

Abstract: This paper explores the standard life-cycle model, showing that (a) under not implausible conditions, there may be an infinity of rational expectation equilibria; this may occur even when under myopic expectations, there is a unique dynamic path; (b) nonetheless, one can provide interesting characterizations of economic dynamics; (c) government policy can affect the equilibrium path, and indeed appropriately chosen government policy rules can ensure that the rational expectations equilibrium is unique and can improve welfare. Moreover, we show that productivity increase may generate fragile economic booms followed by stagnation trap. Appropriate government policy can prevent an economy from falling into stagnation trap and can improve welfare.