

## MACROECONOMICS II (Advanced Macroeconomics)

Semester: spring 2003

Faculty: Ashima Goyal

TA: Ishita Chatterjee, Ext:276(R), 585(O)

Office Hours: Monday and Wednesday 3.30 - 5pm.

Office: RB II-202, Tel. Ext.524

The course will selectively cover recent developments in macroeconomics of fluctuations, open economy, policy, microfoundations and growth. The focus will be on substantive issues, and applications of basic principles. The workhorses of macroeconomics will be developed and applied to analyse economy-wide topics of current interest. Familiarity with the material covered in undergraduate texts such as Dornbush and Fischer (1998) or Mankiw (2000) is assumed. The basic text is Romer (1996). Starred readings are compulsory. Other reference books are given at the end.

Grading will be through a mid-term, a final exam and class assignments. The weights assigned to the different requirements are:

Mid-term Exam (2 hours):	40 per cent
Final Exam (2 hours):	40 per cent
Class assignments:	20 per cent

### 1. The Short and Medium-Run

1.1 *History and Methodology. Fluctuations of macroeconomic variables, the stylised facts.*

R4.1, BF1, AM 1.2, AG 1.3, 1.4, 4.2, M 19.

\*AEA symposium, 1997, "Is there a core of usable macroeconomics?" *AEA Papers and Proceedings*, 87(2), 244-246.

Agenor, P-R. McDermott, J.C. and E.S. Prasad, 2000, "Macroeconomic Fluctuations in Developing Countries: Some Stylised Facts", *The World Bank Economic Review*, 2,14, 251-286.

1.2 *Wage-price rigidities and Keynesian cycles. The inflation unemployment trade-off.*

\*R5.4, 5.5

\*Romer, D., 2000, "Keynesian macroeconomics without the LM curve", *Journal of Economic Perspectives*, 14(2), 149-169.

Blanchard, O. J. and D.Quah 'The Dynamic Effects of Aggregate Demand and Supply Disturbances', *The American Economic Review*, Vol. 79, pp.655-673, 1989.

### 1.3 Open Economy IS-LM-MP. The Mundell-Fleming Model

\*R 5.3, BF 10.4, AG 4.3-4.5, Dornbusch and Fisher 12.5.

\*Romer, D., 1999, "Short-run fluctuations", August,  
<http://elsa.berkeley.edu/~dromer/index.html>.

## 2. Macro Policy

2.1 Co-ordination of Fiscal and Monetary Policy. Rules versus discretion. Credibility. Commitment devices.

\*R 9.4, 9.5, 9.6, LS 17, BF 11.4, TW 22, GC 15, GC \*Introduction and Introduction to Part V.

\*Goyal, A., 2002, 'Coordinating Monetary and Fiscal Policies: a role for rules?', chapter 11 in the India Development Report, Kirit S. Parikh and R. Radhakrishna (ed.), IGIDR and Oxford University Press.

\*Goyal, A., 'Governing a Democracy: Constrained Discretion for Development,' available at <http://www.gdnet.org>.

Clarida, R., Gali, J., and Gertler, M. (1999), "The science of monetary policy: A New Keynesian perspective", *Journal of Economic Literature*, 37 (4), 1661-707.

Kydland F.E. and E.C. Prescott (1977), "Rules Rather than Discretion": The Inconsistency of Optimal Plans", *Journal of Political Economy* 85, 3 (June), 473-492.

TW22: "Political Economics and Macro Economic Policy", T.Persson and G.Tabellini, (Vol-1C, p1397-1482)

### 2.2 Monetary transmission mechanism and targeting

\*R 9.6, BF 11.2, TW 23, AM 7.2

Allsop, C. and D.Vines, (2000), "The assessment: Macroeconomic policy", *Oxford Review of Economic Policy*, 16 (4), 1-32.

Bernanke, B.S. and F. Mishkin, 1997, "Inflation targeting: A new framework for monetary policy?" *Journal of Economic Perspectives*.

Mishkin, F.S., 1995, "Symposium on the monetary transmission mechanism", *Journal of Economic Perspectives*, 9 (4), 3-10.

Svensson, L.E.O, 2000, "Open-economy inflation targeting", *Journal of International Economics*, 50, 155-183.

TW23: "Issues in the Design of Monetary Policy Rules", Bennett T. McCallum, (Vol-1C, p1483-1503)

### **3. Open economy issues**

*3.1 . Stabilisation, macro policy and exchange rate regimes. Asset price volatility, interest and exchange rates, crises models and strategic interaction.*

\*R 9.2, AM 10.

\*Goyal, A., (Section 1B and 1E) 'Reform Proposals from Developing Asia: Finding a Win-win Strategy', in *Debating the Global Financial Architecture*, Edited by Leslie Elliott Armijo, forthcoming in SUNY Press Global Politics series, under the general editorship of James Rosenau, SUNY Press, New York. IGIDR Preprint no. 463-2000.

Dornbusch, R., 'Expectations and Exchange Rate Dynamics', *Journal of Political Economy*, Vol.84, pp.1161-76, 1976.

\*Obstfeld, Maurice, 1996, "Models of Currency Crises with Self-fulfilling Features", *European Economic Review*, 40, 1037-1047, section 1 and 2.

\*Obstfeld, Maurice and Kenneth Rogoff, 1996, *Foundations of International Macroeconomics*, Cambridge, Massachusetts: MIT Press, section 8.4.2.

Corbo, V. and S. Fischer, 1995, "Structural Adjustment, Stabilisation and Policy Reform: Domestic and International Finance," ch.44 in *Handbook of Development Economics*, Vol. III, (eds.) J. Behreman and T.N. Srinivasan.

TW 24: Calvo G.A. and C. A. Vegh, 1999, "Inflation Stabilisation and BOP Crises in Developing Countries".

Yoshitomi, M. and Shirai, S., 2000, "Policy recommendations for preventing another capital account crisis", ADBI and Asian Policy Forum.

#### **4. Microfoundations of real and nominal rigidities**

##### *4.1 Imperfect information*

\*R 6 Part A

*4.2 Imperfect competition and asymmetric information. Solving for the rational expectations equilibrium.*

\*R 6.5-6.8, 6.10-6.13, \*BF 9.5, TW 15, 16, MR8, 15, 26, 33.

Stiglitz, J.E., 2000, "The contribution of the economics of information to 20th century economics," *The Quarterly Journal of Economics*, November.

MR8 : "Staggered Wage Setting in a Macro Model", J.Taylor,(Vol-I, p233-241)

MR15: "Market Structure and Macro Economic Fluctuations", R.E.Hall, (Vol-I, p387-424)

MR33: "A Super-Game Theoretic Model of Price Wars During Booms", J.J. Rotemberg and G. Saloner, (VOL-II, p387-415)

TW15: "Staggered Price and Wage Setting in Macro Economics", J.B.Taylor, (Vol-1B, p1009-1049)

TW16: "The Cyclical behaviour of Prices and Wages", J.J. Rotemberg and M.Woodford, (Vol-1B, p1051-1136)

##### *4.3 Coordination failures*

\*R 6.14, TW 6, BF 9.5, AG 2.3, 3.6

Cooper, R. and A. John, "Coordinating Coordination Failures in Keynesian Models", *The Quarterly Journal of Economics*, Vol. CIII, No.3, August 1988, available in MR16

Diamond, P., 'Aggregate Demand Management in Search Equilibrium', *Journal of Political Economy*, Vol. 90, No. 5, pp.881-894, 1982, available in MR18

TW6: “*Indeterminacy and Sun spots in Macro Economics*”, J.Benhabib and R.E.A.Farmer, (Vol-1A, p387-448).

*4.4 Contracts in labour markets, Efficiency wages, Insider-outsider and hysteresis*

\*R 10.2, 10.5, 10.6, 10.7, BF 9.4, MR 22

MR22: “*Equilibrium Unemployment as a Worker-Discipline Device*”, C.Shapiro and J.E.Stiglitz, (Vol-II, p123-142)

MR26: “*Hysteresis in Unemployment*”, O.J.Blanchard and L.H.Summers, (Vol-II, p235-243)

## **5. The long- and medium-run**

*5.1 Growth, the stylised facts. The Solow growth model and its application to convergence of country growth rates.*

\*R1, TW9

Easterly, W. and L. Levine, 2001, "It's not factor accumulation: Stylized facts and growth models", *World Bank Economic Review*, 177-220, 15 (2).

TW9: “*Neo Classical Growth Theory*”, R.M.Solow, (Vol-1A, p637-668)

*5.2 The microfoundations of growth.*

5.2.1 Ramsey model with infinitely lived agents. Application to household behaviour and interaction with the Government. Ricardian equivalence. The open economy. Consumption smoothing and foreign capital. The firm. Tobin’s q theory of investment.

\*R2 Part A, BF 2, \*2.4, \*R 8.2, \*BF 2.4, \*R 8.7, TW12, \*AKD 9, 11.

TW12: “*Aggregate Investment*”, R.J.Caballero, (Vol-1A, p813-862).

Krugman, P.R., 1998, “It’s Baaack: Japan’s slump and the return of the liquidity trap”, *Brookings Papers on Economic Activity*, 2.

*5.2.2 Endogenous growth theories. Research and development, human capital and externalities. Empirical issues.*

\*R3, TW4, 10

Romer, P.M., 1989, "Capital Accumulation in the Theory of Long-Run Growth," Barro R. J. (ed.) *Modern Business Cycle Theory*, Oxford: Basil Blackwell.

Temple, Jonathan, 1999, The New Growth Evidence, *Journal of Economic Literature*, 37, March, pp. 112-156.

TW4: "*The Empirics of Economic Growth*" S.N.Durlauf and D.T.Quah, (Vol-1A, p235-308)

TW10: "*Explaining Cross Country Income Differences*", Ellen R. McGrattan and James A. Schmitz, Jr, (Vol-1A, p669-737)

### **Text-Book**

Romer D., 1996, *Advanced Macroeconomics*, McGraw-Hill International. (R)

### **Other Reference Books**

Agenor P.R. and P.J. Monteil, (1996), *Development Macroeconomics*, New Jersey: Princeton University Press.(AM)

Barro R. J. ed. (1989), *Modern Business Cycle Theory*, Basil Blackwell, Oxford. (RB)

Blanchard O. J. and Fischer S. (1989), *Macroeconomics*, MIT Press, Mass. (BF)

Calvo, G., (1996), *Money, Exchange Rates and Output*, MIT Press: Cambridge, Mass.(GC)

Dixit, A.K., 1978, *Optimisation over in Economic Theory*, OUP. (AKD)

Goyal, A., (1999), *Developing Economy Macroeconomics: Fresh Perspectives*, New Delhi: Allied Publishers. (AG)

Ljungqvist, L. and T.L. Sargent, 2000, *Recursive Macroeconomic Theory*, Massachusetts: MIT Press. (LS)

Mankiw, N.G., 2000, *Macroeconomics*, Fourth Edition, New York: Worth Publishers. (M)

Mankiw, N.G. and Romer D. (ed.) (1991), *New Keynesian Economics*, MIT Press, Mass. (MR)

Obstfeld, Maurice and Kenneth Rogoff, 1996, *Foundations of International Macroeconomics*, Cambridge, Massachusetts: MIT Press. (OR)

Taylor, John B. and Michael Woodford (Editors), 1999, *Handbook of Macroeconomics*, Vol.1A, B and C, Elsevier: North Holland. (TW)