\tilde{p}_t^{H*})^{-\epsilon_{H*}} + \theta_{H*} \left( \frac{p_{t-1}^{H*}}{p_t^{H*}} \frac{g_{t-1}^{H*}}{\pi_t^*} \right)^{-\epsilon_{H*}} \Delta_{t-1}^{H*} \quad (\text{EE.153})$$

$$o_t = c_t^O + x_t^O \quad (\text{EE.154})$$

$$y_t^C = c_t + p_t^{CG} c_t^G + p_t^I i_t^f + p_t^{ICo} i_t^{Co,f} + p_t^{IG} i_t^G + p_t^H x_t^L \quad (\text{EE.155})$$

$$tb_t = rer_t (p_t^{H*} y_t^{H*} + p_t^{Co*} y_t^{Co} - p_t^{M*} m_t^* - p^{O*} o_t) \quad (\text{EE.156})$$

$$y_t = c_t + c_t^G + i_t^f + i_t^G + i_t^{Co,f} + x_t^L + y_t^{H*} + y_t^{Co} - m_t^* - o_t \quad (\text{EE.157})$$

$$p_t^Y y_t = y_t^C + tb_t \quad (\text{EE.158})$$

$$d_t = p_t^Y y_t - rer_t p_t^{Co*} y_t^{Co} + o_t (rer_t p_t^{O*} - p_t^O) - r_t^K k_t^S - w_t n_t h_t - p_t^H x_t^L \quad (\text{EE.159})$$

$$rer_t \left( b_t^* - \frac{b_{t-1}^*}{\pi_t^* a_{t-1}} \right) = rer_t \frac{b_{t-1}^*}{\pi_t^* a_{t-1}} (R_{t-1}^* \xi_{t-1} - 1) + tb_t + rer_t ren_t^* \quad (\text{EE.160})$$

$$ren_t^* = (1 - \omega) ren_t^{R*} - (1 - \chi^{Co}) \frac{cf_t^{Co} - \tau_t^{Co} (cf_t^{Co} + p_t^{ICo} i_t^{Co,f})}{rer_t} \quad (\text{EE.161})$$

$$ren_t^{R*} = \overline{ren}^{R*} \xi_t^{ren} \quad (\text{EE.162})$$

$$b_t^{Pr} + b_t^G + b_t^{UFA} = 0 \quad (\text{EE.163})$$

The exogenous processes for

$$X_t = \{a_t, R_t^*, \varpi_t, \varrho_t, \xi_t^G, \xi_t^{CG}, \varpi_t^{Co}, \xi_t^{IG}, \xi_t^O, \xi_t^*, \xi_t^{Co*}, \xi_t^{M*}, \xi_t^{O*}, \pi_t^{F*}, \xi_t^{TR}, \xi_t^{REN}, \xi_t^{XH*}, z_t, z_t^A, z_t^{Co}, \zeta_t^O, \zeta_t^U, z_t^*, \kappa_t, m_t, e_t^R, \bar{\pi}_t\}$$

are  $\log(X_t/\bar{X}) = \rho_X \log(X_{t-1}/\bar{X}) + \varepsilon_t^X$ , where the  $\varepsilon_t^X$  are i.i.d. shocks,  $\rho_X \in (0, 1)$  and  $\bar{X} > 0$ . The exogenous process for  $\rho^x$  follows  $\rho_t^x - \bar{\rho}^x = \rho_{\rho^x} (\rho_{t-1}^x - \bar{\rho}^x) + \varepsilon_t^{\rho^x}$

In the specification with Calvo wages, we replace equations EE.21, EE.23, EE.24, EE.25, EE.26, EE.72, EE.73, EE.74, EE.75, EE.76, EE.77, EE.78, EE.79, EE.80, EE.81, EE.82, EE.121 and EE.122 with:

$$\begin{aligned} n_t &= 1 \\ mc_t^W &= \frac{\Theta_t^U \kappa_t \nabla_{t-1}^H (h_t^d)^\phi}{(1 - \tau_t^W) w_t \lambda_t^U} \\ h_t^d &= (1 - \alpha) \left( \frac{w_t}{mc_t^{\bar{Z}}} \right)^{-1} y_t^{\bar{Z}} \\ f_t^W &= mc_t^W \tilde{w}_t^{-\epsilon_W(1+\phi)} h_t^d + \frac{\beta}{a_t^{\sigma-1}} \theta_W \\ &\quad \times E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^U}{\lambda_t^U} \left( \frac{g_t^{\Gamma^w}}{\pi_{t+1}} \frac{\tilde{w}_t}{\tilde{w}_{t+1}} \right)^{-\epsilon_W(1+\phi)} \left( \frac{w_t}{w_{t+1}} \right)^{-1-\epsilon_W(1+\phi)} f_{t+1}^W \right\} \\ f_t^W &= \tilde{w}_t^{1-\epsilon_W} h_t^d \left( \frac{\epsilon_W - 1}{\epsilon_W} \right) + \frac{\beta}{a_t^{\sigma-1}} \theta_W \\ &\quad \times E_t \left\{ \frac{\varrho_{t+1}}{\varrho_t} \frac{\lambda_{t+1}^U}{\lambda_t^U} \left( \frac{g_t^{\Gamma^w}}{\pi_{t+1}} \frac{\tilde{w}_t}{\tilde{w}_{t+1}} \right)^{1-\epsilon_W} \left( \frac{w_t}{w_{t+1}} \right)^{-\epsilon_W} f_{t+1}^W \right\} \\ 1 &= (1 - \theta_W) \tilde{w}_t^{1-\epsilon_W} + \theta_W \left( \frac{w_{t-1}}{w_t} \frac{g_{t-1}^{\Gamma^w}}{\pi_t} \right)^{1-\epsilon_W} \\ g_t^{\Gamma^w} &= \left[ (\pi_t)^{\vartheta_\pi} (\pi_t^Z)^{1-\vartheta_\pi} \right]^{\vartheta_W} \pi^{1-\vartheta_W} \\ h_t &= h_t^d \Delta_t^W \\ \Delta_t^W &= (1 - \theta_W) \tilde{w}_t^{-\epsilon_W} + \theta_W \left( \frac{g_{t-1}^{\Gamma^w}}{\pi_t^W} \right)^{-\epsilon_W} \Delta_{t-1}^W \\ \lambda_t^U &= \omega^U \lambda_t^{NR} + (1 - \omega^U) \lambda_t^R \\ \Theta_t^U &\equiv \omega^U \Theta_t^{NR} + (1 - \omega^U) \Theta_t^R \end{aligned}$$

$$x_t^L = 0$$

$$b_t^{UFA} = 0$$

$$tr_t^{UFA} = 0$$

## B.2 Steady State

We show how to compute the steady state for given values of  $h, \pi^S, p^O, p^{Co}, p^H, s^{OC} = p^O c^O / c, s^{k^{Co} y^{Co}} = \frac{q^{Co} k^{Co}}{rer \times p^{Co*} y^{Co}}, s^{iCo} = p^{ICo} i^{Co} / (p^Y y), s^{Co} = rer \times p^{Co*} y^{Co} / (p^Y y), s^{cg} = p^{CG} c^G / (p^Y y), s^{ig} = p^{IG} i^G / (p^Y y), s^{trG} = tr^G / (p^Y y), s^{tb} = tb / (p^Y y), s^{def} = -\bar{s}_B, s^{CA} = rer \times b^* (1 - \frac{1}{a\pi^*}) / (p^Y y), u, \rho, s_{\rho^x} = \rho^x / \rho, s^{Hc} = p^H h^C n / (p^Y y)$  and  $e$  and with the parameters  $\bar{R}^*, \bar{\pi}^*, \bar{\chi}^{PO*}, \bar{\chi}^{PCo*}, \bar{\kappa}, \kappa_O, ub, o_{KG}, \bar{z}^{Co}, \alpha_{Co}, \delta_{Co}, \alpha_{CG}, \alpha_{IG}, \alpha_T, o^*, o_{\hat{C}}, \bar{tr}^{UFA}, ren^{R^*}, \rho, \rho^x, v, \mu_{\hat{C}}$  and  $\Omega_v$  determined endogenously, while the values of the remaining parameters are taken as given.

From the exogenous processes for

$$X_t = \{a_t, R_t^*, \varpi_t, \varrho_t, \xi_t^G, \xi_t^{CG}, \varpi_t^{Co}, \xi_t^{IG}, \xi_t^O, \xi_t^*, \xi_t^{Co*}, \xi_t^{M*}, \xi_t^{O*}, \pi_t^{F*}, \xi_t^{TR}, \xi_t^{REN}, \xi_t^{XH*}, z_t, z_t^A, z_t^{Co}, \zeta_t^O, \zeta_t^U, z_t^*, \kappa_t, m_t, e_t^R, \bar{\pi}_t\}$$

we have that  $X = \bar{X}$ .

The steady state for the remaining endogenous variables is defined as the set of values for which all equations below hold. The system of equations is solved numerically. Starting from arbitrary values for  $utCo, y_{VA}^{H*}$  (both defined below),  $k^G, h^C, k^S, r^{\tilde{K}}, c^O$ , and  $x^O$ , we iterate repeatedly through the set of equations until finding a fixed point.<sup>35</sup>

$$\tau^L = \tau^W + \tau^{UFA} \quad (\text{SS.1})$$

$$a^{Co} = a \quad (\text{SS.2})$$

$$a^H = a \quad (\text{SS.3})$$

$$\nabla^{Co} = 1 \quad (\text{SS.4})$$

$$\nabla^H = 1 \quad (\text{SS.5})$$

$$\Theta_t^R = 1 \quad (\text{SS.6})$$

$$\Theta_t^{NR} = 1 \quad (\text{SS.7})$$

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<sup>35</sup>This is a rather fast process, usually converging after around 25 iterations for a tolerance of  $10^{-8}$  on the root of the sum squared differences.

$$\tilde{p}^H = 1 \quad (\text{SS.8})$$

$$\tilde{p}^F = 1 \quad (\text{SS.9})$$

$$\Delta^H = (\tilde{p}^H)^{-\epsilon_H} \quad (\text{SS.10})$$

$$\Delta^F = (\tilde{p}^H)^{-\epsilon_F} \quad (\text{SS.11})$$

$$mc^H = \frac{\epsilon_H - 1}{\epsilon_H} \tilde{p}^H \quad (\text{SS.12})$$

$$mc^F = \frac{\epsilon_F - 1}{\epsilon_F} \tilde{p}^F \quad (\text{SS.13})$$

$$p^{\tilde{H}} = mc^H p^H \quad (\text{SS.14})$$

$$mc^{\tilde{Z}} = \left[ \frac{\left( z \times p^{\tilde{H}} \right)^{1-\eta_O} - o_O \left( p^O \right)^{1-\eta_O}}{1 - o_O} \right]^{\frac{1}{1-\eta_O}} \quad (\text{SS.15})$$

$$\pi = \bar{\pi}. \quad (\text{SS.16})$$

$$g^{\Gamma^H} = \pi. \quad (\text{SS.17})$$

$$g^{\Gamma^F} = \pi. \quad (\text{SS.18})$$

$$R = a^\sigma \pi / \beta. \quad (\text{SS.19})$$

$$\tilde{p}^{H*} = 1 \quad (\text{SS.20})$$

$$\Delta^{H*} = (\tilde{p}^{H*})^{-\epsilon_{H*}} \quad (\text{SS.21})$$

$$mc^{H*} = \frac{\epsilon_{H*} - 1}{\epsilon_{H*}} \tilde{p}^{H*} \quad (\text{SS.22})$$

$$\kappa_O = s^{OC} \left( p^O \right)^{-\eta_C} \quad (\text{SS.23})$$

$p^A$  is then obtained numerically from:

$$1 = (1 - \kappa_O - \kappa_A) \left( (1 - o_Z) \left( p^H \right)^{1-\eta_Z} + o_Z \left[ \frac{\left( p^A \right)^{1-\eta_A} - (1 - o_A) \left( p^H \right)^{1-\eta_A}}{o_A} \right]^{\frac{1-\eta_Z}{1-\eta_A}} \right)^{\frac{1-\eta_C}{1-\eta_Z}} + \kappa_O \left( p^O \right)^{1-\eta_C} + \kappa_A \left( p^A \right)^{1-\eta_C} \quad (\text{SS.24})$$

$$p^F = \left[ \frac{\left( p^A \right)^{1-\eta_A} - (1 - o_A) \left( p^H \right)^{1-\eta_A}}{o_A} \right]^{\frac{1}{1-\eta_A}} \quad (\text{SS.25})$$

$$p^Z = \left( (1 - o_Z) (p^H)^{1-\eta_Z} + o_Z (p^F)^{1-\eta_Z} \right)^{\frac{1}{1-\eta_Z}} \quad (\text{SS.26})$$

$$rer = mc^F p^F \quad (\text{SS.27})$$

$$p^{H*} = \frac{p^H mc^H}{rer \times mc^{H*}} \quad (\text{SS.28})$$

$$p^I = \left[ (1 - o_I) (p^H)^{1-\eta_I} + o_I (p^F)^{1-\eta_I} \right]^{\frac{1}{1-\eta_I}} \quad (\text{SS.29})$$

$$p^{CG} = \left[ (1 - o_{CG}) (p^H)^{1-\eta_{CG}} + o_{CG} (p^F)^{1-\eta_{CG}} \right]^{\frac{1}{1-\eta_{CG}}} \quad (\text{SS.30})$$

$$p^{IG} = \left[ (1 - o_{IG}) (p^H)^{1-\eta_{IG}} + o_{IG} (p^F)^{1-\eta_{IG}} \right]^{\frac{1}{1-\eta_{IG}}} \quad (\text{SS.31})$$

$$p^{ICo} = \left[ (1 - o_{Co}) (p^H)^{1-\eta_{Co}} + o_{Co} (p^F)^{1-\eta_{Co}} \right]^{\frac{1}{1-\eta_{Co}}} \quad (\text{SS.32})$$

$$f^* = \left( \frac{1}{\xi^*} \right)^{\frac{1}{\Gamma^*}} \quad (\text{SS.33})$$

$$p^{O*} = \frac{p^O}{rer} (\xi^O)^{\frac{1}{1-\rho_O}} \quad (\text{SS.34})$$

$$p^{Co*} = \frac{p^{Co}}{rer} \quad (\text{SS.35})$$

$$\xi^{Co*} = \left( \frac{p^{Co*}}{f^*} \right)^{\Gamma^{Co*}} \quad (\text{SS.36})$$

$$\xi^{O*} = \left( \frac{p^{O*}}{f^*} \right)^{\Gamma^{O*}} \quad (\text{SS.37})$$

$$\lambda^{Co} = (1 - \tau^{Co} (1 - \chi^{Co})) rer \times p^{Co*} \quad (\text{SS.38})$$

$$\bar{u} = 1 - \frac{\log(p^I)}{\Phi_{\bar{u}}} \quad (\text{SS.39})$$

$$q = \frac{p^I}{\varpi} \quad (\text{SS.40})$$

$$r^K = \frac{q \left( \frac{a^\sigma}{\beta} - 1 + \delta \right) - p^I \tau^K \delta}{(1 - \tau^K) \left( \bar{u} - \frac{p^I}{\Phi_{\bar{u}}} [\exp(\Phi_{\bar{u}} (\bar{u} - 1)) - 1] \right)} \quad (\text{SS.41})$$

$$\phi^{\bar{u}} = \frac{r^K}{\Phi_{\bar{u}}} [\exp(\Phi_{\bar{u}} (\bar{u} - 1)) - 1] \quad (\text{SS.42})$$

$$R^* = a^\sigma \pi / (\beta \pi^S \xi). \quad (\text{SS.43})$$

$$\pi^* = \pi / \pi^S \quad (\text{SS.44})$$

$$\pi^{F*} = \pi^* \quad (\text{SS.45})$$

$$\pi^{Co*} = \pi^* \quad (\text{SS.46})$$

$$\pi^{O*} = \pi^* \quad (\text{SS.47})$$

$$\pi^{M*} = \pi^* \quad (\text{SS.48})$$

$$p^{M*} = (\xi^{M*})^{\frac{1}{\Gamma^{M*}}} f^* \quad (\text{SS.49})$$

$$n = 1 - u \quad (\text{SS.50})$$

$$\rho^x = s_{\rho^x} \rho \quad (\text{SS.51})$$

$$\rho^n = \frac{\rho - \rho^x}{1 - \rho^x} \quad (\text{SS.52})$$

$$\mu_{\bar{c}} = \log \left[ \frac{h^C (1 - \rho^n)}{\Phi (\Phi^{-1} (1 - \rho^n) - \sigma_{\bar{c}}) \nabla^H} \right] - \frac{\sigma_{\bar{c}}^2}{2} \quad (\text{SS.53})$$

$$\bar{c} = \exp (\sigma_{\bar{c}} \Phi^{-1} (1 - \rho^n) + \mu_{\bar{c}}) \quad (\text{SS.54})$$

$$v = \frac{n\rho}{e(1-\rho)} \quad (\text{SS.55})$$

$$m = e \left( \frac{v}{u} \right)^\mu \quad (\text{SS.56})$$

$$s = m \left( \frac{v}{u} \right)^{1-\mu} \quad (\text{SS.57})$$

$$o_{KG} = \frac{k^G}{k^S + k^G} \quad (\text{SS.58})$$

$$\tilde{k} = \left[ (1 - o_{KG})^{\frac{1}{\eta_{KG}}} (k^S)^{\frac{\eta_{KG}-1}{\eta_{KG}}} + o_{KG}^{\frac{1}{\eta_{KG}}} (k^G/a)^{\frac{\eta_{KG}-1}{\eta_{KG}}} \right]^{\frac{\eta_{KG}}{\eta_{KG}-1}} \quad (\text{SS.59})$$

$$k = \frac{k^S a}{\bar{u}} \quad (\text{SS.60})$$

$$i = k \left( \frac{1 - (1 - \delta)/a}{\varpi} \right) \quad (\text{SS.61})$$

$$y^{\tilde{Z}} = \left( \tilde{k} \right)^\alpha (a \nabla^H n h)^{1-\alpha} \quad (\text{SS.62})$$

$$y^{\tilde{H}} = z \left[ (1 - o_O)^{\frac{1}{\eta_O}} \left( y^{\tilde{Z}} \right)^{\frac{\eta_O-1}{\eta_O}} + o_O^{\frac{1}{\eta_O}} (x^O)^{\frac{\eta_O-1}{\eta_O}} \right]^{\frac{\eta_O}{\eta_O-1}} \quad (\text{SS.63})$$

$$\gamma^W = a\pi \quad (\text{SS.64})$$

$$w = \frac{1}{h} \left[ a^{1-\sigma} \beta (1-\rho) p^H (\nabla^H \bar{c} - h^C) + mc^{\tilde{Z}} (1-\alpha) \frac{y^{\tilde{Z}}}{n} - p^H \nabla^H \bar{c} \right] \quad (\text{SS.65})$$

$$w^n = w \quad (\text{SS.66})$$

$$\Omega_v = \frac{e}{\nabla^H p^H} \left[ wh + \nabla^H p^H \bar{c} - mc^{\tilde{Z}} (1-\alpha) \frac{y^{\tilde{Z}}}{n} \right] \quad (\text{SS.67})$$

$$x^L = h^C n + \nabla^H \Omega_v v \quad (\text{SS.68})$$

$$\Psi^U \kappa = \frac{mc^{\tilde{Z}} (1-\alpha)^2 \frac{y^{\tilde{Z}}}{n}}{\frac{h^{\frac{1}{1+\phi}}}{(1-\tau^L)} (\nabla^H)^{1-\sigma}} \quad (\text{SS.69})$$

$$ub = \frac{(1-\tau^L)}{(1-\varphi^U)} \left[ w^n h - \varphi^U \left( mc^{\tilde{Z}} (1-\alpha) \frac{y^{\tilde{Z}}}{n} - p^H h^C + \frac{p^H \nabla^H s \Omega_v}{e} \right) \right] - \Psi^U \kappa (\nabla^H)^{1-\sigma} \frac{h^{1+\phi}}{1+\phi} \quad (\text{SS.70})$$

$$o = c^O + x^O \quad (\text{SS.71})$$

$$i^f = i + \phi \bar{u} \frac{k}{a} \quad (\text{SS.72})$$

$$p^Y y = \frac{p^H y^{\tilde{H}} + p^O c^O - rer \times p^{O*} o + y_{VA}^{H*} + p^F (1 - mc^F \Delta^F) \Theta_1}{1 - s^{Co} - p^F (1 - mc^F \Delta^F) \Theta_2} \quad (\text{SS.73})$$

where

$$\begin{aligned} \Theta_1 &= -o_Z \left( \frac{p^F}{p^Z} \right)^{-\eta_Z} (1 - \kappa_O - \kappa_A) (p^Z)^{-\eta_C} (p^I i^f + p^{ICo} ut^{Co} + p^H x^L) \\ &\quad - o_A \left( \frac{p_t^F}{p_t^A} \right)^{-\eta_A} \kappa_A (p^A)^{-\eta_C} (p^I i^f + p^{ICo} ut^{Co} + p^H x^L) \\ &\quad + o_I \left( \frac{p^F}{p^I} \right)^{-\eta_I} i^f \\ &\quad + o_{Co} \left( \frac{p^F}{p^{ICo}} \right)^{-\eta_{Co}} ut^{Co} \\ \Theta_2 &= o_Z \left( \frac{p^F}{p^Z} \right)^{-\eta_Z} (1 - \kappa_O - \kappa_A) (p^Z)^{-\eta_C} (1 - s^{tb} - s^{cg} - s^{ig} - s^{iCo}) \\ &\quad + o_A \left( \frac{p^F}{p^A} \right)^{-\eta_A} \kappa_A (p^A)^{-\eta_C} (1 - s^{tb} - s^{cg} - s^{ig} - s^{iCo}) \\ &\quad + o_{CG} \left( \frac{p^F}{p^{CG}} \right)^{-\eta_{CG}} \frac{s^{cg}}{p^{CG}} \\ &\quad + o_{IG} \left( \frac{p^F}{p^{IG}} \right)^{-\eta_{IG}} \frac{s^{ig}}{p^{IG}} \\ &\quad + o_{Co} \left( \frac{p_t^F}{p_t^{ICo}} \right)^{-\eta_{Co}} \frac{s_t^{iCo}}{p^{ICo}} \end{aligned}$$

$$tb = s^{tb} p^Y y \quad (\text{SS.74})$$

$$i^G = s^{ig} \frac{p^Y y}{p^{IG}} \quad (\text{SS.75})$$

$$i^{Co} = \frac{s^{iCo} p^Y y}{p^{ICo}} \quad (\text{SS.76})$$

$$tr^G = s^{tr} p^Y y \quad (\text{SS.77})$$

$$i^{AG} = (i^G/\varphi_0) \frac{1 - (\rho^\varphi/a)}{1 - (\rho^\varphi/a)^{N^G}} \quad (\text{SS.78})$$

$$i^{aCo} = (i^{Co}/\varphi_0^{Co}) \frac{1 - (\rho^{\varphi Co}/a)}{1 - (\rho^{\varphi Co}/a)^{N^{Co}}} \quad (\text{SS.79})$$

$$c^G = s^{cg} \frac{p^Y y}{p^{CG}} \quad (\text{SS.80})$$

$$q^{Co} = p^{ICo} \varphi_0^{Co} \frac{1 - (\rho^{\varphi Co} \frac{\pi}{R})^{N^{Co}}}{1 - \rho^{\varphi Co} \frac{\pi}{R}} \left( \frac{R}{\pi} \right)^{N^{Co}-1} \quad (\text{SS.81})$$

$$y^{Co} = s^{Co} p^Y y / (rer \times p^{Co*}) \quad (\text{SS.82})$$

$$k^{Co} = \nabla^{k^{Co}, y^{Co}} y^{Co} \frac{rer \times p^{Co*}}{q^{Co}} \quad (\text{SS.83})$$

$$\delta_{Co} = \frac{i^{aCo}}{k^{Co} a^{N^{Co}-2}} - a + 1 \quad (\text{SS.84})$$

$$\bar{u}^{Co} = 1 - \frac{\log(p^{ICo})}{\Phi_{\bar{u}}^{Co}} \quad (\text{SS.85})$$

$$\alpha_{Co} = \frac{k^{Co} q^{Co} \left( \frac{R}{\pi} - (1 - \delta_{Co}) \right)}{a \lambda^{Co} y^{Co} \left[ 1 - \frac{p^{ICo}}{\Phi_{\bar{u}}^{Co} \bar{u}^{Co}} (e^{\Phi_{\bar{u}}^{Co} (\bar{u}^{Co}-1)} - 1) \right]} \quad (\text{SS.86})$$

$$r^{K, Co} = [1 - \tau^{Co} (1 - \chi^{Co})] rer \times p^{Co*} \alpha^{Co} \frac{y^{Co}}{\bar{u}^{Co} k^{Co}} a \quad (\text{SS.87})$$

$$\phi_{\bar{u}}^{Co} = \frac{r^{K, Co}}{\Phi_{\bar{u}}^{Co}} \left( e^{\Phi_{\bar{u}}^{Co} (\bar{u}^{Co}-1)} - 1 \right) \quad (\text{SS.88})$$

$$i^{Co, f} = i^{Co} + \phi_{\bar{u}}^{Co} \frac{k^{Co}}{a} \quad (\text{SS.89})$$

$$z^{Co} = y^{Co} \left( \frac{\bar{u}^{Co} k^{Co}}{a} \right)^{-\alpha^{Co}} (a \nabla^{Co} \bar{L})^{\alpha^{Co}-1} \quad (\text{SS.90})$$

$$cf^{Co} = rer \times p^{Co*} y^{Co} - p^{ICo} i^{Co, f} \quad (\text{SS.91})$$



$$ren^{R*} = \frac{p^Y y}{rer \times (1 - \omega)} \left[ s_{CA} \left( \frac{a\pi^* - R^* \xi}{a\pi^* - 1} \right) - s_{tb} + \frac{(1 - \chi^{Co})}{p^Y y} (cf^{Co} - \tau^{Co} (cf^{Co} + p^{ICo} i^{Co,f})) \right] \quad (SS.92)$$

$$ren^* = (1 - \omega) ren^{R*} - \frac{(1 - \chi^{Co}) (cf^{Co} - \tau^{Co} (cf^{Co} + p^{ICo} i^{Co,f}))}{rer} \quad (SS.93)$$

$$c = p^Y y - p^I i^f - p^{ICo} i^{Co,f} - p^{CG} c^G - p^{IG} i^G - tb - p^H x^L \quad (SS.94)$$

$$c^A = \kappa_A (p^A)^{-\eta_C} c \quad (SS.95)$$

$$x^{A,H} = (z^A)^{\eta_A - 1} (1 - o_A) \left( \frac{p^H}{p^A} \right)^{-\eta_A} c^A \quad (SS.96)$$

$$x^{A,F} = (z^A)^{\eta_A - 1} o_A \left( \frac{p^F}{p^A} \right)^{-\eta_A} c^A \quad (SS.97)$$

$$c^Z = (1 - \kappa_O - \kappa_A) (p^Z)^{-\eta_C} c \quad (SS.98)$$

$$y^C = c + p^I i^f + p^{ICo} i^{Co,f} + p^{CG} c^G + p^{IG} i^G + p^H x^L \quad (SS.99)$$

$$x^{Z,H} = (1 - o_Z) (p^H/p^Z)^{-\eta_Z} c^Z \quad (SS.100)$$

$$x^{Z,F} = o_Z (p^F/p^Z)^{-\eta_Z} c^Z \quad (SS.101)$$

$$x^{I,H} = (1 - o_I) \left( \frac{p^H}{p^I} \right)^{-\eta_I} i^f \quad (SS.102)$$

$$x^{I,F} = o_I \left( \frac{p^F}{p^I} \right)^{-\eta_I} i^f \quad (SS.103)$$

$$x^{CG,H} = (1 - o_{CG}) \left( \frac{p^H}{p^{CG}} \right)^{-\eta_{CG}} c^G \quad (SS.104)$$

$$x^{CG,F} = o_{CG} \left( \frac{p^F}{p^{CG}} \right)^{-\eta_{CG}} c^G \quad (SS.105)$$

$$x^{IG,H} = (1 - o_{IG}) \left( \frac{p^H}{p^{IG}} \right)^{-\eta_{IG}} i^G \quad (SS.106)$$

$$x^{IG,F} = o_{IG} \left( \frac{p^F}{p^{IG}} \right)^{-\eta_{IG}} i^G \quad (SS.107)$$

$$x^{Co,H} = (1 - o_{Co}) \left( \frac{p^H}{p^{ICo}} \right)^{-\eta_{Co}} i^{Co,f} \quad (SS.108)$$

$$x^{Co,F} = o_{Co} \left( \frac{p^F}{p^{ICo}} \right)^{-\eta_{Co}} i^{Co,f} \quad (SS.109)$$

$$x^H = x^{Z,H} + x^{I,H} + x^{Co,H} + x^{CG,H} + x^{IG,H} + x^{A,H} + x^L \quad (SS.110)$$

$$y^H = x^H \quad (SS.111)$$

$$f^H = mc^H (\tilde{p}^H)^{-\epsilon_H} y^H / (1 - \beta a^{1-\sigma} \theta_H) \quad (\text{SS.112})$$

$$y^{H*} = \left( y^{\tilde{H}} - y^H \Delta^H \right) / \Delta^{H*} \quad (\text{SS.113})$$

$$x^{H*} = y^{H*} \quad (\text{SS.114})$$

$$x^F = x^{Z,F} + x^{I,F} + x^{Co,F} + x^{CG,F} + x^{IG,F} + x^{A,F} \quad (\text{SS.115})$$

$$y^F = x^F \quad (\text{SS.116})$$

$$f^F = mc^F (\tilde{p}^F)^{-\epsilon_F} y^F / (1 - \beta a^{1-\sigma} \theta_F) \quad (\text{SS.117})$$

$$m^* = y^F \Delta^F \quad (\text{SS.118})$$

$$y = c + i^f + i^{Co} + c^G + i^G + y^{H*} + y^{Co} - m^* - o + x^L \quad (\text{SS.119})$$

$$p^Y = (y^C + tb) / y \quad (\text{SS.120})$$

$$\overline{tr}^{UFA} = (1 - n) ub - \tau^{UFA} wnh \quad (\text{SS.121})$$

$$b^{UFA} = \frac{\left( \tau^{UFA} wnh - (1 - n) ub + \overline{tr}^{UFA} \right)}{1 - \frac{R}{\pi a}} \quad (\text{SS.122})$$

$$tr^{UFA} = \overline{tr}^{UFA} \quad (\text{SS.123})$$

$$tr^{NR} = \frac{\omega_G}{\omega} (tr^G - tr^{UFA}) \quad (\text{SS.124})$$

$$tr^R = \frac{1 - \omega_G}{1 - \omega} (tr^G - tr^{UFA}) \quad (\text{SS.125})$$

$$b^* = \frac{s_{CA} \times p^Y y \times a\pi^*}{rer(a\pi^* - 1)} \quad (\text{SS.126})$$

$$y^* = a \times z^* \quad (\text{SS.127})$$

$$o^* = (y^{H*} / y^*) (p^{H*})^{\eta^*} \quad (\text{SS.128})$$

$$i_t^R = \frac{i_t}{1 - \omega} \quad (\text{SS.129})$$

$$k_t^R = \frac{k_t}{1 - \omega} \quad (\text{SS.130})$$

$$k_t^{S,R} = \frac{k_t^S}{1 - \omega} \quad (\text{SS.131})$$

$$g = p^{CG} c^G + p^I i^G + tr^G \quad (\text{SS.132})$$

$$\tilde{g}^{rule} = g \quad (\text{SS.133})$$

$$\tilde{g}^{exo} = g \quad (\text{SS.134})$$

$$\tilde{g} = g \quad (\text{SS.135})$$

$$\alpha^{CG} = \frac{p^{CG} c^G}{g \xi^{CG}} \quad (\text{SS.136})$$

$$\alpha^{IG} = \frac{p^{IG} i^G}{g \xi^{IG}} \quad (\text{SS.137})$$

$$d = p^Y y - rer \times p^{Co*} y^{Co} - r^K k^S - wnh - p^H x^L \quad (\text{SS.138})$$

$$b^G = \frac{-s^{def} p^Y y}{(1 - 1/a\pi) + \frac{\alpha^D}{1-\alpha^D} (1 - 1/a\pi^*)} \quad (\text{SS.139})$$

$$b^{Pr} = -b^G - b^{UFA} \quad (\text{SS.140})$$

$$b^{G*} = \left( \frac{\alpha^D}{1 - \alpha^D} \right) \frac{b^G}{rer} \quad (\text{SS.141})$$

$$b^{Pr*} = b^* - b^{G*} \quad (\text{SS.142})$$

$$b_t^R = \frac{b_t^{Pr}}{1 - \omega} \quad (\text{SS.143})$$

$$b_t^{R*} = \frac{b_t^{Pr*}}{1 - \omega} \quad (\text{SS.144})$$

$$d^R = \frac{d}{1 - \omega} \quad (\text{SS.145})$$

$$\begin{aligned} \tau' = & \tau^C c + \tau^W wnh + \tau^K \left[ r^K \bar{u} - p^I \left( \delta + \frac{r^K}{\Phi_{\bar{u}}} [\exp(\Phi_{\bar{u}}(\bar{u} - 1)) - 1] \right) \right] \frac{k}{a} \\ & + \tau^D d + \tau^{Co} (1 - \chi^{Co}) (cf^{Co} + p^{ICo} i^{Co,f}) \end{aligned} \quad (\text{SS.146})$$

$$t = g + b^G \left( 1 - \frac{R}{a\pi} \right) + b^{G*} rer \left( 1 - \frac{\xi R^*}{a\pi^*} \right) - \tau' - \chi^{Co} cf^{Co} \quad (\text{SS.147})$$

$$t^{NR} = \left( \frac{\omega_G}{\omega} \right) t \quad (\text{SS.148})$$

$$t^R = \left( \frac{1 - \omega_G}{1 - \omega} \right) t \quad (\text{SS.149})$$

$$\alpha_T = \frac{t}{p^Y y} \quad (\text{SS.150})$$

$$\tau = \tau' + t \quad (\text{SS.151})$$

$$\tilde{\tau} = \tau \quad (\text{SS.152})$$

$$\hat{p}^{Co*} = p^{Co*} \quad (\text{SS.153})$$

$$\bar{s}_B = -s^{def} \quad (\text{SS.154})$$

$$g_t^{\Gamma^{H*}} = \pi^* \quad (\text{SS.155})$$

$$c^{NR} = \frac{(1 - \tau^L) whn + ub \times u + tr^{NR} - \frac{\omega^G}{\omega} t}{1 + \tau^C} \quad (\text{SS.156})$$

$$c^R = \frac{c - \omega c^{NR}}{1 - \omega} \quad (\text{SS.157})$$

$$o_{\hat{C}} = \frac{c^G}{c^R - \varsigma \frac{c^R}{a} + c^G} \quad (\text{SS.158})$$

$$\hat{c}^R = \left[ (1 - o_{\hat{C}})^{\frac{1}{\eta_{\hat{C}}}} \left( c^R - \varsigma \frac{c^R}{a} \right)^{\frac{\eta_{\hat{C}} - 1}{\eta_{\hat{C}}}} + o_{\hat{C}}^{\frac{1}{\eta_{\hat{C}}}} (c^G)^{\frac{\eta_{\hat{C}} - 1}{\eta_{\hat{C}}}} \right]^{\frac{\eta_{\hat{C}}}{\eta_{\hat{C}} - 1}} \quad (\text{SS.159})$$

$$\hat{c}^{NR} = \left[ (1 - o_{\hat{C}})^{\frac{1}{\eta_{\hat{C}}}} \left( c^{NR} - \varsigma \frac{c^{NR}}{a} \right)^{\frac{\eta_{\hat{C}} - 1}{\eta_{\hat{C}}}} + o_{\hat{C}}^{\frac{1}{\eta_{\hat{C}}}} (c^G)^{\frac{\eta_{\hat{C}} - 1}{\eta_{\hat{C}}}} \right]^{\frac{\eta_{\hat{C}}}{\eta_{\hat{C}} - 1}} \quad (\text{SS.160})$$

$$\lambda^R = \frac{(\hat{c}^R)^{-\sigma}}{1 + \tau^C} \left( \frac{(1 - o_{\hat{C}}) \hat{c}^R}{c^R - \varsigma \frac{c^R}{a}} \right)^{\frac{1}{\eta_{\hat{C}}}} \quad (\text{SS.161})$$

$$\lambda^{NR} = \frac{(\hat{c}^{NR})^{-\sigma}}{1 + \tau^C} \left( \frac{(1 - o_{\hat{C}}) \hat{c}^{NR}}{c^{NR} - \varsigma \frac{c^{NR}}{a}} \right)^{\frac{1}{\eta_{\hat{C}}}} \quad (\text{SS.162})$$

$$\tilde{\chi}^R = (\nabla^H)^{-\sigma} (\hat{c}^R)^\sigma \quad (\text{SS.163})$$

$$\tilde{\chi}^{NR} = (\nabla^H)^{-\sigma} (\hat{c}^{NR})^\sigma \quad (\text{SS.164})$$

$$\Psi^U = (1 - \omega) \frac{\Theta^R}{\lambda^R} + \omega \frac{\Theta^{NR}}{\lambda^{NR}} \quad (\text{SS.165})$$

$$\kappa = \bar{\kappa} = \frac{mc^{\tilde{Z}} (1 - \alpha)^2 \frac{\tilde{y}}{n}}{\frac{\Psi^U h^{1+\phi}}{(1 - \tau^L)} (\nabla^H)^{1-\sigma}} \quad (\text{SS.166})$$

$$s^{R,U} = \frac{(1 - \tau^L) w^n h - \Theta^R \kappa (\nabla^H)^{1-\sigma} \frac{h^{1+\phi}}{1+\phi} / \lambda^R - ub}{1 - (1 - s) \frac{\beta}{a^{\sigma-1}} (1 - \rho)} \quad (\text{SS.167})$$

$$s^{NR,U} = \frac{(1 - \tau^L) w^n h - \Theta^{NR} \kappa (\nabla^H)^{1-\sigma} \frac{h^{1+\phi}}{1+\phi} / \lambda^{NR} - ub}{1 - (1 - s) \frac{\beta}{a^{\sigma-1}} (1 - \rho)} \quad (\text{SS.168})$$

$$\sigma^U = \frac{\beta}{a^{\sigma-1}} (1 - \rho) \left[ (1 - \omega^U) s^{R,U} + \omega^U s^{NR,U} \right] \quad (\text{SS.169})$$

$$f^{H*} = \frac{(\tilde{p}^{H*})^{-\epsilon_{H*}} y^{H*} m c^{H*}}{1 - \beta a^{1-\sigma} \theta_{H*}} \quad (\text{SS.170})$$

$$\breve{\tau} = 0 \quad (\text{SS.171})$$

$$\breve{c} f^{Co} = 0 \quad (\text{SS.172})$$

$$\tilde{c} f^{Co} = rer \times p^{Co*} y^{Co} - p^{ICo} I^{Co,f} \quad (\text{SS.173})$$

$$y^D = y - x^L - i^f + i - i^{Co,f} + i^{Co} \quad (\text{SS.174})$$

$$ut^{Co} = \frac{\phi_{\bar{u}}^{Co} k^{Co}}{a} \quad (\text{SS.175})$$

$$k^G = \frac{i^{AG}/a^{N_G-1}}{1 - (1-\delta^G)/a} \quad (\text{SS.176})$$

$$h^C = \frac{s^{Hc} p^Y y}{n \times p^H} \quad (\text{SS.177})$$

$$r^{\tilde{K}} = \alpha \frac{m c^{\tilde{Z}}}{\tilde{k}} y^{\tilde{Z}} \quad (\text{SS.178})$$

$$k^S = \left( \frac{r^{\tilde{K}}}{r^{\tilde{K}}} \right)^{\eta_{KG}} \tilde{k} (1 - o_{KG}) \quad (\text{SS.179})$$

$$y_{VA}^{H*} = p^{H*} rer \times y^{H*} - p^H y^{H*} \quad (\text{SS.180})$$

$$c^O = \kappa_O (p^O)^{-\eta_C} c \quad (\text{SS.181})$$

$$x^O = o_O \left( \frac{p^O}{p^H m c^H} \right)^{-\eta_O} y^{\tilde{H}} \quad (\text{SS.182})$$

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