

We will review theories of inflation and unemployment. The following is a reading list for the material that will be covered in this class. Starred articles should be given higher priority, although you should read as many of these articles as you can. The acronym "R" stands for Romer, David, *Advanced Macroeconomics*, which is available in the bookstore. "BF" stands for Blanchard, Olivier and Stanley Fischer, *Lectures on Macroeconomics*, which you probably already own. The sections in the two textbooks overlap to a great extent, but it is helpful to have the same material surveyed in two different ways.

## **THEORIES OF INFLATION AND MONETARY POLICY**

### **Lecture 1. Money-market equilibrium and the monetary causes of inflation`**

\*R: 9.1-9.2

### **Lectures 2 through 6. The theory of moderate inflation: Time-inconsistency**

#### *The time-inconsistency problem*

\*R: 9.4-9.5; BF, 11.4

Cukierman, Alex (1992). *Central bank strategy, credibility, and independence: theory and evidence* (Cambridge, Mass: MIT Press).

Barro, R. and D. Gordon (1983), "A Positive Theory of Monetary Policy in a Natural Rate Model," *Journal of Political Economy* 91, pp. 589-610.

Kydland, Finn and Edward Prescott (1977). "Rules Rather than Discretion: The Inconsistency of Optimal Plans." *Journal of Political Economy* 85(3).

#### *Addressing the time-inconsistency problem: implicit contracts*

\*Barro, R. and D. Gordon (1983), "Rules, Discretion and Reputation in a Model of Monetary Policy," *Journal of Monetary Economics* 12, pp. 101-22.

\*Canzoneri, Matthew (1985), "Monetary Policy Games and the Role of Private Information," *American Economic Review* 75, pp. 1056-1070.

#### *Addressing the time-inconsistency problem: incomplete information and reputation*

\*Backus, D. and J. Driffill (1985), "Inflation and Reputation," *American Economic Review* 75, pp. 530-538.

Barro, R. (1986) "Reputation in a Model of Monetary Policy with Incomplete Information," *Journal of Monetary Economics* 17, pp. 1-20.

Driffill, John (1988). "Macroeconomic Policy Games with Incomplete Information: A Survey." *European Economic Review* 32.

Cukierman, Alex and Allan Drazen (1991). "Optimal Accommodation by Strong Policymakers under Incomplete Information." *Journal of Monetary Economics* 27, 99-127.

#### *Addressing the time-inconsistency problem: institutional design*

\*Rogoff, K. (1985), "The Optimal Degree of Commitment to an Intermediate Monetary Target," *Quarterly Journal of Economics* 100, pp. 1169-1190.

\*Alesina, Alberto and L. Summers (1993), "Central Bank Independence and Macroeconomic

- Performance: Some Comparative Evidence", *Journal of Money, Credit and Banking* 25, pp. 151-62.
- Lohman, Susanne (1992), "Optimal Commitment in Monetary Policy: Credibility versus Flexibility," *American Economic Review* 82, pp. 273-86.
- Walsh, C. (1995), "Optimal Contracts for Central Bankers," *American Economic Review*, 85, 150-167.

#### *Misgivings about the time-inconsistency problem*

- McCallum, B. (1995), "Two Fallacies Concerning Central Bank Independence," *American Economic Review* 85, pp. 207-211.
- Goodhart, Charles and Haizhou Huang, "What is the Central Bank's Game?", Discussion paper No. 222, London School of Economics.
- Canavan, Chris (1996), "Can Ignorance Make a Central Bank Behave?" Boston College.

### **Lecture 7. The theory of high inflation: Monetary policy and seigniorage**

- \*R: 9.7; BF, 4.7, 10.2
- \*Bruno, Michael and Stanley Fischer (1990), "Seigniorage, operating rules, and the high inflation trap." *Quarterly Journal of Economics* 105, pp. 353-74.
- Cagan, Philip (1956). "The Monetary Dynamics of Hyperinflation." In Milton Friedman (ed.), *Studies in the Quantity Theory of Money*, University of Chicago Press
- Drazen, Allan, and Elhanan Helpman (1990), "Inflationary Consequences of Anticipated Macroeconomic Policies." *Review of Economic Studies* 57, pp. 147-64.

### **Lecture 8. The theory of hyperinflation: Price-level bubbles**

- \*BF, Ch. 4.5, 5.3
- \*Sidrauski, Miguel (1967). "Rational Choice and Patterns of Growth in a Monetary Economy." *American Economic Review* 57, 2 (May) pp. 534-544.
- \*Obstfeld, M. and K. Rogoff (1983). "Speculative Hyperinflations in Macroeconomic Models: Can We Rule Them Out?" *Journal of Political Economy* 91, 4 (Aug) pp. 675-687.
- Brock, William (1975). "A Simple Perfect Foresight Monetary Model." *Journal of Monetary Economics* 1, 2 (April), pp. 133-150.
- Calvo, Guillermo (1978). "On the Indeterminacy of Interest Rates and Wages with Perfect Foresight," *Journal of Economic Theory* 19 (Dec) pp. 321-337.

## **THEORIES OF UNEMPLOYMENT**

### **Lecture 9. Introduction**

- \*R: 10.1; BF: 9.1

### **Lecture 10. Efficiency Wages**

- \*R: 10.2-10.4; BF: 9.4
- \*Shapiro, Carl and Joseph Stiglitz (1984). "Equilibrium Unemployment as a Worker Discipline Device." *American Economic Review* 74, 433-444.
- Yellen, Janet (1984). "Efficiency Wage Models of Unemployment." *American Economic Review* 74, 200-205.
- Katz, L. (1986). "Efficiency Wage Theories: A Partial Evaluation." *NBER Macroeconomics Annual* 1: 235-276.
- Summers, Lawrence (1988). "Relative Wages, Efficiency Wages, and Keynesian

Unemployment." *American Economic Review* 78, 383-388.

### **Lecture 11. Implicit Contracts**

\*R: 10.5; BF: 9.2

\*Azariadis, Costas (1975). "Implicit Contracts and Underemployment Equilibria." *Journal of Political Economy* 83, 1183-1202.

Baily, Martin (1974). "Wages and Unemployment under Uncertain Demand." *Review of Economic Studies* 41, 37-50.

Gordon, David (1974). "A Neo-Classical Theory of Unemployment." *Economic Inquiry* 12, 432-459.

### **Lecture 12. Insider-Outsider theories**

\*R: 10.6-10.7; BF: 9.3

\*Blanchard, Olivier and Lawrence Summers (1987). "Hysteresis in Unemployment." *European Economic Review* 31, 288-295.

Solow, Robert (1985). "Insiders and Outsiders in Wage Determination." *Scandinavian Journal of Economics* 87, 411-428.

Gregory, R.G. (1986). "Wages Policy and Unemployment in Australia." *Economica* 53 (Supplement), S53-S74.

Lindbeck, Assar and Dennis Snower (1988). *The Insider-Outsider Theory of Employment and Unemployment*. Cambridge: MIT Press.

Blanchard, Olivier and Lawrence Summers (1986). "Hysteresis and the European Unemployment Problem." *NBER Macroeconomics Annual* 1: 15-78.

### **Lecture 13. Search and Matching**

\*R: 10.8

\*Diamond, Peter (1982). "Aggregate Demand Management in Search Equilibrium." *Journal of Political Economy* 90, 881-894.

Pissarides, Christopher (1985). "Short-Run Dynamics of Unemployment, Vacancies, and Real Wages." *American Economic Review* 75, 676-690.

Mortenson, Dale (1986). "Job Search and Labor Market Analysis," in O. Ashenfelter and R. Layard, eds., *Handbook of Labor Economics*, v. 2, 849-919

Howitt, Peter (1988). "Business Cycles with Costly Search and Recruiting." *Quarterly Journal of Economics* 102, 147-165.

Blanchard, Olivier and Peter Diamond (1989). "The Beveridge Curve." *Brookings Papers on Economic Activity*, no. 1, 1-60.