

Fall 2004  
Classroom: Saunders 244  
MWF 10:30-11:20 am

Prof. Xiaojun Wang (xiaojun@)  
Office: Saunders 527 (956-7721)  
Office Hours: MW 3-4 pm

## Econ 440: MONETARY THEORY AND POLICY

### 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 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

Champ, Bruce, and Scott Freeman. (2001) *Modeling Monetary Economies*, 2nd ed., John Wiley & Sons.

Various Journal Articles

### Examinations

Pop Quizzes will be given regularly throughout the semester.

The **Midterm exam** will be given on Wednesday Oct. 20.

The **Final exam** is comprehensive and will be given on Friday December 17 9:45-11:45 AM

### Weighting of Course Grade

Pop Quizzes	20%
Midterm	40%
Final	40%

### Policies

- No +/- will be used in grading.
- Attendance is mandatory; no make up quizzes will be given.
- There will be no make up exams. Only medical emergencies are valid reasons for missing exams.

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

## 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*

#### Chapter 3. Inflation

*A Growing Money Supply*  
*Seigniorage*

##### Additional Readings

Aiyagari, Rao S., "Deflating the Case for Zero Inflation," [Federal Reserve Bank of Minneapolis Quarterly Review](#) Vol. 14 (Summer), 1990, 2-11.

Sniderman, Mark S., "Inflation Targets: The Next Step for Monetary Policy," [Federal Reserve Bank of Cleveland Economic Commentary](#), August 1, 1996.

#### Chapter 4. International Monetary Systems

*International Exchange*  
*Fixed vs. Flexible Exchange Rates*  
*Optimal International Monetary Systems*

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Additional Readings

[A Hitchhiker's Guide to Understanding Exchange Rates](#), by Owen F. Humpage, Federal Reserve Bank of Cleveland *Economic Commentary*, January 1, 1998.

Rolnick, Arthur J. and Warren E. Weber, "A Case for Fixing Exchange Rates," [Federal Reserve Bank of Minneapolis 1989 Annual Report](#), 1989, 3-14.

Wallace, Neil, "Why Markets in Foreign Exchange Are Different from Other Markets," [Federal Reserve Bank of Minneapolis Quarterly Review](#) (Fall), 1979, 1-7.

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

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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

**If you feel you need reasonable accommodations because of the impact of a disability, please 1) contact the KOKUA Program (V/T) at 956-7511 or 956-7612 in room 013 of the QLCSS; 2) speak with me privately to discuss your specific needs. I will be happy to work with you and the KOKUA Program to meet your access needs related to your documented disability.**