Macroeconomics–1

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Course description

Macroeconomics for the second-year students is a one-semester course, which is taught in English. The course examines main principles of real income determination, basic concepts of general equilibrium in the economy with goods and financial assets markets, as well as means and ends of monetary, fiscal and redistribution policies. It deals with the stabilisation policy problems in a simple IS-LM-AS framework leaving microeconomic foundations of consumption, investment, money demand etc. functions as well as long-run issues for the third-year course. It also assesses the effectiveness of stabilization and re-distribution policies in the open economy setup by utilising the IS-LM-BP model with full and no capital mobility and different exchange rate regimes.

Prerequisites

For studying the course the knowledge of APT level of Economics and Mathematics for Economists is necessary. Since the course is taught in English and students also study for Russian degree in Economics, the knowledge of Russian terminology is necessary. In turn, the Introduction to Economics (Macroeconomics) is a pre-requisite for the third-year course on Macroeconomics as well as Monetary Economics, International Economics, Economics of Transition.

Teaching objectives

The purpose of the course is to develop the economic way of thinking and make students ready to use logic and methods of economic analysis in their further studies. Specifically the course aims at:

- giving students a solid grasp of macroeconomic analysis at the intermediate level using both graphical and algebraic techniques;
- ensuring students can apply macroeconomic analysis to the study of contemporary and historical economic problems;
- broadening the students' knowledge in the field of macroeconomics,

Having completed this course the students are expected to

- understand the IS-LM-AS model in the closed economy with fixed and flexible prices and wages and be able to apply it when analysing the impact of monetary, fiscal and redistribution policies;

- understand the IS-LM-BP model with full and no capital mobility and be able to apply for the small open economy and two-country settings under different exchange rate regimes;

- understand the theoretical and practical limitations of macroeconomic policy in stabilising the economy, for instance the impact on the economy of public debt and deficits.

Teaching methods

The following methods and forms of study and control are used in the course:

Lectures. Attendance at lectures is optional, but it is strongly recommended. Lectures offer a verbal presentation of the material to be mastered. More importantly, they indicate the relative importance of sub-topics and offer approaches to understanding the material that a reading of the notes or textbook sometimes leaves obscure. Those who cannot attend a lecture should endeavour to discuss its content with a fellow student who did attend and to borrow and copy notes. Because of the size of the class, questions and discussion are not encouraged during lectures. If lecture material is unclear, it is best to consult the tutor, preferably during tutorials or the tutor's office hours.

Classes. Classes commence in the second week of the semester. Tutors provide an opportunity to discuss lecture material at the beginning or end of their tutorials. The course emphasis is on conducting economic analysis rather than simply establishing a set of facts to be memorised. With this aim, a set of exercises (problem sets) is distributed each week and discussed in tutorials. Students are strongly encouraged to carefully prepare written answers to home assignments in advance of attending tutorials.

Teachers' consultations. Unresolved questions on the lecture material can be addressed with tutors on appointment during their consultation times (office hours).

Self-study. Before consulting a tutor, however, students are expected to make a serious attempt to solve the problem. Since learning for understanding can only be done by the student lecturers and tutors can do no more than offer advice as to how to go about it. Without prior effort to master a topic on the part of the student, consultation is a wasteful repeat of the lecture experience.

Written home assignments (problem sets). A set of home assignments (problem sets) is distributed each week (10 in total). Students are strongly encouraged to have completed problem sets. Writing answers to questions before they are discussed in tutorials is the best way to master the course material.

Use of Internet resources. One can easily find plenty of useful materials in the Internet by simply typing "interactive macroeconomics" in the search browser. To avoid a waist of time students are recommended to begin with the most suitable links listed in the literature section.

Assessment

Intermediate control. Students are expected to have a Mock exam in the University of London (UL) examination format in the middle of semester. The Mock exam is set in April by local teachers, graded in accordance with UL examination rules.

Final control. Students have joint examination paper in micro- and macroeconomics in the University of London examination format following the semester.

The structure of the final examination is standard as little in the content of the course has been changing from year to year. Though some questions on earlier examination papers may not be an appropriate preparation for the next year final examination, past examinations will nonetheless appear in the library.

Grade determination

The UL exam gives 40% of ICEF grade and other 60% is provided by home assignments (problem sets) and Mock exam. The Mock exam counts for 40%, the rest 20% is equally distributed between 10 problem sets.

Main reading

1. Witztum A. (2005) Economics – An Analytical Introduction. Oxford University Press (W)

2. Blanchard O. (2000) Macroeconomics. 2nd edition, Prentice–Hall (B)

3. Begg, D., S. Fischer and R. Dornbusch (2005) Economics. Eighth edition, McGraw Hill (BFD).

4. Perlman M. (1996) Macroeconomics. Bath. M. Perlman Publishing. (P)

5. Blake D. (1993) A Short Course of Economics. McGraw Hill. (Blake)

6. Lipsey R.G., Chrystal K. (1995) An Introduction to Positive Economics. Oxford University Press. (LC)

It is worth mentioning here that UL lists the last four textbooks (Begg et.al, Perlman, Blake and Lipsey) as essential for the course "Introduction to economics" while Witztum's book as additional reading. Admitting the importance of studying macroeconomics from different perspectives provided by a number of various intermediate level textbooks, we recommend to shape your understanding of the subject, at first, on the basis of lecture notes which are significantly supported by the Witztum's Economics. You may benefit from the

usage of lecture notes (slides) when studying specific topics[1] which are unique to this course (comparing to standard Intermediate Macroeconomics courses taught outside ICEF and UL External Programme).

Most of data and case studies in Blanchard's Macroeconomics come from the US. However, students may find helpful the similarity of notations and exchange rate definition used in this book and employed in the ICEF course. Moreover, the Blanchard's book provides a good example of internationally recognised standard one-year Intermediate Macroeconomics course (for instance, this book has been serving as a main text for the HSE students of Economics Department).

Begg's book (particularly chapters 20–29, 32, 34) is really essential because it covers almost all the material studied in the course. Nevertheless it does not provide students with necessary analytical tools. It also oversimplifies some micro-foundations and behavioural functions that are ignored in our course because they are thoroughly explained in the third-year course taught at ICEF during Spring semester. Blake's textbook is good as a condensed summary but can not be used without other suggested readings.

Additional reading

1. Barro R., Grilli V. (1994) European Macroeconomics, Macmillan.

2. Burda M., Wyplosz C. (2001) Macroeconomics: A European Text, 3rd edition, Oxford University Press,

3. Dornbusch R. (1980) Open economy macroeconomics, New York: Basic Books (D).

4. Dornbush R., Fischer S., Startz R., Macroeconomics. 8th edition, McGraw-Hill, 2001. (DFS).

5. Heijdra B., van der Ploeg F. (2002) Foundations of Modern Macroeconomics, Oxford University Press, ch. 1–11.

6. Mankiw N. G. (1992) Macroeconomics, NY Worth Publishers,. (M) / Russian translation: Н.Г.Мэнкью, Макроэкономика. Изд-во Московского университета, 1994/.

7. Sachs J.D., Larrain F. (1993) Macroeconomics in the Global Economy, (S&L) /Russian translation: Сакс Дж.Д., Ларрен Ф.Б. Макроэкономика. Глобальный подход. М., Дело, 1996.

8. Turner P. (1993) Modern Macroeconomic Analysis, McGraw-Hill.

[1] Those topics are "Redistribution policy in a macroeconomic context" and "International macroeconomics and policy transmission"

Mankiw is slightly more basic than Blanchard. Barro-Grilli and Burda-Wyplosz are classical in spirit and more useful for the economy in the long run. Mathematically inclined students might also look at the concise treatment of many of the topics in this course in Turner.

Articles

1. Blanchard O. J. (2000) "What Do We Know About Macroeconomics That Fisher and Wicksell Did Not?" NBER Working Paper No. 7550.

2. Gordon R. J. (1990) "What is New-Keynesian Economics?". Journal of Economic Literature, 28(3), pp. 1115–71.

3. Greenwald B., Stiglitz J. E. (1987) "Keynesian, New Keynesian, and New Classical Economics". Oxford Economic Papers, 39, pp. 119–32.

4. Greenwald B., Stiglitz J. E. (1993) "New and old Keynesians". Journal of Economic Perspectives, 7(1), pp. 23–44. (Also NBER Working Paper No. R1810.)

5. Phillips A. W. (1958) "The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom", 1862–1957. Economica, 25, pp. 283–99.

6. Romer D. (2000) "Keynesian Economics without the LM curve" Journal of Economic Perspectives 14 (Spring), pp. 149–169.

Internet resources and databases

1. Russian Federal Educational Portal contains a brilliant collection of various useful links to internet resources in macroeconomics:
   `http://ecsocman.edu.ru/db/sect/23`

2. An interactive model of the Goods market equilibrium can be downloaded from:
   `http://www.ecsocman.edu.ru/db/msg/118753`

3. More advanced students can find it interesting to look through other macroeconomics topics such as Economic growth, Business cycles, Consumption and Investments, Money and Inflation, Unemployment, Open Economy Macroeconomics, Macroeconomics of financial markets, Macroeconomic policy, Applied Macroeconomics, as well as New Political Economy in Macroeconomics on:
   `http://ecsocman.edu.ru/db/sect/3156`

4. Companion Website for Blanchard's Macroeconomics, the basic textbook for the course, offers interactive Multiple Choice Questions, Essay Topics selected for each chapter of the textbook (27 in total):
   `http://myphlip.pearsoncmg.com/cw/mpbookhome.cfm?vbookid=388`
   This site can be used to graphically analyse and explore micro- and macroeconomic theories and concepts. The lessons are interactive and each topic presents subsidiary issues that may be analysed by the student and results are illustrated with a click.

5. Simple Keynesian Cross Model, Consumption and Savings Functions, Goods Market Equilibrium, Supply and Demand for Money, as well as Simultaneous Equilibrium in IS-LM Model are presented on:
   `http://nova.umuc.edu/~black/pageg.html`

6. The following tutorial is primarily intended to serve as a pathfinder through the tools part of Macroeconomics. Emphasising graphs and animations, it explains the essentials of macroeconomics, shows how the different building blocks are related, and offers interactive numerical exercises:
   `http://www.fgn.unisg.ch/eurmacro/macroeconomics.html`

Course outline

1. Basic macroeconomic concepts (a review)

Macroeconomics and its central issues: inflation, unemployment, economic growth, stabilisation policy. Aggregation and the macroeconomic problem. Common denominator.

Gross domestic product, value added, final and intermediate goods. Double counting. Savings and investment. The government, GDP at market prices and at factor costs. Personal disposable income. Foreign sector: exports, imports, net exports (trade balance). Gross national product, national income. Real vs. nominal variables. Some important national accounting identities.

(W ch. 8; Blake ch. 8)

2. Aggregate demand components

National accounts. Determinants of consumption (consumption function) and marginal propensity to consume. Consumption function with income dependent MPC. Savings and marginal propensity to save. Relationship between consumption and savings in a closed economy without government. Changes in MPC and the effect on savings.

Investment. Savings and transmission mechanism. Interest rate and the present value concept. Bonds of the console type (perpetuities). Internal rate of return. Paradox of thrift.

The government sector. Public consumption and marginal propensity to spend of the government. Government revenues and forms of taxation: lump-sum and proportional (marginal) taxes, progressive and regressive taxes, income and expenditure taxes, corporate tax and the dividends double taxation problem. Budget surplus and government savings. Tax incentives to save.

The foreign sector. National accounts for the open economy. Demand for export and import, marginal propensity to import. Net export function with a fixed exchange rate.

(W ch. 8, 14.1–14.2; Blake ch. 5.1–5.2; P ch. 2.1–2.4)

3. Goods market equilibrium

The complete goods market and Keynesian Cross in the closed economy. Characterisation of equilibrium and mechanism of adjustment. Autonomous expenditure and the multiplier. Goods market equilibrium and the multiplier in the open economy.

Government spending and crowding out. The effects of government spending and taxation on output. Balanced budget multiplier.

The IS representation of the goods' market equilibrium in the closed economy. Derivation of the IS curve. Shifts in the IS schedule. The interest rate elasticity of investment expenditure function: extreme Keynesian and Classical views. The effects of change in the MPC.

(W ch. 10, 14.2; Blake ch. 5.3; P ch. 2.5–2.7)

4. Redistribution policy in a macroeconomic context

Transfer payments, taxation and redistribution vs. fiscal policies. Income dependent MPC and income distribution. Heterogeneous agents and the total consumption function. Inequality, poverty, and transfer effect. Redistribution policy and poverty-driven inequality. Redistribution and poverty alleviation. Income redistribution, changes in population composition and the consumption function.

(W ch. 10, pp. 309–312)

5. Financial market equilibrium in the closed economy

Money and Banking. Functions of Money: a Numeraire, Means of Exchange and Store of Value. Demand for Liquid Assets. Liquidity Preference Approach.

Central Bank, Commercial Banks and Supply of Liquid Assets. Money Base, Public Cash, Reserves, Deposits. Money Creation process. Deposit multiplier. Loans multiplier.

Liquid Assets Market Equilibrium. The derivation of the LM curve. Slope of the LM schedule. Excess demand and Excess supply. Monetary Policy and Shifting in the LM schedule.

(W ch. 11; ch. 25–5; Blake ch. 5.5, ch. 11; P ch. 3)

6. General equilibrium and macroeconomic policies in the closed economy: IS-LM model

Notion of general equilibrium in a macroeconomics context. Algebra and geometry of general equilibrium, IS-LM framework. Macroeconomic policies and output determination. Classical and Keynesian views.

Expansionary and contractionary fiscal policy: tax financing, internal debt financing, borrowing from the central bank. Expansionary and contractionary monetary policy, policy mix.

(W ch. 12; Blake ch.6, 7.1; P ch. 4–5; LC Ch. 24 pp. 418–422, Ch. 26 pp. 454–458)

7. AD-AS model (prices, wages and adjustment process)

Prices and output. Aggregate demand derivation using IS-LM framework. Aggregate supply and labour market. Short-run and long-run aggregate supply. The AD-AS schedule.

Actual and potential output. Aggregate supply in Keynesian and classical cases. Aggregate-supply shock and stagflation. Changes in the potential output: human capital and productive education, land stock and capital accumulation. Demand management and supply-side economics.

Say's law and general equilibrium in supply determined economy. Criticism of the Say's law and market imperfections.[2]

(W ch. 9, ch. 13; Blake ch. 7.2.1–7.2.2, 7.3; P ch. 6.1)

8. Open economy macroeconomics: exchange rate determination

Balance of payments: current account, capital account and foreign reserves. Real and nominal exchange rate. Exchange rate determination and the money sector. Foreign exchange market, foreign currency reserves. Appreciation and depreciation of the exchange rate. Exchange rate regimes: fixed and flexible.

(W Ch. 14.3; Blake Ch. 9.2–9.3; p Ch. 7; LC Ch. 22, 28–29)

9. General equilibrium in a small open economy: IS-LM-BP model

General equilibrium in an open economy and macroeconomic policies. Capital mobility vs. capital controls. Mundell-Fleming model. Monetary and fiscal policies under fixed and flexible exchange rates with perfect capital movements and no capital mobility. The effects of the fall in international prices: the benchmark case of a "small" open economy.

Introducing flexibility of prices and wages. Effectiveness of macroeconomic policies under various institutional settings.

(W Ch. 14.4; Blake Ch. 9.4; P Ch. 7; LC Ch. 22, 28–29)

10. International macroeconomics and policy transmission

[2]This material is not directly examinable and it offers interested students a better understanding of some of the current debates.

Relaxing assumption of a "small" open economy. Two-country setting and simultaneous determination of income and exchange rate when countries are main trading partners. Repercussion effects.

Monetary policy abroad: the case of perfect and no capital mobility under alternative exchange rate regimes. Policy transmission and repercussion effects in the case of simultaneous changes in current account and capital account.

Social vs. fiscal policy abroad: sensitivity of macroeconomic outcomes to distribution policy. A shift in demand and transfer problem.

(W Ch. 14, pp. 419–423, D ch. 3, pp. 33–56)

11. Unemployment

Types of unemployment: frictional, structural, demand-deficient (cyclical), classical unemployment. Natural rate hypothesis. Voluntary and involuntary unemployment. Private and social costs of unemployment.

Short-run and long-run unemployment, nominal and real wage rigidity. Trade union bargaining, efficiency wage theory, implicit contracts, insider-outsider models, search and matching.

(W ch. 9.3, ch. 13; Blake ch. 7.2.2, 7.3–7.5; P ch. 8.3; LC Ch. 23–24, 27 pp.469–474, 30–31)

12. Inflation

Inflation: CPI, PPI and GDP deflator. Real money balances. Hyperinflation and flight from money. The role of expectations and inflation persistence.

Output-inflation trade-off. Short-run and long-run Phillips curves. AS shocks and stagflation.

(W ch.13; Blake ch. 7.2.3, 7.3–7.5; P ch. 8.3; LC Ch. 23–24, 27 pp. 469–474, 30–31)

Distribution of hours

#	Topic	Total hours	Contact hours		Self study
			Lectures	Seminars	
1.	Basic macroeconomic concepts (a review)	14	2	2	10
2.	Aggregate demand components	14	2	2	10
3.	Goods market equilibrium	18	4	4	10
4.	Redistribution policy in a macroeconomic context	26	4	4	18
5.	Financial market equilibrium in the closed economy	14	2	2	10
6.	General equilibrium and macroeconomic policies in the closed economy: IS-LM model	24	2	2	18

#	Topic	Total hours	Contact hours		Self study
			Lectures	Seminars	
7.	AD-AS model (prices, wages and adjustment process)	24	2	4	18
8.	Open economy macroeconomics: exchange rate determination	14	2	2	10
9.	General equilibrium in a small open economy: IS-LM-BP model	22	2	2	18
10.	International macroeconomics and policy transmission	18	4	4	10
11.	Unemployment	14	2	2	10
12.	Inflation	14	2	2	10
	Total:	216	32	32	152