

George Mason University
Department of Economics
Economics 715: Macroeconomic Theory I
Fall 2001

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Mondays, 1920-2200
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One purpose of this course is to provide a beginning graduate-level introduction to contemporary macroeconomic theory. But this is not my only purpose. Most students who come to George Mason do so not because they have strong interests in macroeconomics. They come here mostly because of their interests in such things as public choice, public finance, law and economics, constitutional economics, new institutional economics, and Austrian economics. To be sure, there are numerous points of tangency between macroeconomics and these other areas. My second purpose in this course is to highlight those tangencies between macroeconomics and those fields that are of particular interest to Mason students.

Macroeconomic discourse is much more characterized by competing and contrasting schools of thought than is microeconomic discourse. Unlike microeconomic theory, there is nothing approaching consensus about the organization and presentation of the subject matter. Rather, you can find numerous antinomies, with different organizational schemes often following from the selection of one side of an antinomy over another.

For instance, some macro theorizing presumes that markets work well to coordinate economic activities. Other theorists presume that markets are characterized by widespread market failure. Some macro theorists treat money as being vital to the economic process, while others treat it as being trivial. Some macro theorists think that Walrasian-type general-equilibrium modeling should provide the framework for economic modeling, while others deny the veracity of such a framework. Some macro theorists think that the economic lynchpin resides in labor markets and wage and price rigidities, while other macro theorists think on the contrary that the lynchpin resides in enterprise planning and achieving coordination among the plans of savers and investors through capital markets. I could easily continue in this vein, but won't.

Moreover, the conventional nomenclature that describes schools of thought is often not very helpful in contributing to clarity of thought. Such names as classicals and New Classicals, Keynesians, New Keynesians, monetarists, and the like, often serve more to obscure thought than to clarify it. For instance, the differences between *Classical* and New Classical economists are more striking than the similarities. It is equally perplexing to find that New Keynesians are closer to monetarists than to traditional Keynesianism. I could easily elaborate, but won't.

There is no obviously best way of trying to provide an introductory mental map of the universe of macro discourse in one semester. A presentation in terms of schools of

thought would involve much duplication and would take too long. A presentation in terms of topics would failure to provide a good sense of the internal coherence of the various schools of thought and of the critical points on which the various schools diverge.

I will attempt to blend these two approaches in this course. My focus will be on contemporary theorizing and not the history of thought. Yet the course will to a large extent follow a kind of “schools of thought” form of organization. In doing this, I hope to convey both a sense of the internal coherence of different approaches to macro theory and an awareness of the central points where these approaches diverge.

Macroeconomics deals with the performance properties of an economic system as a whole. Its two main questions that can be discerned pretty directly from any examination of economic time series: long-term progress and short-term variability. Growth, negative as well as positive, and cycles are the two primary phenomena that macroeconomics studies.

In his *Lectures on Jurisprudence*, Adam Smith claimed that

Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things.

Smith’s three conditions for progress seem simple and straightforward. Not only is opulence easy to achieve, it is universally desired. Yet progress has not been easy and general throughout the world. How to give an economically interesting account of a failure to achieve something that is apparently easy (“natural”) and universally desired is the distant target at which this course aims.

Course Texts and Other Readings

Three texts have been ordered for the course, and these will comprise about half the reading for the semester. These are (1) *Advanced Macroeconomics*, 2nd ed, by David Romer; (2) *Structural Slumps*, by Edmund Phelps, and *Micromotives and Macrobehavior*, by Thomas Schelling.

None of these texts presents the course material in the way I will present it. I do not know of any text that does this. Each text, however, has features that collectively address most of the issues and topics I wish to address. Other readings will cover the rest. Some of these are cited in the course outline, and others of these will be cited throughout the semester.

Advanced Macroeconomics is a solid account of contemporary macroeconomics, and is written by a significant contributor to modern macroeconomics. It gives good insight into both the kinds of topics that most macroeconomists deal with and the methods by which they approach those topics. This book will also be used during the second semester, where Professor Ramirez will examine certain macro topics, including

growth and financial markets in particular, in greater and more formal detail than will be the case this semester.

Structural Slumps is more a treatise than a text. Phelps presents an alternative explanation for variations in unemployment over time, and seeks to do so in terms of real and not monetary disturbances. While I am skeptical of this effort, I think there is great value in thinking of an economy as possessing a complex structure, as against being treated as homogeneous and capable of ready summarization by a few aggregate variables.

Micromotives and Macrobehavior is the only one of the three textual items with which I find myself predominately in agreement. The main theme of this book is that macro outcomes are not direct objects of choice, but rather are simply emergent outcomes or unintended consequences that arise through human interaction. Schelling does not address topics that are traditionally treated in macroeconomics, but I think there is much of value in the relationship between micro and macro phenomena that he presents there.

Your Work and My Appraisal of It (Grading)

My appraisal of your performance will be based on four things. Two of these will be examinations: a midterm and a final. Each will count for 30 percent of your course grade, and each will be two hours long. The midterm will be given in mid- to late-October. The final will be given at the scheduled time, 1630 on 17 December.

I prefer not to ask first semester students to write research essays, and yet I believe there is much value to be gained in writing longer, thematic essays. Hence, you will be asked to write a review essay on a significant book of macroeconomic relevance. These essays should be modeled after the review essays (as distinct from the book reviews) that are published in such journals as the *Journal of Economic Literature*. This essay should run generally between 15 and 20 pages, and is due the end of class on 3 December. No book can be reviewed by more than three students, and books to be reviewed must receive my approval. Requests and approvals will be by email only.

The remaining 10 percent of your course grade will be based on my judgment of the quality of your classroom performance.

Course Outline and Readings

1. The Keynesian Challenge to Classical Macroeconomics

Romer, pp. 217-60

Phelps, pp. 351-58

R. Clower, "Keynes and the Classics: A Dynamical Perspective," *Quart. Jour. Econ.* 74 (1960): 318-23.

- G. S. Becker and W. J. Baumol, "Classical Monetary Theory: Outcome of the Discussion." *Economica* 19 (1952): 355-76.
- L. B. Yeager, "A Cash-Balance Interpretation of Depression," *So. Econ. Jour.* 22 (1956): 438-47.
- J. Tobin, "Price Flexibility and Output Stability: An Old Keynesian View," *Jour. Econ. Perspectives* 7(1993): 45-65.

2. New Classical Economics

Romer, pp. 168-212
Phelps, pp. 9-19

- R. J. Barro, "Are Government Bonds Net Wealth?" *Jour. Polit. Econ.* 82 (1974): 1095-1117.
- J. Long and C. Plosser, "Real Business Cycles," *Jour. Polit. Econ.* 91 (1983): 39-69.
- C. Plosser, "Understanding Real Business Cycles," *Jour. Econ. Perspectives* 3 (1989): 51-77.
- R. G. King, "Will the New Keynesian Macroeconomics Resurrect the IS-LM Model?" *Jour. Econ. Perspectives* 7 (1993): 67-82.
- V. V. Chary, "Robert Lucas: Architect of Modern Macroeconomics," *Jour. Econ. Perspectives* 12 (1998): 171-86.

3. New Keynesian Economics

Romer, pp. 265-405
Phelps, pp. 20-58

- N. G. Mankiw, "Real Business Cycles: A New Keynesian Perspective," *Jour. Econ. Perspectives* 3 (1989): 79-90.
- R. J. Gordon, "What is New Keynesian Economics?" *Jour. Econ. Lit.* 28 (1990): 1115-71.
- D. Romer, "The New Keynesian Synthesis," *J. Econ. Perspectives* 7 (1993): 5-22.
- B. Greenwald and J. Stiglitz, "New and Old Keynesianism," *J. Econ. Perspectives* 7 (1993): 23-44.
- S. Fisher, "Long Term Contracts, Rational Expectations, and the Optimal Money Supply Rule," *Jour. Polit. Econ.* 85 (1977): 191-205.

4. Monetarism

Romer, pp. 468-524

- M. Friedman, "A Theoretical Framework for Monetary Analysis," *Jour. Polit. Econ.* 78 (1970): 193-238.
- Brunner & Meltzer, Tobin, Davidson, Patinkin, Friedman: Symposium on "Milton Friedman's Theoretical Framework," *Jour. Polit. Econ.* 80 (1972): 837-950.
- A. Meltzer, "Monetary, Credit (and Other) Transmission Processes: A Monetarist Perspective," *Jour. Econ. Perspectives* 9 (1995): 49-72.
- L. B. Yeager, "The Significance of Monetary Disequilibrium," *Cato Jour.* 6 (1986): 369-95.

5. Swedes, Austrians, and Emergent vs. Choice-Theoretic Macro

Schelling, pp. 11-133

G. P. O'Driscoll, "Money: Menger's Evolutionary Theory," *History of Polit. Econ.* 18 (1986): 601-16.

R. W. Garrison, "Time and Money: the Universals of Macroeconomic Theorizing," *Jour. Macroeconomics* 6 (1984): 197-213.

R. Garrison and D. Bellante, "Phillips Curves and Hayekian Triangles: Two Perspectives on Monetary Dynamics," *History of Polit. Econ.* 20 (1988): 207-34.

Stiglitz, Schleifer/Summers, Garber, Schiller, White, & Flood/Hodrick: Symposium on "Bubbles," *Jour. Econ. Perspectives* 4 (1990): 13-101.

6. Pricing, Labor Markets, Investment-Saving Coordination, and Unemployment

Romer, pp. 410-61

Phelps, pp. 59-166, 245-308

J. Taylor, "Staggered Wage Setting in a Macro Model," *Am. Econ. Rev.*, Proceedings 69 (1979): 108-13.

L. Ball and S. C. Checchetti, "Imperfect Information and Staggered Price Setting," *Am. Econ. Rev.* 78 (1988): 999-1018.

J. Yellin, "Efficiency Wage Models of Unemployment," *Am. Econ. Rev.*, Proceedings 74 (1984): 200-05.

C. Shapiro and J. Stiglitz, "Equilibrium Unemployment as a Worker-Discipline Device," *Am. Econ. Rev.* 74 (1984): 433-44.

7. Politics, Institutions, and Macro Policy

Romer, pp. 468-582

Phelps, pp. 359-75

A. Alesina and R. Perotti, "Fiscal Discipline and the Budget Process," *Am. Econ. Rev.* Proceedings 86 (1996): 401-07.

R. Barro, "On the Determination of the Public Debt," *Jour. Polit. Econ.* 87 (1979): 940-71.

M. Toma, "Inflationary Bias of the Federal Reserve System," *Jour. Monetary Econ.* 10 (1982): 163-90.

T. Iversen, "The Political Economy of Inflation: Bargaining Structure or Central Bank Independence?" *Public Choice* 99 (1999): 237-58.

G. Selgin and L. White, "A Fiscal Theory of Government's Role in Money," *Econ. Inquiry* 37 (1999): 154-65.

M. Olson, "Big Bills Left on the Sidewalk: Why Some Nations are Rich and Others are Poor," *Jour. Econ. Perspectives* 10 (1996): 3-24.