

## Macroeconomics, Pre-term 2010

### Instructor:

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### Course Description:

Macroeconomics is the study of the aggregate behavior of economic agents, i.e., consumers, firms, workers, and policymakers. Understanding today's global economy requires an increasingly sophisticated knowledge of how these agents interact and of the policies that influence economic activity. The goal of this course is to provide a coherent framework for the analysis of the forces that affect national and international economies at the aggregate level. After having taken this course you should be able to provide answers to some important questions:

- Why do some countries grow faster than others?
- Why does economic activity fluctuate?
- What is price stability and why does it matter?
- Why are unemployment rates generally higher in Western Europe than in the U.S.?

### Prerequisite:

High school algebra and ability to read graphs. Differential calculus will be needed but concepts will be overviewed in class and tutorials. Proficiency in math will be tested during the first lecture. 300.701 is an intermediate macroeconomics course and previous knowledge of the field at the introductory level is required.

### Textbook:

*Macroeconomics* (Seventh Edition, 2010), Andrew B. Abel, Ben S. Bernanke, and Dean Croushore (ABC), Addison-Wesley series in economics. If you are only able to find the sixth edition, that also works.

## Other Course Material:

You can retrieve all the readings on this syllabus from ERes. I will post, on my web page, notes and additional reading material, which will be used as basis for discussion. I encourage you to read not only the prescribed class materials but also current issues of *The Wall Street Journal*, *The Economist*, and the *Financial Times* and bring to my attention articles of interest. Always bring the textbook and a calculator to class. A basic scientific calculator will do. If you are planning on taking finance courses you may want to invest in a financial calculator, such as the Texas Instruments BA II PLUS Financial Calculator (approx. \$35) or the Texas Instruments BA-II Plus Professional Calculator (approx. \$65).

## Evaluation:

**Class duration is 2 hours and 30 minutes**, with a 15 minute break. Course evaluation is based on two exams, one midterm and one final, bi-weekly problem sets, and class participation. Exams are closed-book and comprehensive and each is worth 40% of the final grade. A calculator is required for both exams. The problem sets are worth 10% of the final grade, and class participation accounts for 10%. Dates for exams are final and no exceptions will be allowed (except medical reasons - which must be documented by your doctor, within a week of the exam - and SAIS related travel).

You need to get at least a 50 point combined average in the midterm and final to pass the course. Passing grades are then subject to a curve with about 15% getting an A, another 15% and A-, 25% a B+, 25% a B and 20% a B-.

Students should form a team of four to work on the problem sets and all members of each team will receive the same grade. Assignments will be graded with a check, a check plus, or a check minus. Each assignment is to be submitted by the due date and no late papers will be accepted. **All assignments must be submitted by email to macropt2010@jhu.edu.**

Requests for regrades: if you have a problem with the grading of any exam, you may request a regrade in writing within one week after I return the exam. The request must include a detailed description of what you think the problem is and why you think your answer deserves a different score. I will regrade the whole exam - not just the question you identify - and your score may go up or down.

I expect you to conduct all activities in accordance to the rules of SAIS' Honor Code (refer to the Red Book). You may contact me by email with questions regarding course rules but not with questions regarding materials and topics reviewed in class or grading (you should use office hours for this purpose).

## Course Outline:

The schedule given below should be considered approximate as the time allocated to each topic may vary.

- **Class 1 - Measurement of Economic Activity.**

In this lecture, we will see how economic activity is measured. We will discuss National Accounting, price indexes, and interest rates. We will also discuss the meaning of the time value of money, including the notion of discounting.

**Readings:**

1. ABC - Chapter 2.
2. Eric Zencey, "G.D.P. R.I.P." The New York Times, 8/09/2009.

- **Class 2 - Production, Employment and Income.**

In this lecture we will discuss the determinants of output, employment, and the distribution of income. We will talk about the role of labor and capital and the productive capacity of the economy. The determinants of labor demand and labor supply (income and substitution effects) and its implications for the equilibrium in the labor market are to be thoroughly discussed.

**Readings:**

1. ABC - Chapter 3.

- **Class 3 - Economic Growth.**

In this lecture we will discuss the meaning of economic growth and the factors that drive long-term economic growth in a country. We will try to explain why some countries grow faster than others. We will discuss the role of productivity and capital accumulation, and of institutions and government (taxes).

**Readings:**

1. ABC Chapter 6.
2. Charles Plosser, "The Search for Growth," in *Policies for Long-Run Economic Growth*, Federal Reserve Bank of Kansas City, 1992, pp. 57-86.

- **Classes 4 and 5 - Consumption, Saving and Investment.**

In these lectures we will focus on the choice between consumption and saving. We will see how consumers choose how much to consume and how firms choose how much to invest. The work horse of the consumption-saving problem is Fisher's intertemporal model. We will also talk about the life-cycle hypothesis, the permanent income theory and the rational expectations hypothesis. The neoclassical

theory of investment is used to determine the level of desired investment. The discussion wraps up with the notion of equilibrium in the goods market.

**Readings:**

1. ABC Chapter 4.
2. Charles Steindel, “The Effect of Tax Changes on Consumer Spending,” *Current Issues*, Federal Reserve Bank of New York, Vol. 7, No. 11, December 2001.

• **Class 6 - Saving and Investment in the Open Economy.**

We introduce trade and capital movements to the discussion of the equilibrium in the goods market. We analyze the implications of saving and investment decisions on the current account balance from the perspective of a small open economy and of a large open economy. The relationship between the current account balance and the international investment position is highlighted with consideration of the importance of valuation effects on net foreign assets.

**Readings:**

1. ABC Chapter 5.
2. Matthew Higgins, Thomas Klitgaard, and Cedric Tille, “The Income Implications of Rising U.S. International Liabilities,” *Current Issues*, Federal Reserve Bank of New York, Vol. 11, No. 12, December 2005. **Optional.**
3. André Faria, Philip R. Lane, Paolo Mauro, and Gian Maria Milesi-Ferretti, 2007. “The Shifting Composition of External Liabilities,” *Journal of the European Economic Association*, MIT Press, vol. 5(2-3), pages 480-490, 04-05. **Optional.**

• **Class 7 - Review Session.**

We will use this lecture to finish discussing previously covered topics and to review concepts.

- **MIDTERM EXAM** (August 5, 5:00pm-7:00pm) -

• **Class 8 - Assets, Money, and Prices**

In this lecture we will define money and explain why people choose to hold it. We will then show how the demand for money and the supply of money can be used to determine the price level. We will also discuss a simple theory of exchange rate determination.

**Readings:**

1. ABC - Chapter 7.
2. ABC Chapter 13, section 13.1.

- **Class 9 - The IS-LM / AD-AS framework.**

Here we will discuss a modeling approach to aggregate demand and aggregate supply.

**Readings:**

1. ABC - Chapter 9.
2. Robert Barro, "Voodoo Multipliers", *Economist's Voice*, February 2009.

- **Class 10 - Business Cycles.**

In this lecture we will extend the AS-AD framework to encompass the short term non-neutrality of money and fiscal policy. We will also discuss the business cycle and classical theories of economic fluctuations.

**Readings:**

1. ABC - Chapters 8 and 10.
2. Satyajit Chatterjee, "Real Business Cycles: A Legacy of Countercyclical Policies," *The Region*, Federal Reserve Bank of Minneapolis, March 1999. Available at <http://www.minneapolisfed.org/pubs/region/99-03/cycles.cfm>.

- **Class 11 - Unemployment and Inflation.**

We will discuss the existence of trade-offs between unemployment and inflation and the role for macroeconomic policy. Topics for discussion include the Phillips curve and the Lucas critique.

**Readings:**

1. ABC - Chapter 12.
2. Stanley Fischer, "Why are Central Banks Pursuing Long-Run Price Stability," in *Achieving Price Stability*, Federal Reserve Bank of Kansas City, 1996, pp. 7-34.

- **Class 12 - Monetary Policy.**

In this lecture we will give an overview on monetary policy and its impact on the price level and interest rates. The important discussion of monetary policy rules versus discretionary policy is pursued using a simple game theory example.

**Readings:**

1. ABC - Chapter 14.

2. Ben Bernanke and Frederic Mishkin, "Inflation Targeting: A New Framework for Monetary Policy?" *Journal of Economic Perspectives*, Spring 1997, pp. 97-116. **Optional.**
3. Charles Plosser, "Monetary Policy and Financial Stability," The 26th Annual Monetary and Trade Conference, The Global Interdependence Center and Drexel's LeBow College of Business, April 18th, 2008. **Optional.**
4. Charles Plosser, "House Prices and Monetary Policy," Federal Reserve Bank of Philadelphia. *European Economics and Financial Centre Distinguished Speakers Series*, July 11, 2007. **Optional.**
5. Charles Plosser, "The Benefits of Systematic Monetary Policy," National Association for Business Economics Washington Economic Policy Conference, March 3rd, 2008.

- **Class 13 - Fiscal Policy.**

In this lecture we will discuss the effects of government spending. We will also see whether it matters or not to finance public spending through public debt or through taxes (Ricardian Equivalence).

1. ABC, Chapter 15.
2. Robert Barro, "It's Spending, Stupid – Not the Deficit," *Business Week*, March 1, 2004, Issue 3872 pg. 28.
3. Edward Prescott, "Why Do Americans Work So Much More Than Europeans?" *Federal Reserve Bank of Minneapolis Quarterly Review*, July 2004, pp. 2-11. **Optional.**
4. Kristin Roberts and Peter Rupert, "The Myth of the Overworked American," *Economic Commentary*, FRB of Cleveland, January 15, 1995. **Optional.**

- **FINAL EXAM** (August 24, 9:00am-12:00pm)