

Economics 715
Macroeconomic Theory I
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Mondays, 1920-2200
Robinson Hall B203

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This course provides a beginning graduate-level introduction to contemporary macroeconomic theory. Macroeconomic discourse is more characterized by competing and contrasting schools of thought than is microeconomic discourse. There is no consensus about the organization and presentation of the subject matter. There are numerous antinomies throughout the literature, and different organizational schemes often follow from the selection of one side of an antinomy over another.

Some macro theorizing presumes that markets work well to coordinate economic activities, while other theorizing presumes that markets are characterized by widespread failure. Some macro theorists treat money as vital to the economic process, while others treat it as 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 linchpin resides in labor markets and wage and price rigidities, while other macro theorists think that the linchpin resides in enterprise planning and achieving coordination among the plans of savers and investors through capital markets.

Moreover, the conventional nomenclature that describes schools of thought is often more confounding than clarifying. 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 Keynesians. Moreover Post Keynesians have almost nothing in common with New Keynesians, other than sharing some long dead ancestor.

This course is organized into seven units, as described in the course outline. The first six of these units follows a “schools of thought” form of organization. The final unit explores what might be called an emergent orientation toward macro theorizing. During this course, 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 books have been ordered for the course, and these will comprise the major portion of the assigned reading for the semester. These are (1) *A Modern Guide to Macroeconomics*, by Brian Snowdon, Howard Vane, and Peter Wynarczyk; (2) *Micromotives and Macrobehavior*, by Thomas Schelling; and (3) *Turtles, Termites, and Traffic Jams*, by Mitchel Resnick.

A Modern Guide to Macroeconomics is subtitled "An Introduction to Competing Schools of Thought." This book provides the organizational framework for the first six of the course's seven units. The organizational framework for the final unit is provided by the other two books.

Micromotives and Macrobehavior does not address topics that are traditionally treated in macroeconomics. The central theme of this book is that there are all kinds of macro outcomes that are not direct objects of choice, but rather are simply emergent outcomes or unintended consequences that arise through human interaction. This theme has, I believe, much potential significance for macro theorizing.

Turtles, Termites, and Traffic Jams pursues these insights by illustrating how computational modeling might be used to develop bottom-up approaches to macro phenomena, in contrast to the conventional top-down approach to macro theorizing. How such insights might be used to illuminate macro phenomena remains a challenge for the future, as people are just now beginning to explore such matters.

I have also listed a few journal articles for each section. With few exceptions, these articles are available through JSTOR. These articles deal with some particular topics I will cover in class, but by no means do they constitute anything approaching a full bibliography. You need to read more widely in the literature, and to cultivate the practice of developing your own lists of references.

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, 1930 on 13 December. My judgment of the quality of your in-class performance during the semester will count for 10 percent of your course grade.

The remaining 30 percent will be based on a short (8-12 pages in standard manuscript style should be sufficient) essay on the generic topic: "Traditional Macro: An Emergent Reorientation." Your task is to take some topic from standard macro theorizing, and attempt to set forth how you might approach that topic from an emergent perspective, as this perspective is illustrated by Schelling and Resnick. This assignment seeks to accomplish two things: one is to get you to explore some standard macro topic more deeply; the other is to think about how you might bring an emergent orientation to bear on that topic. These papers will be due at the start of the last class period on 6 December.

The basic GMU grading scale for graduate courses has four grades (A, B, C, and F), though there are also some plusses and minuses to fill some of the interstices. For each of your writing efforts, whether it is an answer to an exam question or a paper, I put it into one of four categories (sometimes appending a plus or minus), according to how closely it evokes one of the following four reactions in me:

A: Crystal clear and expertly done. Everything essential is there; nothing important is left out. Nothing misleading or ambiguous is present. It exhibits some imagination and creativity, in that it surprised me pleasantly.

B: While the response is essentially correct, it falls short of an A grade response in either of two ways: (1) it is a bit on the ragged and disjointed side and (2) while the workmanship is good, it is predictable and not surprising in any way. Moreover, while there might be some minor errors of omission, there should not be any errors of commission, for a response that fails to present a fully clear insight is better than one that presents some erroneous insight.

C: A reader comes away with a significant degree of confusion, with errors of commission being the most likely source of that confusion, though poorly implemented rhetorical skills can also create significant confusion. (In any case, it is the burden of the writer to make his meaning clear. It is not the duty of the reader to infer that meaning.)

F: The reader is sent positively in the wrong direction, and the writer would be well advised to do something else than study economics, unless this particular instance is an outlier that does not form part of a pattern.

The reference to surprise reminds me of George Shackle, who you will encounter later in this course, and who developed some interesting formulations around the notion of potential surprise. In *Uncertainty in Economics*, Shackle sketched what he thought it took to be a good economist. I assume that each of you aspires to be a good economist, so I thought I would pass along Shackle's considered opinion, as it might provide sustenance for your aspirations:

To be a complete economist, a man need only be a mathematician, a philosopher, a psychologist, an anthropologist, a historian, a geographer, and a student of politics; a master of prose exposition; and a man of the world with experience of practical business and finance, an understanding of the problems of administration, and a good knowledge of four or five languages. All this is, of course, in addition to familiarity with the economic literature itself.

As for the type of person best suited to the study of economics, Shackle later suggests it is

. . . the outstanding intellectual all-rounder with some leaning towards the arts rather than the natural science side. The person who finds mathematics fascinating without, perhaps, marching through the school course with that instinctive and professional certainty that would mark him as an out-and-out mathematician; who betrays a connoisseurship of words and a delight in language, a gift for expression in English and a sufficient pleasure in the classical languages to awaken thoughts of scholarships, without really promising to become a Porson's prizeman; who can find in every chapter of the history book the universal and eternal problems of man's dependence on his fellow-men side by side with his rivalry and conflict with them, and can see with the historian's eye the age-long empirical struggle to reconcile self-interest and enlightened compassion; who delights in maps and finds them, perhaps, more interesting than test tubes—this is the potential real economist.

Course Outline and Readings

1. Classical Macroeconomics

Snowdon, Vane, and Wynarczyk, Chs. 1, 2 (pp. 42-60).

G. S. Becker and W. J. Baumol, "Classical Monetary Theory: Outcome of the Discussion." *Economica* 19 (1952): 355-76.

2. The Keynesian Challenge to Classical Macroeconomics

Snowdon, Vane, and Wynarczyk, Chs. 2 (pp. 60-end), 3.

- J. Tobin, "Price Flexibility and Output Stability: An Old Keynesian View," *Jour. Econ. Perspectives* 7(1993): 45-65.
- D. Collander, "The Stories We Tell: A Reconsideration of AS/AD Analysis," *Jour. Econ. Perspectives* 9 (1995): 169-88.
- R. Marchionatti, "On Keynes' Animal Spirits," *Kyklos* 52 (1999): 415-39.
- G. Lowenstein, "Because It is There: The Challenge of Mountaineering for Utility Theory," *Kyklos* 52 (1999): 315-44.

3. Monetarist Response to Keynesian Claims

Snowdon, Vane, and Wynarczyk, Ch. 4.

- M. Friedman, "A Theoretical Framework for Monetary Analysis," *Jour. Polit. Econ.* 78 (1970): 193-238.
- A. Meltzer, "Monetary, Credit (and Other) Transmission Processes: A Monetarist Perspective," *Jour. Econ. Perspectives* 9 (1995): 49-72.
- G. Anderson, W. F. Shughart, and R. D. Tollison, "A Public Choice Theory of the Great Contraction," *Public Choice* 59 (1988): 3-23.
- 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.

4. New Classicism

Snowdon, Vane, and Wynarczyk, Chs. 5-6.

- R. B. Lucas, "An Equilibrium Model of the Business Cycle," *Jour. Polit. Econ.* 83 (1975): 1113-44
- 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.
- R. Barro, "On the Determination of the Public Debt," *Jour. Polit. Econ.* 87 (1979): 940-71.
- P. Romer, "Increasing Returns and Long-Run Growth," *Jour. Polit. Econ.* 94 (1986): 1002-37.

5. New Keynesianism

Snowdon, Vane, and Wynarczyk, Ch. 7.

- 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.
- G. A. Akerlof, "Behavioral Macroeconomics and Macroeconomic Behavior," *Am. Econ. Rev.* 92 (2002): 411-33.
- L. Ball and S. C. Cecchetti, "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.

6. Austro-Swedish Macro (and Post Keynesianism also)

Snowdon, Vane, and Wynarczyk, Ch. 8

- S. Horwitz. "The Costs of Inflation Revisited." *Review of Austrian Economics* 16 (2003): 77-95.
- 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.
- D. Bellante, "Sticky Wages, Efficiency Wages, and Market Process," *Review of Austrian Economics* 8 (1994): 21-33.

7. Emergence and Macro Theorizing: New Austrianism?

Schelling, Chs. 1-3 especially, but Chs. 4-7 also highly recommended.
Resnick, Chs. 1-5.

- P. Howitt and R. Clower, "The Emergence of Economic Organization," *Journal of Economic Behavior and Organization* 41 (January 2000): 55-84.
- A. Leijonhufvud, "Three Items for the Macroeconomic Agenda," *Kyklos* 51 (1998): 197-218.
- R. Wagner, "Austrian Cycle Theory: Saving the Wheat while Discarding the Chaff," *Review of Austrian Economics* 12 (1999): 65-80.
- R. Oprea and R. Wagner, "Institutions, Emergence, and Macro Theorizing," *Review of Austrian Economics* 16 (2003): 97-109.