

Revised 12/21/98

BOSTON COLLEGE
SCHOOL OF MANAGEMENT

EC 364/MF364
Spring 1999
T Th 12:00-1:15

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Office hours: T Th 3:00-4:00

MONETARY AND FISCAL POLICY: THEORY AND PRACTICE

The purpose of this course is to introduce students to current issues in macroeconomic policy. It will explore both the theoretical debates and the practical issues faced by policymakers. It will cover a wide range of monetary and fiscal policy topics, from the desirability of moving from low to zero inflation to the outlook for reforming Social Security and Medicare. In addition to the assigned readings, students will be expected to follow the economy closely through the *Wall Street Journal*.

COURSE REQUIREMENTS:

1. The course will have a mid-term exam on March 11 (25%) and a final exam in May 11, 9:00 (40%).
2. Students will be required to prepare three (3) two-page memos making the case clearly and concisely for one course of action over another (25%).
3. Class participation will be an important part of the course (10%).

SYLLABUS

INTRODUCTION - BRIEF REVIEW OF MACRO POLICY

Jan. 19, 21 - The state of the debate: the theory and the mechanics

“Paradigm Lost,” *The Economist*, Nov. 3, 1990, pp.84-85.

“Tales of the Expected,” *The Economist*, Nov. 10, 1990, pp.90-91.

“Keynes Rides Again,” *The Economist*, Nov. 17, 1990, pp.97-98.

Alan S. Blinder, “Do We Know How To Manage the National Economy?” in *Hard Heads, Soft Hearts*, Ch. 3 Addison-Wesley Publishing Co.1987, pp. 67-108.

Christina D. Romer, “Is the Stabilization of the Postwar Economy a Figment of the Data?” *American Economic Review* 76, June 1986, pp.314-334.

N. Gregory Mankiw, *Macroeconomics*, Chapters 9 and 10, pp. 227-298 or
Dornbush and Fisher, *Macroeconomics*

Jan. 26 - The Great Depression – what happened?

Christina D. Romer, “The Nation in Depression,” *Journal of Economic Perspectives*, Spring 1993, Vol. 7, No 2, pp. 18-39.

Peter Temin, “Transmission of the Great Depression,” *Journal of Economic Perspectives*, Spring 1993, Vol. 7, No. 2, pp. 87-102.

THE FED AND MONETARY POLICY

Jan. 28 - The history and structure of the Federal Reserve

“Overview of the Federal Reserve System” *The Federal Reserve System: Purposes and Functions*, Board of Governors of the Federal Reserve System, Washington, DC, 1994, Chapter 1, pp. 1-15.

Frederic S. Mishkin, “Structure of Central Banks and the Federal Reserve System” *The Economics of Money, Banking, and Financial Markets*, Chapter 15, Addison-Wesley Publishing Co.1998, pp. 389-412.

Geoffrey M. B. Tootell, “Are Presidents More Conservative than Board Governors?” *New England Economic Review*, Federal Reserve Bank of Boston, Sept/Oct 1991.

Geoffrey M. B. Tootell, “Appointment Procedures and a Partisan Political Model,” *Southern Economic Journal*, July 1996.

Feb. 2 - How does monetary policy affect the economy?

Christina D. Romer and David H. Romer, “Credit Channel or Credit Actions? An Interpretation of the Postwar Transmission Mechanism,” in *Changing Capital Markets: Implications for Monetary*, Symposium Sponsored by the Federal Reserve Bank of Kansas City, 1993, pp. 71-129.

Feb. 4 - Does independence matter?

Alberto Alesina and Lawrence H. Summers, “Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence,” *Journal of Money, Credit, and Banking*, May 1993, pp. 151-162.

Jeffrey C. Fuhrer, “Central Bank Independence and Inflation Targeting: Monetary Policy Paradigms for the Next Millenium?” *New England Economic Review*, Federal Reserve Bank of Boston, January/February 1997, pp. 19-36.

Feb. 9 - Inflation targeting

Ben S. Bernanke and Frederic S. Mishkin, "Inflation Targeting: A New Framework for Monetary Policy?" *Journal of Economic Perspectives*, Spring 1997, Vol. 11, No. 2, PP. 97-116.

Mervyn King, "How Should Central Banks Reduce Inflation? —Conceptual Issues," in *Achieving Price Stability*, Symposium Sponsored by the Federal Reserve Bank of Kansas City, 1996, pp. 53-82.

Feb. 11 – What's up with the CPI?

Michael J. Boskin et al, "Consumer Prices, the Consumer Price Index, and the Cost of Living," *Journal of Economic Perspectives*, Winter 1998, pp. 3-26.

Katharine G. Abraham, John Greenlees, and Brent R. Moulton, "Working to Improve the Consumer Price Index," *Journal of Economic Perspectives*, Winter 1998, pp. 27-36.

Feb. 16, 18 - Do we want stable prices?

"Stable prices and fast growth: just say no," *The Economist*, Aug. 31, 1996.

Alan S. Blinder, "Striking a Balance Between Unemployment and Inflation" in *Hard Heads, Soft Hearts*, Ch. 2 Addison-Wesley Publishing Co.1987, pp. 32-66.

Martin Feldstein, "Overview," in *Achieving Price Stability*, Symposium Sponsored by the Federal Reserve Bank of Kansas City, 1996, pp. 319-329.

Stanley Fischer, "Why Are Central Banks Pursuing Long-run Price Stability?" in *Achieving Price Stability*, Symposium Sponsored by the Federal Reserve Bank of Kansas City, 1996, pp. 7-34.

Important but somewhat difficult:

George A. Akerlof, William T. Dickens, George L. Perry, "The Macroeconomics of Low Inflation," *Brookings Papers on Economic Activity*, 1996:I, pp. 1-76.

Martin Feldstein, "The Costs and Benefits of Going from Low Inflation to Price Stability," in C. Romer and D. Romer, eds, *Reducing Inflation: Motivation and Strategy*, Chicago: Chicago University Press, 1996, pp. 123-166.

Feb. 23 – Why do we need inflation-indexed bonds?

Alicia H. Munnell, “Should the U.S. Government Issue Index Bonds?” *New England Economic Review*, Federal Reserve Bank of Boston, Sept./Oct. 1986, pp. 3-21.

“Inflation-Indexed Securities” in *Economic Report of the President*, February 1997, pp. 62-67.

Jeffrey M. Wrase, “Inflation-Indexed Bonds: How Do They Work?” *Business Review*, Federal Reserve Bank of Philadelphia, July/August 1997, pp.3-16.

Feb. 25 - Is the NAIRU a useful concept?

Joseph Stiglitz, “Reflections on the Natural Rate Hypothesis,” *Journal of Economic Perspectives*, Winter 1997, Vol. 11, No. 1, pp. 3-10.

Robert J. Gordon, “The Time-varying NAIRU and its Implications for Economic Policy,” *Journal of Economic Perspectives*, Winter 1997, Vol. 11, No. 1.

Douglas Staiger, James H. Stock, and Mark W. Watson, “The NAIRU, Unemployment and Monetary Policy,” *Journal of Economic Perspectives*, Winter 1997, Vol. 11, No. 1, pp. 33-49.

March 2, 4 SPRING VACATION

March 9 - Monetary policy in theory and practice

Alan S. Blinder, “What Central Bankers Could Learn from Academics--and Vice Versa,” *Journal of Economic Perspectives*, Spring 1997, Vol. 11, No. 2, pp. 3-19.

March 11 - MID-TERM EXAM

FISCAL POLICY AND THE BUDGET

March 16 – What is the outlook for fiscal policy? The surpluses are coming!

“Summary,” in Congressional Budget Office, *The Economic and Budget Outlook: 1999-2008*, August 1998, pp. ix-xvii.

“The Long-Term Budget Outlook,” Chapter Two in Congressional Budget Office, *Long-Term Budgetary Pressures and Policy Options*, May 1998, pp17-29.

“Sensitivity of the Budget to Economic Assumptions,” in *Budget of the United States Government Fiscal Year 1999: Analytical Perspectives*, p.14.

March 18 – Can fiscal policy be effective in an open economy?

Mankiw, *Macroeconomics*, ch.11, pp. 299-331.

March 23 - Do (did) deficits matter?

Benjamin M. Friedman, “Learning from the Reagan Deficits,” *American Economic Review*, May 1992, pp. 299-304.

Robert Eisner, “Deficits: Which, How Much, and So What?” *American Economic Review*, May 1992, pp. 295-98.

Robert Barro, “The Ricardian Approach to Budget Deficits,” *Journal of Economic Perspectives*, Spring 1989, pp. 37-55.

March 25 - Generational accounting--a useful perspective?

Alan Auerbach, Jagadeesh Gokhale, and Laurence J. Kotlikoff, “Generational Accounting: A Meaningful Way to Evaluate Fiscal Policy,” *Journal of Economic Perspectives*, Winter 1994, pp. 73-94.

Dean Baker, *Robbing the Cradle? A Critical Assessment of Generational Accounts*, Economic Policy Institute, 1995.

March 30 – Capital budgeting for the U.S. Government?

“Budget Issues: Budgeting for Capital” Paul L. Posner, Director, Budget Issues, Accounting and Financial Management Division, General Accounting Office, Testimony before the President’s Commission to Study Capital Budgeting, March 6, 1998.

Robert W. Hartman, Assistant Director, Special Studies Division, Congressional Budget Office, Testimony before the House of Representatives, Subcommittee on Economic Development, Committee on Public Works and Transportation, May 26, 1993.

“Federal Investment Spending and Capital Budgeting: Part IV” in *Budget of the United States Government Fiscal Year 1999: Analytical Perspectives*, pp. 130-41.

“Budget Alternatives Memorandum” for National Economic Council, July 22, 1994.

April 1 – EASTER WEEKEND

April 6 – What about the distribution of income and wealth?

Edward N. Wolff, “Recent Trends in the Size Distribution of Household Wealth” *Journal of Economic Perspectives*, Summer 1998, pp. 95-111.

U.S. Department of Commerce, Bureau of the Census, *Money Income in the United States: 1997*, pp. v-xviii.

April 8 – What are tax expenditures?

“Tax Expenditures” in *Budget of the United States Government Fiscal Year 1999: Analytical Perspectives*, pp. 89-100.

“Current Taxation of Qualified Plans: Has the Time Come?” *New England Economic Review*, Federal Reserve Bank of Boston, March/April 1992, pp. 12-25.

April 13, 15 -- Outlook for major tax reform

C. Eugene Steuerle, “What Are Those Tax Forms Going to Look Like?” *Tax Notes*, 1995 reprinted by Urban Institute.

C. Eugene Steuerle, “The Simple Arithmetic of Flat Taxes,” *Tax Notes*, August 4, 1997 reprinted by Urban Institute.

Henry J. Aaron and William G. Gale, *Economic Effects of Fundamental Tax Reform*, Brookings Institution Press, 1996.

Chapter 1	Introduction
Chapter 3	The Effects of Fundamental Reform on Saving
Chapter 8	Distributional Effects of Fundamental Tax Reform
Chapter 9	Transition Issues in Moving to a Consumption Tax

April 20, 22, 27 -- The outlook for entitlement reform: Social Security

Economic Report of the President 1997, “Economic Challenges of an Aging Population,” Chapter 3, pp.93-117.

Fast Facts & Figures about Social Security 1997, Office of Research and Statistics, Social Security Administration.

John Geanakoplos, Olivia S. Mitchell, Stephen P. Zeldes, “Would a Privatized Social Security System Really Pay a Higher Rate of Return?” in R. Douglas Arnold, Michael Graetz, and Alicia H. Munnell eds. *Framing the Social Security Debate: Values, Politics and Economics*, The Brookings Press, 1998 forthcoming.

Edward M. Gramlich, "Different Approaches for dealing with Social Security," *Journal of Economic Perspectives*, Summer 1996, pp. 55-66.

Peter A. Diamond, "Proposal to Restructure Social Security," *Journal of Economic Perspectives*, Summer 1996, pp.67-88.

Laurence J. Kotlikoff and Jeffrey Sachs, "It's High Time to Privatize," *Brookings Review*, Summer 1997, pp. 16, 18, 20, 22.

Henry J. Aaron, "A Bad Idea Whose Time Will Never Come," *Brookings Review*, Summer 1997, pp. 17, 19, 21, 23.

April 29, May 4 - The outlook for entitlement reform: Medicare

Economic Report of the President 1997, "Economic Challenges of an Aging Population," Chapter 3, pp.117-138.

David M. Cutler, "Restructuring Medicare for the Future," in Robert D. Reischauer, ed., *Setting National Priorities: Budget Choices for the Next Century*, Brookings Institution Press, 1997, pp. 197-234.

May 11 – FINAL EXAM