

Macroeconomic Theory

ECO 701

Section 1

MW 7:00 to 8:15 PM

CBC C225

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Text: *Macroeconomics*, fifth edition, Andrew B. Abel and Ben S. Bernanke, Pearson/Addison-Wesley 2005.

Objective: Students who successfully complete this course will understand how to use basic macroeconomic models to consider monetary and fiscal policy questions. Those macroeconomic models rely on several aggregate markets -- labor, goods, and asset markets. The analyses will consider both long-run growth and short-run stabilization issues. Further, while much of the discussion focuses on a closed economy, considerable attention is also given to open economy macroeconomic analysis.

Office Hours: MW 4:00 to 5:30 PM and by appointment

Evaluation: The course grade will incorporate three components -- problem sets, brief summaries of journal articles, and exams. You will have six (6) problem sets during the semester (20 points each), but only the best five (5) scores count. You will also have four (4) journal articles to read and write brief summaries (25 points each). Finally, you will have a mid-term and (non-cumulative) final (100 points each). Your final grade will be an average of all components.

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Academic

Dishonesty: Academic dishonesty (e.g., cheating and plagiarism) will not be tolerated. At the instructor's discretion, a student suspected of academic dishonesty may receive an F for the course and be expelled from the class. Additional penalties, up to expulsion from the University, are possible.

Disabilities: If you have a documented disability that may require assistance, you will need to contact the Disability Resource Center (DRC) for coordination in your academic accommodations. Disabilities Services is located within Learning Enhancement Services (LES), in the Reynolds Student Services Complex, Suite 137. The phone number is 895-0866 or TDD 895-0652. The e-mail address is drcssc@ccmail.nevada.edu.

Course Outline and Readings:

- I. Introduction (1 week)
 - A. Method of Analysis
 - B. Measurement Issues
 - 1. Trends and Cycles
 - 2. National Income Accounting
 - 3. Saving and Investment
 - 4. Price Level and Interest Rates
 - 5. Employment and Unemployment

Readings:

1. Abel and Bernanke (AB), Chapters 1, 8, 2, 5 (pp. 173-185), and 3 (pp. 94-101).
2. Nelson and Plosser, "Trends and Random Walks in Macroeconomic Time Series: Some Evidence and Implications," *Journal of Monetary Economics*, September 1982.
3. Perron, "The Great Crash, the Oil Price Shock, and the Unit Root Hypothesis," *Econometrica*, November 1989.

II. Microeconomics of Macroeconomics (3 weeks)

- A. Labor Market
 - 1. Demand for Labor
 - 2. Supply of Labor
 - 3. Market Equilibrium
- B. Goods Markets
 - 1. Consumption Demand
 - 2. Investment Demand
 - 3. Saving Equals Investment
- C. Asset Markets
 - 1. Demand for Money
 - 2. Supply of Money
 - 3. Market Equilibrium

Readings:

1. AB, Chapters 3 (pp. 62-93), 4, 4A, 5 (pp. 185-202), 7, and 14 (pp. 521-532).
2. Friedman, *The Theory of the Consumption Function*, Princeton University Press, 1957.
3. Ando and Modigliani, "The 'Life-Cycle' Hypothesis of Saving: Aggregate Implication and Tests," *American Economic Review*, March 1963.
4. Hall, "Stochastic Implications of the Life Cycle--Permanent Income Hypothesis: Theory and Evidence," *Journal of Political Economy*, December 1978.
5. Witte, "The Micro-Foundations of the Social Investment Function," *Journal of Political Economy*, October 1963.
6. Jorgenson, "Capital Theory and Investment Behavior," *American Economic Review*, May 1963.
7. Tobin and Brainard, "Asset Markets and the Cost of Capital," in Balassa and Nelson, eds., *Economic Progress, Private Values and Public Policy: Essays in Honor of William Fellner*, New York: North Holland, 1977.

8. Baumol, "The Transactions Demand for Cash: An Inventory Theoretic Approach," *The Quarterly Journal of Economics*, November 1952.
9. Friedman, "The Quantity Theory of Money: A Restatement," in Friedman, *Studies in the Quantity Theory of Money*, 1956.
10. Miller, "Financial Innovation, Depository-Institution Deregulation, and the Demand for Money," *Journal of Macroeconomics*, Summer 1986.
11. Miller, "Disequilibrium Macroeconomics, Money as a Buffer Stock, and the Estimation of Money Demand," *Journal of Macroeconomics*, Fall 1990.
12. Tobin, "The Interest Elasticity of the Transactions Demand for Cash," *The Review of Economics and Statistics*, August 1956.
13. Tobin, "Liquidity Preference as Behavior Towards Risk," *Review of Economic Studies*, February 1958.

III. Long-Run Growth (1 week)

- A. Determinants of Economic Growth
 1. Labor
 2. Capital
 3. Technology
- B. Potential GDP
- C. Neo-Classical Growth Models
 1. Solow Model
 2. Optimal Growth Model
 3. Overlapping Generations Model
- D. Endogenous Growth Models
- E. Convergence Hypothesis
 1. Absolute Convergence
 2. Conditional Convergence

Readings:

1. AB, Chapter 6.
2. Mankiw, "The Growth of Nations," *Brookings Papers on Economic Activity*, (1) 1995 and Comments by Phelps and Romer.
3. Barro and Sala-i-Martin, "Convergence" *Journal of Political Economy*, April 1992.
4. Miller and Russek, "Fiscal Structures and Economic Growth: International Evidence," *Economic Inquiry*, July 1997.

IV. Generic Macroeconomic Model (2 weeks)

- A. Aggregate Demand (AD)
 1. Goods market Equilibrium (IS)
 2. Money Market Equilibrium (LM)
- B. Aggregate Supply (AS)
 1. Short-Run Aggregate Supply (SRAS)
 2. Long-Run Aggregate Supply (LRAS)
- C. Macroeconomic Equilibrium
 1. Long- and Short-Run Equilibrium

Readings:

1. AB, Chapter 9 and 9A.

V. Alternative Interpretations of Generic Macroeconomic Model (3 weeks)

- A. Classical Interpretation
 1. Misperceptions Model and SRAS

- 2. Long- and Short-Run Equilibrium
- B. Keynesian Interpretation
 - 1. Sticky Wages and Prices
 - 2. Long- and Short-Run Equilibrium
- C. Disequilibrium Interpretation
 - 1. Disequilibrium and Consumption
 - 2. Disequilibrium and Unemployment
 - 3. Integration and a Simple Disequilibrium Model

Readings:

1. AB, Chapters, 10, 11, 11A, and 11B.
 2. Barro and Grossman, "A General Disequilibrium Model of Income and Employment," *American Economic Review*, March 1971.
 3. Clower, "The Keynesian Counter-Revolution: A Theoretical Appraisal," in Hahn and Brechling, *The Theory of Interest Rates*, 1962.
 4. Patinkin, Chapter 13, *Money, Interest and Prices*, second edition, 1965.
 5. Miller, "Credit Rationing in a Disequilibrium Macroeconomic Model," *Journal of Macroeconomics*, Spring 1982.
 6. Miller, "Disequilibrium Macroeconomics, Money as a Buffer Stock, and the Estimation of Money Demand," *Journal of Macroeconomics*, Fall 1990.
- VI. Unemployment and Inflation (**1 week**)
- A. Expectations Augmented Phillips Curve
 1. Imperfect Information and Rational Expectations
 - a. Lucas Supply Curve
 - b. Friedman-Phelps Phillips Curve
 2. Policy Implications
 - a. Anticipated Versus Unanticipated Policy

Readings:

1. AB, Chapter 12.
2. Lucas, "Expectations and the Neutrality of Money," *Journal of Economic Theory*, April 1972.
3. Lucas, "Some International Evidence on Output-Inflation Tradeoffs," *American Economic Review*, June 1973.
4. Friedman, "The Role of Monetary Policy," *American Economic Review*, March 1968.
5. Phelps, "Money Wage Dynamics and Labor Market Equilibrium," *Journal of Political Economy*, July-August 1963.
6. Sargent and Wallace, "Rational Expectations, the Optimal Monetary Instrument, and the Optimal Money Supply Rule," *Journal of Political Economy*, April 1975.
7. Barro, "Rational Expectations and the Role of Monetary Policy," *Journal of Monetary Economics*, January 1976.
8. Barro, "Unanticipated Money, Output, and the Price Level in the United States," *Journal of Political Economy*, August 1978.

VII. Open Economy Macroeconomic Model (**1 week**)

- A. Exchange Rate
 1. Purchasing Power Parity

- 2. Interest Rate Parity
- B. Exchange Rate Determination
 - 1. Short-Run Equilibrium
 - 2. Long-Run Equilibrium
- C. Macroeconomic Policy
 - 1. Flexible Exchange Rates
 - 2. Fixed Exchange Rates

Readings:

- 1. AB, Chapter 13.

VIII. Macroeconomic Policy Analysis (**2 weeks**)

- A. Monetary Policy
 - 1. Central Bank Policy
 - 2. Rules Versus Discretion
- B. Fiscal Policy
 - 1. Government Budget Deficits and Debt
 - 2. Government Deficits and Inflation

Readings:

- 1. AB, Chapters 14 (533-560) and 15.
- 2. Poole, "The Optimal Choice of Monetary Policy in a Simple Stochastic Macro Model," *The Quarterly Journal of Economics*, May 1970.
- 3. Kydland and Prescott, "Rules Rather than Discretion: The Inconsistency of Optimal Plans," *Journal of Political Economy*, June 1977.
- 4. Lucas, "Economic Policy Evaluation: A Critique," in Brunner and Meltzer, eds. *The Phillips Curve and Labor Markets*, Carnegie-Rochester Conference Series, 1, Amsterdam: North Holland, 1976.
- 5. Friedman, B., "Targets, Instruments, and Indicators of Monetary Policy," *Journal of Monetary Economics*, October 1975.
- 6. Demopolous, Katsimbris, and Miller, "Monetary Policy and Central-Bank Financing of Government Budget Deficits," *European Economic Review*, July 1987.
- 7. McCallum, "Recent Developments in the Analysis of Monetary Policy Rules," *Federal Reserve Bank of St. Louis Review*, November/December 1999.