

## WWS 524 – Advanced Macroeconomics: Domestic Policy Issues

Fall 2004  
Monday and Wednesday, 9:00-10:30  
Classroom: 010

Professor Ricardo Reis  
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OH: Monday, 10:45-12:00

### Course Description

An extension of 512c, the course covers specific topics such as economic growth, the roles of R&D, education, and institutions in long-run development, fiscal and monetary policy in the long run, unemployment, short-run fiscal and monetary policy, economic fluctuations, and the budget and state of the US economy. A central aim of the course is to show how modern theoretical and quantitative methods can be useful in analyzing important macroeconomic policy issues. Rather than provide a survey of the field of macroeconomics, this course focuses on a series of specific topics of current policy interest. Prerequisite: 512c.

### Course Requirements

The assessment in this class will consist of: one final exam, one mid-term 10-15 pages paper **due on the 20<sup>th</sup> of October**, one group class presentation and discussion in December, and class participation throughout the term. The weight of the different components will be:

**Final exam:** 50%

**Paper:** 25%

**Class presentation and participation:** 25%

### Course Outline and Readings

Background readings refer to the relevant sections from Abel and Bernanke, Macroeconomics, (AB) which I will assume that you know from WWS 512c.

Required readings are what I expect you to read. These include three books that you should consider buying:

- Charles Jones (2002) Introduction to Economic Growth, 2<sup>nd</sup> edition, W. H. Norton.
- William Easterly (2002) The Elusive Quest for Growth, MIT Press.
- Alberto Alesina, Nouriel Roubini and Gerald Cohen (1997) Political Cycles and the Macroeconomy, MIT Press.

The additional readings are for your reference and for the instances in which you wish to explore a topic further, but you are not required to read them.

Most of the readings are available electronically, mainly through JSTOR, and I have added links to the others.

#### **Week I - Long-run Growth and Productivity**

The ultimate sources of long-run growth; the relative roles of capital accumulation, human capital, and R&D; growth accounting; the success and failures of the theories when they were used for policy.

Background reading: AB, Ch. 6

Required readings:

- Jones, C. (2002) Introduction to Economic Growth, Chapters 1, 2, 3, 5, 9.
- Easterly, W. (2002) The Elusive Quest for Growth, Chapters 3, 4, 9.

Additional readings:

- Mankiw, N. G., D. Romer and D. Weil (1992) “A Contribution to the Empirics of Economic Growth,” *Quarterly Journal of Economics*, vol. 107, pp. 407-438. (JSTOR)
- Young, A. (1995) “The Tyranny of Numbers: Confronting the Statistical Realities of the East Asian Growth Experience,” *Quarterly Journal of Economics*, vol. 110, pp. 641-680. (JSTOR)
- Romer, P. (1994) “The Origins of Endogenous Growth,” *Journal of Economic Perspectives*, vol. 8, pp. 3-22 (JSTOR)

**Week II – Institutions and Growth**

The role of institutions in promoting growth; government and political systems; foreign aid; legal systems and the rule of law; colonialism.

Required readings:

- Jones, C. (2002) *Introduction to Economic Growth*, Chapter 7.
- Easterly, W. (2002) *The Elusive Quest for Growth*, Chapters 6, 7, 11, 12.

Additional readings:

- Sokoloff, K. and S. Engerman (2000) “Institutions, Factor Endowments, and Paths of Development in the New World,” *Journal of Economic Perspectives*, vol. 14, pp. 217-232. (JSTOR)
- Acemoglu, D., S. Johnson, and J. Robinson (2001) “The Colonial Origins of Comparative Development: An Empirical Investigation,” *American Economic Review*, vol. 91, pp. 1369-1401. (earlier version at <http://papers.nber.org/papers/w7771>)
- Acemoglu, D., S. Johnson, and J. Robinson (2002) “Reversal of Fortune: Geography and Institutions in the Making of the Modern World Income Distribution,” *Quarterly Journal of Economics*, vol. 118, pp. 1231-1294. (Catchword)
- La Porta, R., F. Lopez-de-Silanes, C. Pop-Eleches, and A. Shleifer (2004) “Judicial Checks and Balances,” *Journal of Political Economy*, vol. 112, pp. 445-470. (<http://www.journals.uchicago.edu/JPE/journal/contents/v112n2.html>)
- La Porta, R., F. Lopez-de-Silanes, A. Shleifer, and R. Vishny (1998) “Law and Finance,” *Journal of Political Economy*, vol. 106, pp. 1113-1155. (<http://www.journals.uchicago.edu/JPE/journal/contents/v106n6.html>)

**Week III – Consumption and Savings**

Models of intertemporal consumption choices: the permanent income hypothesis, precautionary savings, liquidity constraints, lack of self-control, and lack of attention. The US facts: the decline in aggregate savings, the net worth of US households, credit card borrowing.

Background reading: AB, Ch. 4

Required readings:

- Lecture notes to be distributed.
- Lusardi, A., J. Skinner and S. Venti (2001) “Saving Puzzles and Saving Policies in the United States,” *Oxford Review of Economic Policy*, vol. 17, pp. 95-115. You can skip section 2. (<http://oxrep.oupjournals.org/content/vol17/issue1/>)

Additional readings:

- Deaton, A. (1992) *Understanding Consumption*, Oxford University Press, Oxford.
- Lusardi, A. and M. Browning (1996) “Household Saving: Micro Theories and Micro Facts,” *Journal of Economic Literature*, vol. 34, pp. 1797-1855. Sections 3 and 4. (JSTOR)

- Symposium on consumption: Journal of Economic Perspectives, vol. 15, 2001  
     Browning, M. and T. Crossley “The Life-Cycle Model of Consumption and Saving.”  
     Carroll C. “A Theory of the Consumption Function, With and Without Liquidity  
     Constraints.”  
     Angeletos, G., D. Laibson, A. Repetto, J. Tobacman and S. Weinberg “The Hyperbolic  
     Consumption Model: Calibration, Simulation, and Empirical Evaluation.”

#### **Week IV – Business Cycles**

Features of business cycles; causes of fluctuations; technology and money; proclaiming the death of business cycles.

Background reading: AB, Chs. 8, 10, 11

#### Required readings:

- Watson, M. and J. Stock (1999) “Business Cycle Fluctuations in U.S. Macroeconomic Time Series,” Handbook of Macroeconomics, edited by J. Taylor and M. Woodford, North Holland, Vol. 1a, pp. 3-64. (<http://papers.nber.org/papers/w6528>)
- Mankiw, N. G. (1989) “Real Business Cycles: A New Keynesian Perspective,” Journal of Economic Perspectives, vol. 3, pp. 79-90. (JSTOR)
- Romer, D. (1993) “The New Keynesian Synthesis,” Journal of Economic Perspectives, vol. 7, pp. 5-22. (JSTOR)
- Romer, C. (1999) “Changes in Business Cycles: Evidence and Explanations,” Journal of Economic Perspectives, vol. 13, pp. 23-44. (JSTOR)

#### Additional readings:

- Plosser, C. (1989) “Understanding Real Business Cycles,” Journal of Economic Perspectives, vol. 3, pp. 51-78. (JSTOR)
- Watson, M. and J. Stock (2003) “Has the Business Cycle Changed? Evidence and Explanations, FRB of Kansas City, Jackson Hole meeting. ([http://www.wws.princeton.edu/~mwatson/papers/jh\\_2.pdf](http://www.wws.princeton.edu/~mwatson/papers/jh_2.pdf))

#### **Week V – The Great Depression**

The facts on the Great Depression; why it happened; could it happen again?

#### Required readings:

- Romer, C. (1993) “The Nation in Depression,” Journal of Economic Perspectives, vol. 7, pp. 19-39. (JSTOR)
- Bernanke, B. (1995) “The Macroeconomics of the Great Depression: A Comparative Approach,” Journal of Money, Credit and Banking, vol. 27, pp. 1-28. (JSTOR)

#### Additional readings:

- Cole, H. and L. Ohanian (1999) “The Great Depression in the United States From A Neoclassical Perspective,” FRB Minneapolis Quarterly Review, vol. 23. (<http://minneapolisfed.org/research/qr/qr2311.html>)
- Eichengreen, B. (1992) Golden Fetters: The Gold Standard and the Great Depression, 1919-39, OUP, Oxford.

## **Week VI – Monetary Policy: Power and Limitations**

The effect of monetary policy on real activity; the Keynesian illusion; the problem of time-inconsistency; the 1970s inflation.

Background reading: AB, Ch. 12

Required readings:

- Walsh, C. (2003) *Monetary Theory and Policy*, 2<sup>nd</sup> edition, MIT Press, Cambridge, MA. Chapter 1.
- De Long, J. B. (1997) “America’s Only Peacetime Inflation: the 1970s,” in *Reducing Inflation: Motivation and Strategy*, edited by C. Romer and D. Romer, University of Chicago Press, Chicago.  
([http://www.j-bradford-delong.net/pdf\\_files/Peacetime\\_Inflation.pdf](http://www.j-bradford-delong.net/pdf_files/Peacetime_Inflation.pdf))

Additional readings:

- Barro, R. and D. Gordon (1983) “A Positive Theory of Monetary Policy in a Natural Rate Model,” *Journal of Political Economy*, vol. 91, pp. 589-610.
- Romer, C. and D. Romer (2002) “The Evolution of Economic Understanding and Postwar Stabilization Policy,” in *Rethinking Stabilization Policy*, FRB Kansas City, Jackson Hole.  
([http://emlab.berkeley.edu/users/cromer/fed\\_kc.pdf](http://emlab.berkeley.edu/users/cromer/fed_kc.pdf))

## **Week VII – Monetary Policy: Institutions**

The appointment of the head of the central bank; central bank independence; the Taylor rule; inflation targeting.

Background reading: AB, Ch. 14

Required readings:

- Alesina, A. and L. Summers (1993) “Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence,” *Journal of Money, Credit and Banking*. (JSTOR)
- Taylor, J. (1999) “A Historical Analysis of Monetary Policy Rules,” in *Monetary Policy Rules*, edited by J. Taylor, University of Chicago Press, Chicago.  
(<http://www.stanford.edu/~johntayl/Papers/w6768.pdf>)
- Bernanke, B. and F. Mishkin, “Inflation Targeting: A New Framework for Monetary Policy?” *Journal of Economic Perspectives*, vol. 11, pp. 97-116. (JSTOR)

Additional readings:

- Rogoff, K. (1985) “The Optimal Degree of Commitment to an Intermediate Monetary Target,” *Quarterly Journal of Economics*, vol. 100, pp. 1169-1189. (JSTOR)
- Svensson, L. (2003) “What Is Wrong with Taylor Rules? Using Judgment in Monetary Policy through Targeting Rules,” *Journal of Economic Literature*, vol. 41, pp. 426-477.  
(<http://www.princeton.edu/~svensson/papers/JEL.pdf>)
- Mankiw, N. G. (2003) *Macroeconomics*, 5<sup>th</sup> edition, Worth Publishers, NY. Chapter 14.

## **Week VIII – Optimal Taxation and Fiscal Policy**

Tax smoothing; financing wars; should capital be taxed?

Required readings:

- Barro, R. (1979) “On the Determination of the Public Debt,” *Journal of Political Economy*, vol. 87, pp. 940-971. (JSTOR)
- Lecture notes on capital taxation

Additional readings:

- Atkeson, A., V. Chari, P. Kehoe (1999) "Taxing Capital Income: A Bad Idea," FRB Minneapolis Quarterly Review, vol. 23. The technical details are above what is expected of you in this course. (<http://minneapolisfed.org/research/qr/qr2331.html>)
- Summers, L. (1981) "Capital Taxation and Accumulation in a Life Cycle Growth Model," American Economic Review, vol. 71, pp. 533-544.

**Week IX – Fiscal Policy: Deficits and Interest Rates**

The effects of fiscal expansions; budget deficits, debt, interest rates, and investment.

Background reading: AB, Ch. 15

Required readings:

- Ball, L. and N. G. Mankiw (1995) "What Do Budget Deficits Do?" in Budget Deficits and Debt: Issues and Options, FRB Kansas City, Jackson Hole. (<http://www.kc.frb.org/PUBLICAT/SYMPOS/1995/pdf/s95manki.pdf>)
- Engen, E. and G. Hubbard (2004) "Federal Government Debt and Interest Rates," in NBER Macroeconomics Annual 2004, edited by M. Gertler and K. Rogoff, MIT Press. See also the discussion by Matthew Shapiro and Jonathan Parker. (in the course website)

Additional readings:

- Barro, R. (1989) "The Ricardian Approach to Budget Deficits," Journal of Economic Perspectives, vol. 3, pp. 37-54. (JSTOR)
- Bernheim, B. D. (1989) "A Neoclassical Perspective on Budget Deficits," Journal of Economic Perspectives, vol. 3, pp. 55-72. (JSTOR)
- Barro, R. (1989) "The Neoclassical Approach to Fiscal Policy," in R. Barro, ed., Modern Business Cycle Theory, Harvard University Press, Cambridge.

**Week X – Politics, Business Cycles, and Deficits**

Politics as the source of business cycles; deficits over the political cycle; strategic games between parties that alternate in power; why is debt so high in some countries?

Required readings:

- Alesina, Roubini and Cohen (1997) Political Cycles and the Macroeconomy, Chapters 2, 3, 4, 9.
- Alesina, A. and R. Perotti (1995) The Political Economy of Budget Deficits, IMF Staff Papers, vol. 42, pp. 1-31.

Additional readings:

- Alesina, A. (1987) "Macroeconomic Policy in A Two-party System as a Repeated Game," Quarterly Journal of Economics, vol. 102, pp. 651-678. (JSTOR)
- Persson, T. and L. Svensson (1989) "Why a Stubborn Conservative Would Run a Deficit: Policy with Time-Inconsistent Preferences," Quarterly Journal of Economics, vol. 104, pp. 325-345. (JSTOR)

**Week XI – American Economic Policy in the 1990s and the 2000s**

Student presentations.

Suggested background reading:

- J. Frankel and P. Orszag, editors, (2002) "American Economic Policy in the 1990s," MIT Press, Cambridge MA. See especially section I on macro policy.

## **Week XII – Unemployment**

The fall of unemployment in the US in the 1990s. The US vs. Europe: facts and explanations.

### Required readings:

- Katz, L. and A. Krueger (1999) “The High-Pressure U.S. Labor Market of the 1990s,” Brookings Papers on Economic Activity, pp. 1-65. (JSTOR)
- Nickell, S. (1997) “Unemployment and Labor Market Rigidities: Europe versus North America,” Journal of Economic Perspectives, vol. 11, pp. 55-74. (JSTOR)

### Additional readings:

- Blanchard, O. and J. Wolfers (2000) “The Role of Shocks and Institutions in the Rise of European Unemployment: The Aggregate Evidence,” Economic Journal, vol. 110, pp. 1-33. ([http://faculty-gsb.stanford.edu/wolfers/personal\\_page/research.html](http://faculty-gsb.stanford.edu/wolfers/personal_page/research.html))
- Blanchard, O. (2000) The Economics of Unemployment: Shocks, Institutions, and Interactions, Lionel Robbins Lectures. ([http://econ-www.mit.edu/faculty/index.htm?prof\\_id=blanchar&type=paper](http://econ-www.mit.edu/faculty/index.htm?prof_id=blanchar&type=paper))
- Prescott, E. (2004) “Why Do Americans Work So Much More Than Europeans?” FRB Minneapolis Quarterly Review, vol. 28. (<http://minneapolisfed.org/research/qr/qr2811.html>)