MONETARY THEORY AND POLICY (WI)
Fall 2003

Overview

The focus of this course is monetary and macroeconomic theory and policy. The purpose of the course is to guide students as they develop critical thinking and writing skills as applied to monetary economics. Students will analyze clear, explicit, and internally consistent models of the monetary economy. This allows students to explore the linkage between assumptions underlying the models and the behavior of these model economies. The lessons from these model economies are used to evaluate government priorities and policies. Specifically, we develop the microfoundations of monetary economics using the basic overlapping generations model. This model will then be modified throughout the course to address policy questions such as: the cause and costs of inflation; what is the optimal international monetary system; should trading partners adopt a single currency?; why are banks special and did the U.S. experience a credit crunch in 1990?; did the S&L crisis play a role in the "credit crunch" of the 1990s?; could the central bank offset a credit crunch?; and what is the optimal monetary policy?

Prerequisites

Intermediate Economics: Macroeconomic Analysis or Microeconomic Analysis

Required Text


Various Journal Articles
Examinations

Problem sets will be assigned for each chapter covered. Problem sets will be checked for completion and one problem will be graded for each assignment. Answer keys will be provided for your benefit.

Pop Quizzes will be given regularly throughout the semester.

Two essays will be assigned. Essays will be based on journal articles or chapters of text we do not cover in class. Essays should be typed, double spaced, four to six pages in length. (All equations and graphs must be numbered sequentially for reference and may be handwritten and attached as a separate sheet). A first draft of each essay will be required and graded.

The Midterm exam will be given on Thursday Oct. 16, 2003.

The Final exam is comprehensive and will be given on December 18, 2003 9:45-11:45 AM

Weighting of Course Grade

Problem sets: average 10%

Pop Quizzes: average 10%

Essays: average 30%

Midterm 20%

Final 30%

Policies

- Attendance is mandatory; no make up quizzes will be
There will be no make up exams. Only medical emergencies are valid reasons for missing exams.

Exams must be taken on the assigned dates. Please note the dates listed above for both the midterm and the final.

Any essay or problem set submitted after the start of class on their due date is late. Late papers will be penalized ten points per day.

All essays should be typed, double spaced with 1.5 inch margins on all sides. (All equations and graphs must be numbered sequentially for reference and may be handwritten and attached as a separate sheet). A first draft of each essay will be required and graded.

All of the assigned readings will not be covered in detail in class. You are responsible for all of the material in these readings. Assigned readings for each class meeting should be read prior to class and then carefully reviewed after class.

Class will be conducted in an open discussion/lecture style. Your participation is expected, and I will frequently call on students to discuss important topics.

I will always be available to you during my office hours and by appointment. I encourage you to make use of my time. Please do not wait until the day of an exam to ask for my assistance.

General Suggestions and Information

A goal of this course is for you to learn to think and communicate in a manner consistent with your training in economics. The philosophy is simple: writing to learn economics implies learning to write economics.

We will employ some writing assignments and evaluation methods that may be new to you. For instance, we will try to do a fair amount of 'free writing' or informal writing in class. This writing will help you to fine tune your understanding of course material.

You should provide a daily writing notebook for the sole purpose of informal writing. By collecting your daily writing
in one place, at the end of the semester you will have an excellent resource for studying for the Final Exam.

- We may also on occasion use in class group writing assignments and group presentations throughout the semester.

**REQUIRED READINGS**

All chapter appendices are required unless I tell you otherwise. I will assign additional readings to accompany most chapters. Although some of these readings will not be covered in class, they are all required reading. In addition, any class handouts are required reading, don't miss class.

**Part One: Money**--The Basic Overlapping Generations Model

Chapter 1. A Simple Model of Money

*Centralized Versus Competitive Solutions (or budget sets vs feasible allocations)*

*The Golden Rule*

*Growing Population*

Additional Readings

*Private Money: Everything Old is New Again* by Barbara A. Good, Federal Reserve Bank of Cleveland *Economic Commentary*, April 1, 1998

Chapter 2. Barter and Commodity Money Exchange

*The Inefficiency of Barter*

*The Inefficiency of Commodity Money*

*Essay # 1: TBA*
Chapter 3. Inflation

A Growing Money Supply
Seigniorage

Additional Readings


Chapter 4. International Monetary Systems

International Exchange
Fixed vs Flexible Exchange Rates
Optimal International Monetary Systems

Additional Readings


Chapter 5. Price Surprises

Expectations and the Neutrality of Money
Optimal Policy
Part Two: Banking--Debt, Financial Intermediation, Monetary Policy and the Money Output Connection

Chapter 6. Capital

Money and Capital
Arbitrage - the equality of risk adjusted returns
Money, Capital, and Private Debt

Additional Readings

Chapter 7. Liquidity and Financial Intermediation

The Fisher Equation and Expected Inflation
Arbitrage and Banking
Bank Monitoring and Intermediation

Additional Readings

Chapter 8. Central Banking and the Money Supply

Reserve Requirements
Open Market Operations
Interest on Money

Additional Readings

Chapter 9. Money Stock Fluctuations

The Money Output Connection
Inside vs Outside Money
Monetary Aggregates
Expected Inflation and Output

Additional Readings

Humpage, Owen F., "Monetary Policy and Real Economic Growth" Federal Reserve Bank of Cleveland Economic Commentary, December 1996
Chapter 12. Bank Risk

Demand Deposits
Preventing Panics/Failures
Moral Hazard and Capital Requirements

Additional Readings

Part Three: Government Debt--National Debt, Savings and Investment, Social Security, Unexpected Inflation and Real Debt Default

Chapter 13. Deficits and the National Debt

Separated Asset Markets
Government Bonds, Budget Constraint, and Intertemporal Choice

Additional Readings

Chapter 14. Saving and Investment

Savings, Consumption, and Taxes

Additional Readings

Chapter 15. The Effect of the National Debt on Capital and Savings

Crowding out of Capital
Neutral Government Debt

Chapter 16. The Temptation of Inflation

Defaulting on Nominal or Real National Debt
Rational Expectations
Commitment and Reputation in Monetary Policy

Additional Readings