

Part II
Papers 1, 2 and 3
Macroeconomic Principles and Problems
1996-7

Aims and scope.

Lecture Course Outline

The lecture courses for 1996-7 are:

Topics in Macroeconomic Policy (8 lectures; Lent 1997, by Prof. W.H.. Buiter)

These lectures will cover a number of macroeconomics policy issues that have both real world significance and significant analytical content. The topics covered will include, but need not be limited to, the following:

- (1) Policy announcement effects in models with forward-looking expectations; the term structure of interest rates, the stock market, the foreign exchange market and the labour market.
- (2) Policy ineffectiveness or neutrality propositions and the Lucas critique.
- (3) Fiscal and financial policy in dynamic models: tax smoothing, the seigniorage Laffer curve and the sustainability of the fiscal-financial-monetary programme.
- (4) Economic policy in endogenous growth models.

Contemporary Economic Problems. (8 lectures, Easter 1997, by Dr. J.L. Eatwell).

This is a very “topics” oriented course which seeks to apply economic analysis to issues of contemporary concern. The subject matter therefore varies from year to year. But the consistent approach is to identify the relevant economic theory and empirical evidence associated with the problem under consideration, and to illuminate the intellectual origins of different approaches to the solution of the problem. Among the topics recently covered are “Unemployment in the G7;” “Personal income distribution in the UK” and “Economic transformation in Eastern Europe”.

The international Financial System. (8 lectures, Michaelmas 1996, by Mr. M.G.

Kuczynski). This course deals , in the context of the international economy, with three influences on financial change (public debt, regulatory and other competition, and interest rate fluctuations); and with three consequences of financial change (in the areas of international payments imbalances, financial fragility, and economic growth)

Unemployment and Pay Determination. (4 lectures, Lent 1997, by Dr. P. Ryan). Course description under Paper 1.

Controlling the Economy: Fiscal and Monetary Policy in an Open Economy, (8 lectures, Michaelmas 1996, by Dr. G. Hess). The purpose of this course is to introduce students to the theory of economic policy. The analysis is set in terms of a targets and instruments framework. The rules versus discretion debate is considered, with particular emphasis on the

credibility issue. Throughout the course, we attempt to relate the core concepts of internal and external equilibrium to current or recent policy problems or economic events. The case for international policy coordination is also considered, with particular reference to the EMS/EMU debate.

International Economic Integration (8 lectures, Michaelmas 1996, by Dr. J.R. Wells).

These lectures can also be taken as part of the M.Phil course.

The lectures cover the Post-World War II processes of trade liberalization and capital account liberalization, the institutional setting within which these developments took place and their national and systemic policy implications.

The Theory and Practice of Monetary Policy (8 lectures, Lent 1997, by Mr. S. Wright).

The lectures cover the aims and instruments of monetary policy and the monetary transmission mechanism. Special attention is given to the conduct of monetary policy in an open economy.

Introductory Readings.

M. Burda and C. Wyplosz [1993], *Macroeconomics, a European Text*, Oxford University Press.

Willem H. Buiter [1990], *Principles of Budgetary and Financial Policy*, Harvester Wheatsheaf.

NBER Macroeconomics Annual, 1986-94.

Robert J. Barro and Xavier Sala-i-Martin [1995], *Economic Growth*, McGraw-Hill, Inc.

C.A.E. Goodhart [1994], *Money, information and uncertainty*, 2nd Edition, Macmillan, 1989.

B. Eichengreen et. al. *Blueprints for exchange rate systems*

R. Shiller, *Who's minding the store?* (20th Century Fund)

W. Carlin and D. Soskice [1990], *Macroeconomics and the wage bargain*. OUP.

R. Levacic and A. Reibmann [1982], *Macroeconomics, 2nd ed.* Macmillan.

J.D. Sachs and F. Larrain [1993], *Macroeconomics in the global economy*, Harvester Wheatsheaf.

J. Williamson and C. Milner [1991], *The world economy: a textbook in international economics*.

A. Wood [1994], *North-South trade and inequality: changing fortunes in a skill-driven world*. Clarendon.

Bean, C. [1994], "European unemployment: a survey", Journal of Economic Literature.

Cowell, F.A. [1995], *Measuring inequality*. Harvester Wheatsheaf.

Examination Requirements.

Sample Questions:

(1) "Deregulation of both national and international financial markets has been a mistake. What is now required is a period of vigorous re-regulation". Discuss.

(2) "Monetary policy should be in the hands of an independent central bank whose sole objective and responsibility should be that of securing stability of the price level". Discuss in the context of the prospect of a single European currency.

(3) Is further liberalization of international trade desirable-from the viewpoint of developed and developing country participants in the international trading system? Are regional free trade agreements a stepping-stone or a stumbling-block to a more liberal world trading order?

(4) What determines short-term interest rates?

(5) Evaluate from the point of view of economic welfare the pursuit of low inflation and the overriding policy goal of the British government in the 1980's.

(6) A closed economy, fixed price IS-LM model is summarized by the following equations:

$$Y = \gamma q + f \quad \gamma > 0 \quad (1)$$

$$M = kY - \lambda i \quad k > 0, \lambda > 0 \quad (2)$$

$$\frac{\dot{q}}{q} + \frac{\eta Y}{q} = i \quad \eta > 0 \quad (3)$$

Y is GDP, i is the short rate of interest, R is the long rate of interest (the interest rate on a consol or perpetuity), q is “Tobin’s q ”, the ratio of the value of installed capital to the current reproduction cost of new capital goods, M is the stock of money. And f is a measure of the expansionary effect of fiscal policy on aggregate demand., γ, η, λ and k are positive constants.

$$R - \frac{\dot{R}}{R} = i \quad (4)$$

(A) Interpret equations (3) and (4).

(B) There is an unexpected announcement at time t_0 of a future permanent move towards a more expansionary fiscal policy, beginning at time $t_1 > t_0$. Describe the complete dynamic response from t_0 on of output, the short rate of interest, the long rate of interest and Tobin’s q . Explain the economic forces driving these variables. Can the government use monetary policy to stabilize real output in the face of the fiscal policy announcement? If yes, how and if not, why not?

(7) “How would you explain (a) the similarities and (b) the differences, in changes in levels of unemployment in the G7 countries over the past decade?”

(8). “To what would you attribute the changes in the U.K. personal income distribution which have occurred in the past decade?”