Boston College
Department of Economics

EC 202.02 , Macroeconomic Theory

Fall 2000

Professor Tommaso Monacelli

- **Office Hours**: You are more than welcome to see me in my office for *any* question basically any time.
- **Class Time and Location: TTh. 1:30 p.m**

- **Textbook**: O. Blanchard, *Macroeconomics*, Prentice Hall.

It is highly recommended that you try to follow the current macroeconomic debate by reading the weekly magazine *The Economist*. Buying daily either *The Wall Street Journal* or the *Financial Times* can also be extremely useful. Several questions in problem sets, midterm and final exam will be based on current economic issues that you might be asked to interpret on the basis of the material analyzed in class.

- **Teaching Assistant:** TBA

- **The Purpose of this Course**

Why is economic growth so persistent in the U. S? Why does Europe have such a high unemployment rate? What can the European Governments do about it? Will the U. S. Government have to reform Social Security? When is it appropriate for the Federal Reserve to move interest rates? What determines the long-run growth of a country? Should the U. S care about the exchange rate with the Euro? The purpose of this course is to provide you with a set of analytical tools to allow you to answer such questions. What makes the answer of an economist different from the one of either a journalist or a sociologist is that this answer is based on formal models. You will learn what a macroeconomic model is and how it can be easily used to understand the main facts of both the U. S and world economy.

- **Prerequisites**

To build and understand models mathematics is essential. I will make an extensive use of algebra and graphical tools. A strong familiarity with these tools is a strict prerequisite. I will not make use of calculus, although a basic knowledge of it may draw the line between a fair and an excellent grade.

- **Requirements**

Your final grade will be based on a midterm (30 %), a final (40%) and problem sets (30%). The final will be *cumulative*. An optimal program for tackling this course does exist, and it is to read in advance before each class the chapters of the book regarding the topic to be covered.

You can improve your grade by as much as 10 % if you manage to have a letter of yours to the editor of either *The Economist, The Financial Times or The Wall Street Journal* (concerning a current economic issue) to be published. Evidence of this should be submitted to me before the last week of class.

Work as hard as possible on the problem sets. If well done they can contribute well beyond 30%. You are expected to attend *each* class. Please notify either me or the TA if for some reason you have to miss two or more consecutive classes. Class notes are crucial. You will soon learn that the book cannot be a good substitute.

- **Rules**

There will be absolutely *no make-up exam* (or midterm). If for a reason independent of your control you are forced to miss an exam you will have to notify me in advance or, in case of illness, provide documentation from your physician. You are personally responsible for bringing the problem sets to class on their due date. *No late problem sets* will be accepted. You are allowed to cooperate on problem sets. However, each student *must* turn in an original problem set. Identical problem sets will be graded zero. If due to this reason you should obtain two or more grades of zero the total weight of *all* your problem sets will be considered zero as well.

- **Course Outline**

The course has three main moduli: short-run, long-run and policy analysis.

1) Short-run analysis

i) Introduction (Ch 1-2)

What is macroeconomics about ? We will try to understand what a macroeconomic issue is. National accounting will be introduced.

ii) The core of macroeconomic modelling: IS-LM model (Chp. 3-6).

This is the central core of introductory-intermediate macroeconomics. Do not proceed in studying any further if you do not feel completely confident with all the details of this model. (Please come see me immediately at this point if you feel you are not making enough progress towards this goal). The market equilibrium concept is introduced. Equilibrium in both the financial and goods markets is then analyzed.

iii)Variations on the IS-LM model.

a) **Introducing expectations (Chp. 7-10).**

The basic IS-LM model is *static,* i.e., expectations on the future course of macroeconomic variables do not play a role. Yet it makes sense to believe, e.g., that my current consumption depends on the expectations about the evolution of my future income. We will analyze how the introduction of expectations may alter the basic predictions of the IS-LM model.

b) **Opening up the economy (Chp. 11-13).**

The basic IS-LM model is *closed*, i.e., the role of trade links with the rest of the world is neglected. We will introduce the role of imports, exports and exchange rate in the basic IS-LM model. This will add a lot of realism to the model.

c) **Adding the labor market (Chp. 15).**

d) **Building the AS-AD model (Chp 16).**

After IS-LM, this is the second key model to be carefully digested. This model features a *supply side* (labor market) in addition to a *demand side* (determined under IS-LM).

2) Long-run Analysis

So far an economy in a short-run perspective only has been considered. In this part of the course we will move from short (quarters) to medium (years) and long run analysis (decades). Typical long-run macroeconomic questions are: In a long-term perspective, are unemployment and inflation related? What determines the secular growth of a country with respect to another? What is going to be the impact of the IT revolution of the 70s on the capital accumulation of the coming years? Does a country that devotes more resources to human capital accumulation (i.e., education) grow more?

Chp. 17-18: The Phillips Curve. Evolution of prices and wages from the short to the long run.
Chp. 22-24: Physical and human capital accumulation and technological progress.
Chp. 25: Relating technological progress, unemployment and income (in)equality.
Why is income distribution in the U. S more unequal than in Europe? What are the costs and benefits of that?

3) Policy analysis (Chp. 27-29)
Can/should economies be governed? The can part concerns the descriptive approach to macroeconomics (i.e., how things actually work). The should part concerns the normative approach (i.e., how things *should* work). We will discuss the role of both monetary and fiscal policy in the economy. Should monetary policy control inflation? How can this be done? Is balancing the budget per se a good idea ? How should the current U. S fiscal surplus be employed?

I hope/believe we will be able to answer all the questions this syllabus has raised. Towards this goal, your cooperation and enthusiasm will be decisive. Have a nice semester. See you in class.