

Economics Tripos, Part II  
Papers 1,2 and 3 (ECONOMIC  
PRINCIPLES AND PROBLEMS),  
**Macroeconomic Principles and Problems.**

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8 lectures

### **Topics in Macroeconomic Policy**

This lecture course will cover a number of macroeconomic policy issues that have both real world relevance and significant analytical content. The topics covered will include, but need not be limited to the following

- (1) Rational expectations in ad-hoc macromodels: the term structure of interest rates; the stock market; the foreign exchange market and the labour market
- (2) Policy ineffectiveness propositions and the Lucas critique.
- (3) Endogenous growth theory.
- (4) Fiscal and financial policy in dynamic optimizing models. Intergenerational distribution and risk-sharing; tax smoothing; seigniorage and the seigniorage Laffer curve; the sustainability of public sector deficits.

There is no textbook for the course. The following general references are useful for parts of the course. More specific reading will be assigned as the course proceeds.

- O.J. Blanchard and S. Fischer [1989], *Lectures on Macroeconomics*, The MIT Press.
- B.T. McCallum [1989], *Monetary Economics, Theory and Policy*, Macmillan Publishing Co.
- NBER Macroeconomics Annual*; 1986/87/88/89/90/91/92/93/94. O.J. Blanchard (or O.J. Blanchard and S. Fischer) ed(s). The MIT Press.
- R.J. Barro and X. Sala-i-Martin [1995], *Economic Growth*, McGraw-Hill.
- Gene M. Grossman and Elhanan Helpman [1991], *Innovation and Growth in the Global Economy*, The MIT Press.

For those whose intermediate macroeconomics is rusty, I recommend a quick perusal of M. Burda and C. Wylasz [1993], *Macroeconomics, A European Text*, Oxford University Press.

Examination questions for this course will be oriented towards problem solving. Typically the student will be asked to analyze a well-defined policy problem or economic event, by bringing

appropriate theory and facts to bear on it. Some questions will involve the manipulation and analysis of a fully specified formal, mathematical model of the economy.

There will be no questions such as "Explain the difference between Blogg's and Blagg's theories of the term structure of interest rates". Instead, they are more likely to look like the following:

(1) What kinds of policy actions or exogenous shocks and what model of the economy could produce the following combination of outcomes: an increase in the short rate of interest, a reduction in the long rate of interest, a fall in the stock market and a depreciation of the spot value of the currency?

(2) The government imposes a tax on the wage income of the generations currently working and pays out the proceeds of this tax as retirement benefits to the generations currently retired. Explain the effect of this policy on aggregate consumption. Show how your answer depends on the following: (a) whether the policy change was *anticipated* or *unanticipated*; (b) whether the policy change is perceived as *permanent* or *temporary*; (c) whether or not successive generations are linked by *operative intergenerational gift motives* and (d) whether different generations are *liquidity constrained* or constrained only by their *permanent income*.

## Topics in macroeconomic policy.

### (1) Rational Expectations in the Aggregate Demand-Aggregate Supply Model.

#### General.

Begg, D.D.H. *The rational expectations revolution in macroeconomics*, Ch. 3.

Blanchard, O.J. and S. Fischer [1989], *Lectures on Macroeconomics*, pp. 529-536 and 542-555.

Blanchard O.J. and C. Kahn [1980], "The solution of linear difference models under rational expectations", *Econometrica*, July, pp. 1305-1311.

Buiter, Willem H. [1984], "Saddlepoint problems in continuous time rational expectations models: a general method and some macroeconomic examples", *Econometrica*, May, pp. 665-680.

Dorfman, R. [1969], "An Economic Interpretation of Optimal Control Theory", *American Economic Review*, pp. 817-831.

#### A flexible, forward-looking general price level.

Sargent, T.J. [1987], *Macroeconomic Theory*, pp. 34-41.

Sargent, T.J. and N. Wallace [1973], "The stability of money and growth with perfect foresight" *Econometrica*, 41, pp. 1043-1048.

#### Unpleasant monetarist arithmetic.

Sargent, T.J. and N.Wallace [1981], "Some unpleasant monetarist arithmetic", *Federal Reserve Bank of Minneapolis Quarterly Review*, 5, Fall, also in B. Griffith and G.E Wood eds. [1982], *Monetarism in the U.K.*, MacMillan, and in T.J. Sargent [1986] *Rational Expectations and Inflation*.

Buiter, Willem H. [1987], "A fiscal theory of hyperdeflations?", *Some surprising monetarist arithmetic*, *Oxford Economic Papers*, 39, pp. 111-118, reprinted in Willem H. Buiter [1990] *Principles of Budgetary and Financial Policy*.

#### The term structure of interest rates.

Turnovsky, Stephen J. and Marcus H. Miller [1984], "The effects of government expenditure on the term structure of interest rates", *JMCB* 16(1), Feb., pp. 16-33.

Fisher, Walter H. and Stephen J. Turnovsky [1992], "Fiscal policy and the term structure of interest rates", *JMCB*, 24(1) Feb., pp.1-26.

#### The stock market and Tobin's q.

Blanchard, O.J. [1981], "Output, the stock market and interest rates", *AER*, March.

Hayashi, Fumio [1982], "Tobin's marginal and average q: a neoclassical interpretation", *Econometrica* (50), Jan. pp. 213-224.

**The open economy: uncovered interest parity.**

Blanchard, O.J. and S. Fischer, [1989], *Lectures on macroeconomics*, pp. 537-542.

Buiter, W.H. and M.H. Miller [1981], "Monetary policy and international competitiveness", *Oxford Economic Papers*, Supplement, July 1981, pp. 143-175.

Buiter, W.H. and W.H. Branson [1983], "Monetary and fiscal policy with flexible exchange rates", in W.H. Buiter, *International Macroeconomics*, Oxford University Press.