

Grinnell College
Economics 282
Spring 2006

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Office Hours: Mon., Thurs. 2:00 – 4:00, and by appointment

MACROECONOMIC ANALYSIS

This course develops a series of theoretical frameworks which can be used to explain economic behavior at the aggregate, or economy-wide, level. We will examine the determinates of long-run economic growth, as well as the causes of short-run fluctuations in economic activity associated with business cycles, considering potential influences of economic policy in both areas. In so doing, we will discuss causes of inflation and unemployment, determinates of aggregate spending on goods and services, the supply of and demand for money, the balance of trade, international capital flows, and labor market conditions, among other topics. The course emphasizes systems of analysis which are both widely used and subject to serious debate. We will concentrate on explaining the quite detailed logic of these analytical systems along with some policy applications. At the same time, we will discuss some of the relevant theoretical and policy debates.

From time to time, we will attempt to apply theory from the course to current events and policy discussions from the press. I will distribute several relevant articles from current periodicals. I recommend that you subscribe to a paper with a good business section, like the *New York Times*, or the *Wall Street Journal*.

Macroeconomics is ultimately an attempt to explain real-world problems. It is not a tight logical bundle of timeless principles; rather, it is an evolving effort to analyze a changing world.

BOOKS (at the bookstore)

Rudiger Dornbusch, Stanley Fischer & Richard Startz (DFS), *Macroeconomics*, Ninth Edition, Boston, MA, McGraw Hill, 2004.

Paul Krugman, *The Age of Diminished Expectations*, **Third Edition**, MIT Press, 1997.

Additional Readings will be placed on e-reserve and some optional readings are contained in N. Gregory Mankiw *Macroeconomics*, Fifth Edition, New York: Worth Publishers, 2003. (On reserve in the library.)

EVALUATION

There will be nine problem sets, several group presentations, three midterm exams, a final exam, and possibly a few quizzes. The final will be cumulative. Exams count for about 75% of the grade, with the final exam counting as two midterms. Problem sets, class participation, *including attendance*, and quizzes make up about 15% of the overall grade. Presentations count for about 10% of the grade. Problem sets are critical to understanding the basic course material; failure to do them will definitely **LOWER** your grade. Students are allowed and encouraged to discuss problem sets in groups, but the final assignment must be written individually. All problem sets must be handed in on time.

READINGS AND COURSE OUTLINE

I. INTRODUCTION

Introduction: Macroeconomics and the U.S. Economy & Economic Models: Jan. 23, 25

Economic questions, key macroeconomic concepts, U.S. data on output and employment, economic thinking and economic models.

DFS, Chapter 1 and part of Chapter 2; Krugman, Introduction.

Introduction to class; group presentations on economic data

Macro data and National Income Accounting: Jan. 27, 30

Components of GDP, real and nominal GDP, measuring inflation and unemployment, real and nominal interest rates, exchange rates; economic models.

DFS, Chapter 2

From e-reserve: "Counting Women's Work," Kathleen Cloud and Nancy Garrett.

Group Presentation 1 on Data Wed. Jan. 25

PROBLEM SET ONE DUE Monday, Jan. 30

II. ECONOMIC GROWTH

Long-Run Economic Growth & Growth Policy: weeks 2-3

Growth accounting, the neoclassical (or Solow) model of economic growth: the influence of national savings, population growth and technological advance on economic growth, along with some policy implications. Endogenous growth theory and growth policy.

DFS, Chapters 3 and 4; Krugman, Chapter 1.

From e-reserve: "Generating Affluence: Productivity Gains Require Worker Support," David M. Gordon, pp. 46-48.

Group Presentation 2 on Growth Policy

** PROBLEM SET TWO DUE **

Additional Reading: Mankiw, Chapters 7 and 8 (on e-reserve)

III. LONG AND SHORT-RUN ADJUSTMENTS

Introduction: The Aggregate Supply and Demand Model: week 4, beginning.

The Classical and Keynesian short and long-run aggregate supply curves; the aggregate demand curve and its relevance to long and short-run adjustment; supply-side economics.

DFS, Chapter 5; Handout on the Classical Model

Wages, Prices and the Aggregate Supply Curve: Weeks 4-5

Derivation of the short and long-run aggregate supply curves from the behavior of wages and prices over time; inflation, unemployment, expectations, and the Phillips curve; theories of slow wage adjustment; short and long-term effects of monetary expansion in a simple AS/AD model, and the question of money neutrality.

DFS, Chapter 6; Krugman, Chapter 3.

**** PROBLEM SET THREE DUE ****

****** First Hour Exam, Friday, Feb. 24******

Policy Issues of Unemployment and Inflation; Income Distribution: Week 6

Okun's Law, unemployment, inflation and the sacrifice ratio; kinds of unemployment and their costs; international comparisons of unemployment and sacrifice ratios; costs of inflation, wage indexation, the political business cycle; trends in the distribution of income.

*DFS, Chapter 7; Krugman, Chapters 2 and 5; Handout on distribution of output;
e-reserve readings:*

“Unnecessary Evil: Why Inequality is Bad for Business,” Randy Albelda and Chris Tilly.

“The Racial Divide Widens: Why African-American Workers Have Lost Ground,” Marc Breslow.

“Why Have Savings Fallen? Rising Inequality Deserves the Blame,” Ted Schmidt.

“The Wealth Gap,” Ben Boothby.

Group Presentation 3 on Costs of Inflation

Group Presentation 4 on The Distribution of Income

**** PROBLEM SET FOUR DUE ****

IV. FOUNDATIONS OF AGGREGATE DEMAND

The Income-Expenditure Approach: week 7

The simple Keynesian model: expenditure and output, the consumption function, savings, investment and the multiplier, the government sector and the government deficit, actual and full-employment deficits; fiscal policy and business cycles.

DFS, Chapter 9

**** PROBLEM SET FIVE DUE ****

The ISLM Model and the AS/AD model: weeks 7-8

Equilibrium in the goods market and the IS curve; money market equilibrium and the LM curve; factors which determine the slopes and positions of both curves and their economic meaning; business cycles, fiscal and monetary policy in the ISLM model; derivation of the AD curve from the ISLM model; the full AS/AD model.

DFS, Chapters 10 and 11; Krugman, Chapter 8

Group Presentation 5 on remedies for recessions

**** PROBLEM SET SIX DUE ****

****** Second Hour Exam, Friday, April 7******

V. OPEN ECONOMY MACROECONOMICS

Modeling the Open Economy in the Short Run and Long Run: weeks 9-10,

The balance of payments, fixed and flexible exchange rates; international trade and domestic expenditure in the ISLM model; the importance of international capital flows; the Mundell-Fleming model with fixed and flexible exchange rates and the impacts of fiscal and monetary policy.

DFS, Chapter 12; Krugman Chapters 9-11.

Exchange Rate Policy, International Debt, and International Interdependence: Weeks 10-11

Policy tradeoffs with fixed exchange rates: the question of devaluation; the example of Mexico 1993-1996. The IMF and the monetary approach to the balance of payments. Risk, exchange rate expectations, and interest differentials in the Mundell-Fleming model.

DFS, Chapter 19

Group Presentation 6 on the effects of risk on exchange rates and output

**** PROBLEM SET SEVEN DUE ****

VI. ADDITIONAL FOUNDATIONS & POLICY ISSUES

The Debate in Contemporary Macroeconomic Theory: Week 12

New classical economics: rational expectations, random walks and real business cycle theory. New Keynesian economics: asymmetric information, coordination failure and the foundations of sticky wages and prices.

DFS, Chapter 8, Wallace Peterson, Chapter 17, "The Rebirth of Classical Economics," and Chapter 18, "The New Keynesian Macroeconomics," on e-reserve.

**** PROBLEM SET EIGHT DUE ****
***** Third Hour Exam, Wednesday, May 3*****

Investment and Money Supply: Week 13

A more detailed foundation for the investment function. Money creation: banks, lending and the central bank; the ability of the central bank to control the money supply.

DFS, Chapters 14, 15 and 16; Krugman Chapters 8 and 12

Macroeconomic Stabilization; Money and Inflation Policy: Week 13-14

Active policy vs. passive policy, rules vs. discretion, policy examples. The link between money and inflation, strategies to reduce inflation, hyperinflation.

DFS, Chapter 18.

Group Presentation 7 on alternative strategies to combat inflation
**** PROBLEM SET NINE DUE ****

****** FINAL EXAM ******

Friday, May 19, 9:00 a.m.
Make your plans accordingly!