

Economics 8050
Macroeconomics II
Fall 2000
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GENERAL

The most important purpose of this course is to give you a solid foundation in dynamic economic theory and its application. A related important purpose of the course is to provide you with a basic background in parts of contemporary macroeconomics. The major part of this course is theoretical, focusing on the related issues of dynamic economic theory, rational expectations, and asset markets. We also will discuss economic growth, a major topic in macroeconomics in recent years. By the end of the course, you should acquire the tools necessary to read and understand the issues raised in the literature.

GRADING

The grades in this course will be based on homework problems, a paper and two exams. The homework will be one-eighth of your grade, the paper will be one-quarter of your grade, the mid-term will be one-quarter of your grade and the final will be three-eighths of your grade.

THE PAPER

There are two parts of the requirement that you write a paper. A preliminary description of the topic and an outline of its expected content is due October 10. The paper itself is due on the last day of class. If you do not hand it in that day, you are very likely to receive a grade of incomplete on your regular grade report.

EXAMS

I will make up the exams assuming that you have worked through much of the algebra in the material discussed in class. There is no way to learn the material without sitting down with a pad of paper and a pencil and working through problems. Only by doing the algebra will you see the intermediate steps and why they are important. I cannot emphasize this too much: there is no substitute for working through the algebra yourself.

The midterm will be a take-home exam on the overlapping generations model. The final will be roughly half take-home exam and half in-class exam. The take-home exam will ask a few significant questions that require thought and nontrivial analysis. The in-class exam will be about one and a half hours long and will ask questions for which going down the wrong track is less devastating for your overall grade. The take-home exam will be handed out at the end of the last class or one week before the final, whichever is earlier.

THE PAPER

The paper should be on a subject in the field of macroeconomics, broadly defined, which you find of interest. You can go into more detail on a subject covered in this course or you can examine a topic that is not covered in this course. *For example*, you might be interested in areas such as households' consumption, labor supply, business cycles, stabilization policy, asset markets, futures markets or central banking. If you are interested in a subject, I probably can give you a starting point. There is no particular format required for the paper. The only restriction is that you cannot simply reproduce someone else's empirical work with different data or reproduce someone else's theoretical work. Some possibilities suggest themselves to me.

You may wish to work on a theoretical problem or an empirical problem that is unresolved. You will *not* be graded on the basis of whether you solve the problem; you will be graded on the basis of whether you approach the problem in a well-defined way.

You may wish to do an *analytical* review of some body of literature. Simply repeating what various authors say will get you a bad grade. An analytical review does not just regurgitate what various authors say. An analytical review puts a set of papers in a general context, focuses on what seem to be the key issues in the papers, what has been resolved and what are the differences among the papers.

You may want to do a different sort of paper than these. If so, ask.

There is no required length. This said, if your paper is 5 pages long, it is unlikely that your paper has said enough (although some classic dissertations are this short.) If your paper is more than 20 pages long, then you undoubtedly are too wordy, but I will not penalize you beyond the opportunity cost of your own time.

READINGS

The following books are available in the bookstore:

Introduction to Dynamic Macroeconomic Theory

by George T. McCandless Jr. and Neil Wallace

Rational Expectations, Second edition by Steven M. Sheffrin

We also will use material from *Economic Growth* by Robert J. Barro and Xavier Sala-i-Martin.

READINGS

I may add readings from articles as we proceed.

I. An Introduction to Dynamic General Equilibrium Models — Overlapping Generations Models

A. The Basic Overlapping Generations Model

McCandless and Wallace, Chs. 1-2

B. The Government and Debt

McCandless and Wallace, Chs. 3-5

C. Infinitely-lived Assets and Fluctuations

McCandless and Wallace, Chs. 6-7

D. Economic Growth in an Overlapping Generations Model
McCandless and Wallace, Ch. 9

II. Rational Expectations

A. Basic Implications of Rational Expectations

Dwyer, Notes on Rational Expectations, available at course web site
Sheffrin, Ch. 1

B. Applications to Issues in Macroeconomics

Required reading:

Sheffrin, Ch. 2, Ch. 3 pp. 79-98.

Lucas, Jr., Robert E. "Econometric Policy Evaluation: A Critique," *The Phillips Curve and Labor Markets*, ed. by Karl Brunner and Allan H. Meltzer. Carnegie-Rochester Conference Series on Public Policy (Volume 1, 1975), pp. 19-46.

Further reading:

Thomas J. Sargent, *The Conquest of American Inflation*. Princeton: Princeton University Press, 1999.

C. Applications to Financial Markets

Sheffrin, Ch. 4

D. Applications to Microeconomics

Sheffrin, Ch. 5

Bray, Margaret. "Rational Expectations, Information, and Asset Markets." In *The Economics of Missing Markets, Information, and Games*, ed. by Frank Hahn, pp. 243-77. Oxford: Clarendon Press, 1990.

D. Dynamic General Equilibrium in Discrete Time

McCallum, Bennett T. "Are Bond-financed Deficits Inflationary? A Ricardian Analysis." *Journal of Political Economy* (February 1984).

III. Economic Growth – Dynamic general equilibrium in continuous time

A. Non-optimizing Models of Growth

Barro and Sala-i-Martin, Ch. 1

B. Economic Growth with Optimizing Households

Romer, Paul M. "Capital Accumulation in the Theory of Long Run Economic Growth." In *Modern Business Cycle Theory*, ed. by Robert J. Barro. Cambridge: Harvard University Press, 1989.

Barro and Sala-i-Martin, Ch. 2