

First semester 2000  
Engineering 235  
Wednesday 10-12 a.m.

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## **ECN 355 Macroeconomic Policy**

### **Course web page**

<http://www.qmw.ac.uk/~ugte176/macropol.htm>

### **Office hours**

Room W302, Wednesdays 12-1, Thursdays 3-4

### **Course structure**

The course is articulated in eleven two-hour lectures and ten one-hour classes. Every week you will be assigned a problem set that you are expected to tackle at home before the class in which it is discussed.

### **Assessment**

The total mark for the course will be made up of two components. The coursework component consists of the three problem sets that you are supposed to hand in in weeks 5, 9 and in the first week of the second semester. Each of them counts for 10% of the final mark. The remaining 70% is determined by your mark in the two-hour, end-of-year exam.

### **Content**

Revision of aggregate demand and supply.

Fiscal policy issues: how to measure the stance of fiscal policy, intertemporal choices and effect of temporary vs. permanent tax changes, tax smoothing, fiscal policy sustainability.

The relationship between fiscal policy and money creation: seignorage, the end of hyperinflations.

Monetary policy issues: the positive theory of inflation, the rationale for and choice of rules in the conduct of monetary policy, the UK monetary arrangements, liquidity traps.

### **Aims**

The course presents the theoretical underpinnings of modern macroeconomic policy. It aims at providing a critical understanding of the policy debate and a working knowledge of the tools of the trade.

### **Learning outcomes**

On successful completion of the course you should:

1. be familiar with the concept of dynamic fiscal policy and its positive and normative implications;
2. understand the public sector intertemporal budget constraint and the link between deficits and money creation;
3. be able to work out the sustainability of alternative fiscal/financial plans;
4. understand the determinants of inflation and the relative desirability of alternative monetary arrangements.

### **Texts**

There does not exist a textbook pitched at the right level for this course. Mankiw, N. G, *Macroeconomics*, 4<sup>th</sup> edition, Worth Publishers covers most of the topics but at a lower level. It provides essential introductory reading and I strongly recommend you buy it (worthy

alternatives are Abel A., B. Bernanke and R. McNabb, *Macroeconomics*, Addison-Wesley, and Barro R. J. and Grilli V., *European Macroeconomics*, MacMillan). The main reference, though, will be my typeset lecture notes (denoted LN in what follows) and various articles. If you have difficulties finding a book at the local bookshop you can get it rather quickly over the Internet.

## **SYLLABUS:**

### **REVISION**

#### **1. Revision of IS-LM and aggregate demand and supply. The Classical dichotomy.**

\*LN, chapter 1

\*Mankiw, chapters 9-10

#### **2. The short run aggregate supply.**

\*LN, chapter 1.

\*Mankiw ch. 13.1 p. 358-360

Friedman, M. (1968), "The role of monetary policy," *American Economic Review*, 1-17.

### **FISCAL POLICY ISSUES**

#### **3. The budget deficit and the stance of fiscal policy. Automatic stabilization.**

\*LN, chapter 2.

\*Blinder, A. S. and R. M. Solow (1974), "Analytic foundations of fiscal policy," in A. S. Blinder et al. eds., *The economics of public finance*, The Brookings Institution, 1973.

#### **4. Consumption smoothing and the effect of temporary and permanent tax changes.**

\*LN, chapter 3.

\*Mankiw chapter 16.2 p. 439-450 and 16.4 p. 457-458

#### **5. The public sector budget constraint and the sustainability of fiscal policy. Ricardian equivalence.**

\*LN. chapter 4 and 5.

\*Buiter, W. H. (1989), "Some thoughts on the role of fiscal policy in stabilization and structural adjustment in development countries," in W. H. Buiter ed. *Principles of budgetary and financial policy*, MIT Press, p. 430-435 and 440-442.

\*Mankiw chapter 15.4 p. 419-425

#### **6. Why running deficits? Consumption and tax smoothing.**

\*LN, chapter 4 and 5

\*Lucas, R. E. Jr. (1986), "Principles of Fiscal and Monetary Policy", *Journal of Monetary Economics* 17, 117-134.

\*Mankiw, chapter 14.2, p. 400

## BUDGET DEFICITS AND MONEY CREATION

### 7. Why is the long run rate of inflation positive (I): seignorage as a source of public sector revenue.

\*LN, chapter 6

\*Buiter, W. H. (1989), "Some thoughts on the role of fiscal policy in stabilization and structural adjustment in development countries," in W. H. Buiter ed. *Principles of budgetary and financial policy*, MIT Press, p. 435-440.

### 8. The end of hyperinflations.

\*LN, chapter 7

\*Mankiw ch.7.7 p. 180-186 and appendix p. 190-192

\*Sargent, T. (1982), "The end of four big inflations," in T. Sargent, *Rational Expectations and Inflation*, Harper and Row.

## MONETARY POLICY

### 9. Why is the long run rate of inflation positive (II): time-inconsistency.

\*LN, chapter 8

\*Mankiw appendix to chapter 14 p. 404-406

Barro, R. and D. Gordon (1983), "Rules, discretion and reputation in a model of monetary policy," *Journal of Monetary Economics*, 101-121.

### 10. When monetary policy is ineffective. Japan's liquidity trap.

\*LN, chapter 10

\*<http://web.mit.edu/krugman/www/japtrap2.html>

### 11. Targets and rules in the conduct of monetary policy. The UK monetary arrangement and inflation forecast targeting.

\*LN, chapter 9

\*<http://www.bankofengland.co.uk/speeches/speech09.pdf>

## Core skills

Knowledge and understanding, analysis, problem solving.

## Assessment criteria

Exam and coursework: sound understanding of the economic issues discussed during the course, ability to argue rigorously using graphical and formal analysis, ability to manipulate the models introduced in the lectures.