

Economics 609

Macroeconomics II

Spring 2005

Instructor: Professor Xiaojun Wang

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Classroom: BUSAD G103

Time: TR 3:00pm-4:15pm

Office Hours: TR 1:30pm-2:30pm

Course Objectives

This is the second course in the two-course sequence, Economics 607 and 609, designed for Ph.D. students in Economics and other related fields who intend to take the macro qualifier examination. It covers the standard macroeconomic subjects such as economic growth, business cycle fluctuation, consumption, unemployment, and government fiscal policy. Students are assumed to know the basic techniques in calculus, differential equation, and optimization.

Requirements and Grading

There will be a midterm (TBA in class) and a final exam (Tuesday, May 10.) The final exam only covers material discussed after the midterm. Each exam counts 40% toward the final grade. I will also assign 5-6 homework problem sets during the semester that count 20% towards the final grade. No late homework is accepted, and no make-up exam is offered, unless strong evidence of medical emergency is provided. Finally, no +/- will be used in grading.

The teaching assistant for this course is Mr. XXX, and he can be reached at (808) 956-xxxx (xxx@hawaii.edu). Mr. xxx's duties mainly include grading/discussing homework and holding office hours.

Readings

The main text is David **Romer**, Advanced Macroeconomics, 2nd Edition, McGraw Hill, 2001. I will also frequently refer to Olivier **Blanchard** and Stanley **Fischer**, Lectures on Macroeconomics, MIT Press, 1989, and Ben J. **Heijdra** and Frederick van der **Ploeg**, Foundations of Modern Macroeconomics. Additional readings are listed below, and most of them should be available on the Web (for example, at www.jstor.org). UH library Web site also provides links to some electronic journals. Since most models find roots in journal articles, you are strongly encouraged to read the original work and important follow-up papers. Study group is also strongly encouraged, but simply copying other students' homework can easily render examination failure.

Schedule

1. Traditional Keynesian Theories of Fluctuations (Week 1, 2)

- Romer: Chapter 5.

2. Microeconomic Foundations of Incomplete Nominal Adjustment (Week 3, 4, 5)

- Romer: Chapter 6.

3. Real Business Cycle Theory (Week 6, 7)

- Romer: Chapter 4

Midterm: TBA.

4. Consumption (Week 9, 10, 12: Week 11 is Spring Recess)

- Romer: Chapter 7.
- Blanchard and Fischer: Chapter 6.

5. Unemployment (Week 13, 14)

- Romer: Chapter 9.
- Blanchard and Fischer: Chapter 9.

6. Budget Deficits and Fiscal Policy (Week 15, 16)

- Romer: Chapter 11.
- Blanchard and Fischer: Chapter 11.

Final Exam: Tuesday May 10, 2:15-4:15pm.

(Download the rest of the syllabus, i.e., the reading list, from my website.)

Reading List

1. Traditional Keynesian Theories of Fluctuations

- Romer: Chapter 5.
- Andersen, Leonall C., and Jordan, Jerry L. 1968. "Monetary and Fiscal Actions: A Test of Their Relative Importance in Economic Stabilization." *Federal Reserve Bank of St. Louis Review* 50 (November): 11-24.
- De Long, J. Bradford, and Summers, Lawrence H. 1986. "Is Increased Price Flexibility Stabilizing?" *American Economic Review* 76 (December): 1031-1044.
- Dornbusch, Rudiger. 1976. "Expectations and Exchange Rate Dynamics." *Journal of Political Economy* 84 (December): 1161-1176.
- Friedman, Milton. 1968. "The Role of Monetary Policy." *American Economic Review* 58 (March): 1-17.
- Kareken, John H., and Solow, Robert M. 1963. "Lags in Monetary Policy." In Commission on Money and Credit, *Stabilization Policy*, 14-96. Englewood Cliffs, NJ: Prentice-Hall.
- King, Robert G., and Plosser, Charles I. 1984. "Money, Credit, and Prices in a Real Business Cycle." *American Economic Review* 64 (June): 363-380.
- Krugman, Paul R. 1991. "Target Zones and Exchange Rate Dynamics." *Quarterly Journal of Economics* 106 (August): 669-682.
- Phelps, Edmund S. 1968. "Money-Wage Dynamics and Labor Market Equilibrium." *Journal of Political Economy* 76 (July/August, Part 2): 678-711.
- Phillips, A. W. 1958. "The Relationship between Unemployment and the Rate of Change of Money Wages in the United Kingdom, 1861-1957." *Economica* 25 (November): 283-299.
- Romer, Christina D., and Romer, David H. 1989. "Does Monetary Policy Matter? A New Test in the Spirit of Friedman and Schwartz." *NBER Macroeconomics Annual* 4: 121-170.
- Rotemberg, Julio J., and Woodford, Michael. 1999. "The Cyclical Behavior of Prices and Costs." In John B. Taylor and Michael Woodford, eds., *Handbook of Macroeconomics*, 1052-1135. Amsterdam: Elsevier.
- Solon, Gary, Barsky, Robert, and Parker, Jonathan A. 1994. "Measuring the Cyclical Behavior of Real Wages: How Important is Composition Bias?" *Quarterly Journal of Economics* 109 (February): 1-25.

2. Microeconomic Foundations of Incomplete Nominal Adjustment

- Romer: Chapter 6.
- Akerlof, George A., and Yellen, Janet L. 1985. "A Near-Rational Model of the Business Cycle, with Wage and Price Inertia." *Quarterly Journal of Economics* 100 (Supplement): 823-838.
- Ball, Laurence. 1991. "The Genesis of Inflation and the Costs of Disinflation." *Journal of Money, Credit, and Banking* 23 (August, Part 2): 439-452.

- Ball, Laurence, and Romer, David. 1990. "Real Rigidities and the Non-Neutrality of Money." *Review of Economic Studies* 57 (April): 183-203.
- Barro, Robert J. 1976. "Rational Expectations and the Role of Monetary Policy." *Journal of Monetary Economics* 2 (January): 1-32.
- Barro, Robert J. 1977. "Unanticipated Money Growth and Unemployment in the United States." *American Economic Review* 67 (March): 101-115.
- Barro, Robert J. 1978. "Unanticipated Money, Output, and the Price Level in the United States." *Journal of Political Economy* 86: 549-580.
- Blanchard, Olivier J., and Kiyotaki, Nobuhiro. 1987. "Monopolistic Competition and the Effects of Aggregate Demand." *American Economic Review* 77 (September): 647-666.
- Caplin, Andrew S., and Spulber, Daniel F. 1987. "Menu Costs and the Neutrality of Money." *Quarterly Journal of Economics* 102 (November): 703-725.
- Fischer, Stanley. 1977. "Long-Term Contracts, Rational Expectations, and the Optimal Money Supply Rule." *Journal of Political Economy* 85 (February): 191-205.
- Lucas, Robert E., Jr. 1972. "Expectations and the Neutrality of Money." *Journal of Economic Theory* 4 (April): 103-124.
- Lucas, Robert E., Jr. 1973. "Some International Evidence on Output-Inflation Tradeoffs." *American Economic Review* 63 (June): 326-334.
- Lucas, Robert E., Jr. 1976. "Econometric Policy Evaluation: A Critique." *Carnegie-Rochester Conference Series on Public Policy* 1: 19-46.
- Mankiw, N. Gregory. 1985. "Small Menu Costs and Large Business Cycles: A Macroeconomic Model of Monopoly." *Quarterly Journal of Economics* 100 (May): 529-539.
- Mishkin, Frederic S. 1982. "Does Anticipated Monetary Policy Matter? An Econometric Investigation." *Journal of Political Economy* 90 (February): 22-51.
- Phelps, Edmund S., and Taylor, John B. 1977. "Stabilizing Powers of Monetary Policy under Rational Expectations." *Journal of Political Economy* 85 (February): 163-190.
- Romer, David. 1993. "The New Keynesian Synthesis." *Journal of Economic Perspectives* 7 (Winter): 5-22.
- Rotemberg, Julio J. 1987. "The New Keynesian Microfoundations." *NBER Macroeconomics Annual* 2: 69-104.
- Sargent, Thomas J., and Wallace, Neil. 1975. "'Rational Expectations,' the Optimal Monetary Instrument, and the Optimal Money Supply Rule." *Journal of Political Economy* 83 (April): 241-254.
- Taylor, John B. 1979. "Staggered Wage Setting in a Macro Model." *American Economic Review* 69 (May): 108-113.
- Taylor, John B. 1980. "Aggregate Dynamics and Staggered Contracts." *Journal of Political Economy* 88 (February): 1-23.

3. Real Business Cycle Theory (TBA)

4. Consumption

- Romer: Chapter 7.
- Blanchard and Fischer: Chapter 6.
- Abel, Andrew B. 1990. "Asset Prices under Habit Formation and Catching Up with the Joneses." *American Economic Review* 80 (May): 38-42.
- Caballero, Ricardo J. 1990. "Expenditure on Durable Goods: A Case for Slow Adjustment." *Quarterly Journal of Economics* 105 (August): 727-743.
- Cambell, John Y., and Cochrane, John H. 1999. "By Force of Habit: A Consumption-Based Explanation of Aggregate Stock Market Behavior." *Journal of Political Economy* 107 (April): 205-251.
- Campbell, John Y., and Mankiw, N. Gregory. 1989. "Consumption, Income, and Interest Rates: Reinterpreting the Time Series Evidence." *NBER Macroeconomics Annual* 4: 185-216.
- Carroll, Christopher D. 1997. "Buffer-Stock Saving and the Life Cycle/Permanent Income Hypothesis." *Quarterly Journal of Economics* 112 (February): 1-55.
- Carroll, Christopher, and Kimball, Miles. 1996. "On the Concavity of the Consumption Function." *Econometrica* 64 (July): 981-992.
- Cochrane, John. 1991. "A Simple Test of Consumption Insurance." *Journal of Political Economy* 99 (October): 957-976.
- Epstein, Larry G., and Zin, Stanley E. 1991. "Substitution, Risk Aversion, and the Temporal Behavior of Consumption and Asset Returns: An Empirical Analysis." *Journal of Political Economy* 99 (April): 263-286.
- Falvin, Marjorie A. 1981. "The Adjustment of Consumption to Changing Expectations about Future Income." *Journal of Political Economy* 89 (October): 974-1009.
- Hall, Robert E. 1978. "Stochastic Implications of the Life Cycle-Permanent Income Hypothesis: Theory and Evidence." *Journal of Political Economy* 86 (December): 971-987.
- Hall, Robert E. 1988. "Intertemporal Substitution in Consumption." *Journal of Political Economy* 96 (April): 339-357.
- Hansen, Lars Peter, and Singleton, Kenneth J. 1983. "Stochastic Consumption, Risk Aversion, and the Temporal Behavior of Asset Returns." *Journal of Political Economy* 91 (April): 249-265.
- Mankiw, N. Gregory. 1981. "The Permanent Income Hypothesis and the Real Interest Rate." *Economics Letters* 7: 307-311.
- Mankiw, N. Gregory. 1982. "Hall's Consumption Hypothesis and Durable Goods." *Journal of Monetary Economics* 10 (November): 417-425.
- Mehra, Rajnish, and Prescott, Edward C. 1985. "The Equity Premium: A Puzzle." *Journal of Monetary Economics* 15 (March): 145-161.
- Merton, Robert C. 1969. "Lifetime Portfolio Selection under Uncertainty: The Continuous Time Case." *Review of Economics and Statistics* 51 (August): 247-257.
- Merton, Robert C. 1973. "An Intertemporal Capital Asset Pricing Model." *Econometrica* 41 (September): 867-887.

- Samuelson, Paul A. 1969. "Lifetime Portfolio Selection by Dynamic Stochastic Programming." *Review of Economics and Statistics* 51 (August): 239-246.
- Shea, John. 1995. "Union Contracts and the Life-Cycle/Permanent- Income Hypothesis." *American Economic Review* 85 (March): 186-200.
- Zeldes, Stephen P. 1989. "Consumption and Liquidity Constraints: An Empirical Investigation." *Journal of Political Economy* 97 (April): 305-346.

5. Unemployment (Week 14, 15)

- Romer: Chapter 9.
- Blanchard and Fischer: Chapter 9.
- Yellen, Janet L. 1984. "Efficiency Wage Models of Unemployment." *American Economic Review* 74 (May): 200-205.
- Katz, Lawrence F. 1986. "Efficiency Wage Theories: A Partial Evaluation." *NBER Macroeconomics Annual* 1: 235-276.
- Akerlof, George A., and Yellen, Janet L. 1990. "The Fair Wage-Effort Hypothesis and Unemployment." *Quarterly Journal of Economics* 105 (May): 255-283.
- Summers, Lawrence H. 1988. "Relative Wages, Efficiency Wages, and Keynesian Unemployment." *American Economic Review* 78 (May): 383-388.
- Shapiro, Carl, and Stiglitz, Joseph E. 1984. "Equilibrium Unemployment as a Worker Discipline Device." *American Economic Review* 74 (June): 433-444.
- Kimball, Miles S. 1994. "Labor-Market Dynamics When Unemployment Is a Worker Discipline Device." *American Economic Review* 84 (September): 1045-1059.
- Barro, Robert J. 1977. "Long-Term Contracting, Sticky Prices, and Monetary Policy." *Journal of Monetary Economics* 3 (July): 305-316.
- Hall, Robert E. 1980. "Employment Fluctuations and Wage Rigidity." *Brookings Papers on Economic Activity*, no. 1, 91-123.
- Azariadis, Costas. 1975. "Implicit Contracts and Underemployment Equilibria." *Journal of Political Economy* 83 (December): 1183-1202.
- Baily, Martin Neil. 1974. "Wages and Employment under Uncertain Demand." *Review of Economic Studies* 41 (January): 37-50.
- Gordon, David. 1974. "A neoclassical Theory of Underemployment." *Economic Inquiry* 12 (December): 432-459.
- Solow, Robert M. 1985. "Insiders and Outsiders in Wage Determination." *Scandinavian Journal of Economics* 87: 411-428.
- Pissarides, Christopher A. 1985. "Short-Run Dynamics of Unemployment, Vacancies, and Real Wages." *American Economic Review* 75 (September): 676-690.
- Krueger, Alan B., and Summers, Lawrence H. 1988. "Efficiency Wages and the Inter-Industry Wage Structure." *Econometrica* 56 (March): 259-293.

6. Budget Deficits and Fiscal Policy (Week 16, 17)

- Romer: Chapter 11.
- Blanchard and Fischer: Chapter 11.
- Barro, Robert J. 1974. "Are Government Bonds Net Wealth?" *Journal of Political Economy* 82 (November/December): 1095-1117.
- Barro, Robert J. 1979. "On the Determination of Public Debt." *Journal of Political Economy* 87 (October): 940-971.
- Barsley, Robert B., Mankiw, N. Gregory, and Zeldes, Stephen P. 1986. "Ricardian Consumers with Keynesian Propensities." *American Economic Review* 76 (September): 676-691.
- Blinder, Alan S., and Solow, Robert M. 1973. "Does Fiscal Policy Matter?" *Journal of Public Economics* 2 (November): 318-337.
- Hayashi, Fumio. 1987. "Tests for Liquidity Constraints: A Critical Survey and Some New Observations." In Truman F. Bewley, ed., *Advances in Econometrics*, vol. 2, 91-120. Cambridge: Cambridge University Press.
- Hubbard, R. Glenn, and Judd, Kenneth L. 1986. "Liquidity Constraints, Fiscal Policy, and Consumption." *Brookings Papers on Economic Activity*, no. 1, 1-50.
- Kydland, Finn E., and Prescott, Edward C. 1977. "Rules Rather than Discretion: The Inconsistency of Optimal Plans." *Journal of Political Economy* 85 (June): 473-492.
- Lucas, Robert E., Jr., and Stokey, Nancy L. 1983. "Optimal Fiscal and Monetary Policy in an Economy without Capital." *Journal of Monetary Economics* 12 (July): 55-93.
- Poterba, James M., and Summers, Lawrence H. 1987. "Finite Lifetimes and the Effects of Budget Deficits on National Saving." *Journal of Monetary Economics* 20 (September): 369-391.
- Yotsuzuka, Toshiki. 1987. "Ricardian Equivalence in the Presence of Capital Market Imperfections." *Journal of Monetary Economics* 20 (September): 411-436.