Standard CGE Model

Short Course on CGE Modeling, United Nations ESCAP

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July 22-26, 2013

Introduction

- We have now learned enough about the basic building blocks of computable general equilibrium models to be a position to build a 'standard' CGE model.
- In this session we will pull all of the pieces together, considering how to construct a typical competitive model for a single, open economy.

Demand

- A typical model features four distinct sources of final demand. There is a single representative household. The household optimization problem generates household demand.
- Government and investment are also sources of final demand, both in fixed quantities.
- The rest of world (the external sector) is a source of demand for exports. Foreign demand is modeled using the constant elasticity of demand function approach.

Supply

- Industries operate under competitive conditions.
- Firms use primary factors in variable proportions (modeled via CES), combined with intermediate goods used in fixed proportions.
- Each industry produces a good aimed at foreign markets and a good aimed at the domestic market. The transformation function takes the CET form.

Trade

- International trade is modeled via the Armington assumption.
- A single Armington composite for household, intermediate, government and investment demands. The Armington aggregator function is of the CES form.
- The economy is assumed to be small with respect to import markets.

Distortions

- Typical policy distortions include tariffs and other trade taxes/subsidies, production taxes, consumption taxes and factor taxes.
- Other policy distortions are incorporated as necessary to study the policy questions at hand.