



Northeastern University
Department of Economics

Macroeconomic Theory 2

ECON7720

Prof. Luengo-Prado

Spring 2011

⌚ Tu./F. 11:45am-1:15pm

📍 Ryder Hall 203

⌚ **Office Hours:** Tu./F. 9:30-10:30am, Tu. 2:00-3:00pm or by appointment.

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Course Description

This is an advanced course in macroeconomic theory which builds on the master-level course entitled “Macroeconomic Theory” (ECON5120). We will cover topics on (1) consumption/saving, (2) economic growth, (3) business cycles (4) unemployment and (5) investment.

The first three topics are standard in any Ph.D. macro course that focuses in the real economy. We will cover unemployment and investment because these topics may be useful for you in terms of future research given our department’s areas of specialization.

The goal of this course is to provide you with an overview of modern macroeconomic research and introducing some analytical tools useful beyond macroeconomics. Whenever possible we will be making the connection between macro and micro.

Prerequisites

The prerequisite for this course is ECON5120 (Macroeconomic Theory) or its equivalent. This course also assumes that you have appropriate mathematical background.

Blackboard (Bb)

I use Blackboard—<http://blackboard.neu.edu/>—to distribute all course materials (lecture notes, handouts, homework, and announcements). Make sure you can access the course site and please check it regularly. Use the “Discussion Board” to ask questions about course content instead of sending me an email.



Course Mechanics

I assign problem sets on a (nearly) weekly basis (10% of your grade); there will be two in-class exams (20% each, February 18 and April 1) and a comprehensive final (50 %, April 26).

I encourage you to work in groups on the problem sets. However, each student must hand in his/her own problem set unless otherwise indicated. Only by working all derivations yourself, you will get to master a certain tool. Problem sets will not be accepted late. Make arrangements to hand in the assignment early if you cannot come to class the day an assignment is due. Please, use Blackboard instead of email if you want to hand in an assignment electronically (use the send message tool within Bb).

There will be no make-up exams without a legitimate, documented excuse. If you need to make up an exam, you must contact me as soon as possible. Once the exam answer key is posted on Blackboard, make-ups are not possible. Depending on the circumstances, the weight of the final may be adjusted.

Textbook and Readings

Required textbook

- David Romer, Advanced Macroeconomics, 3rd edition, McGraw-Hill/Irwin—available at the bookstore.
- You can purchase the ebook version of the required book for this course for \$34.90. Go to: <http://create.mcgraw-hill.com/shop/> and enter the ISBN for this class: 9781121116283.

Other useful books

- It is a good idea to refer to an intermediate undergraduate textbook for background reading. For example, Gregory N. Mankiw, Macroeconomics, 7th edition, Worth Publishers.
- For the growth part, Charles Jones, Introduction to Economic Growth, W. W. Norton & Company, is a nice introduction.
- Other useful graduate books include:
 - Olivier Blanchard and Stanley Fischer, Lectures on Macroeconomics, MIT Press.
 - Maurice Obstfeld and Kenneth Rogoff, Foundations of International Macroeconomics, MIT Press.
 - Angus Deaton, Understanding Consumption, Clarendon Lectures in Economics, Oxford University Press.
 - Robert Barro and Xavier Sala-i-Martin, Economic Growth, MIT Press.
 - Michael Wickens, Macroeconomic Theory, Princeton University Press.



➤ Useful math books:

- Alpha Chiang, Fundamental Methods of Mathematical Economics, McGraw-Hill/Irwin.
- Avinash Dixit, Optimization in Economic Theory, Oxford University Press.

Lecture notes

- I will provide you with lecture notes over the course of the semester. I hope that having these notes will allow you to spend less time writing and more time thinking and asking questions during lectures.

Reading from Journals

- Additional articles on the course outline will be posted on Bb if property rights allow it. If not, instructions on how to obtain them will be provided. The articles selected are often non-technical but very relevant. In general, you should expect questions from these articles on the examinations. Articles marked with (**) are more advanced and will not be included in examinations if not discussed in class. Articles marked with (*) were covered in Macro I and may not be discussed this term but are fair game for qualifying examinations.

Course Outline

1. Introduction

- ⇒ Conversations with Leading Economists: Interpreting Modern Macroeconomics, Brian Snowdon and Howard R. Vane, Edward Elgar Pub., 2000, chapter 1.
- ⇒ George A. Akerlof, “The Missing Motivation in Macroeconomics”, 2005.
- ⇒ Barry Eichengreen, “The Last Temptation of Risk”, *The National Interest*, 2009.
- ⇒ Paul Krugman, “How Did Economists Get It So Wrong?”, *NY Times*, 2009.
- ⇒ John H. Cochrane, “How did Paul Krugman get it so Wrong?”, 2009.
- ⇒ N. Kocherlakota, “Some Thoughts on the State of Macro”, 2009.

2. Consumption and Saving

(3-4 weeks)

- The Fisher model.
- Ricardian equivalence.
- The PIH/LC model.
- Liquidity constraints and uncertainty.
- CCAPM model.
- Behavioral models: hyperbolic discounting and inattentive consumers.



- Risk Sharing.
- Empirical evidence.

[EXAM 1]

Readings:

- ⇒ Romer, chapter 7.
- ⇒ Browning, Martin; Crossley, Thomas F., “The Life-Cycle Model of Consumption and Saving.” *Journal of Economic Perspectives*, 15(3), 2001.
- ⇒ Carroll, Christopher D, “A Theory of the Consumption Function, with and without Liquidity Constraints,” *Journal of Economic Perspectives*, 15(3), 2001.
- ⇒ Martin Browning and Annamaria Lusardi, “Household Saving: Micro Theories and Micro Facts, *Journal of Economic Literature* 34(4), 1996.
- ⇒ John Karl Scholz, Ananth Seshadri and Surachai Khitatrakun, “Are Americans Saving ‘Optimally’ for Retirement?”, *Journal of Political Economy* 104(4), 2006.
- ⇒ F. Thomas Juster, Joseph P. Lupton, James P. Smith, and Frank Stafford, “The Decline on Household Saving and the Wealth Effect”, *Review of Economics and Statistics*, 87(4), 2006.
- ⇒ George-Marios Angeletos, David Laibson, Andrea Repetto, Jeremy Tobacman and Stephen Weinberg, “The Hyperbolic Consumption Model: Calibration, Simulation, and Empirical Evaluation”, *Journal of Economic Perspectives*, 15(3), 2001.
- ⇒ (**) David Laibson, “Golden Eggs and Hyperbolic Discounting,” *The Quarterly Journal of Economics*, MIT Press, vol. 112(2), 1997.
- ⇒ (**) Ricardo Reis, “Inattentive Consumers”, *Journal of Monetary Economics*, 53, 2006.
- ⇒ (**) Attanasio, Orazio and Martin Browning, “Consumption Over the Life Cycle and Over the Business Cycle”, *American Economic Review*, 85(5), 1995.
- ⇒ (**) Aguiar, Mark and Erik Hurst, “Consumption versus Expenditure”, *Journal of Political Economy*, 113(5), 2005.
- ⇒ (**) Krueger, Dirk and Fabrizio Perri, “Does income Inequality Lead to Consumption Inequality? Evidence and Theory”. *Review of Economic Studies*, 73(1), 2006
- ⇒ (**) Blundell, Richard, Luigi Pistaferri and Ian Preston . “Consumption Inequality and Partial Insurance”, *American Economic Review*, 98(5), 2009.

3. Growth

(3-4 weeks)

- The facts.
- The Solow growth model (previous knowledge assumed; notes will be distributed but we will not cover it in class as it was done in Macro I.)
- The Ramsey model.



- OLG models.
- Endogenous growth.
- Empirical evidence.

Readings:

- ⇒ Romer, chapters 1–3.
- ⇒ (*) Gregory Mankiw, David Romer and David Weil, “A Contribution to the Empirics of Economic Growth,” *Quarterly Journal of Economics*, 107(2), 1992.
- ⇒ (*) Robert Hall and Charles Jones, “Why Do Some Countries Produce So Much More Output per Worker than Others?,” *Quarterly Journal of Economics*, 114, 1999.
- ⇒ Philippe, Weil, “Overlapping Generations: The First Jubilee,” *Journal of Economic Perspectives* 22(4), 2008.
- ⇒ Romer, Paul M., “The Origins of Endogenous Growth.,” *Journal of Economic Perspectives*, 8(1), 1994.
- ⇒ Grossman, Gene M.; Helpman, Elhanan, “Endogenous Innovation in the Theory of Growth,” *Journal of Economic Perspectives*, 8(1), 1994.
- ⇒ Solow, Robert M, “Perspectives on Growth Theory,” *Journal of Economic Perspectives*, 8(1), 1994.
- ⇒ (**) Philippe Aghion, Diego Comin and Peter Howitt, “When Does Domestic Saving Matter for Economic Growth?,” HBS Working Paper 09-080, 2009.

4. Business Cycles

(2-3 weeks)

- The changing facts.
- A basic real business cycle model and introduction to calibration. [\[EXAM 2\]](#)
- Nominal rigidities and economic fluctuations: background; Fischer and Taylor models of staggering price and wage adjustment; the Mankiw-Reis model.

Readings:

- ⇒ Romer, chapter 4, and chapter 6 (6.1-6.3, 6.9 and 6.13 only).
- ⇒ Edward Prescott, “Theory Ahead of Business Cycle Measurement,” *Federal Reserve Bank of Minneapolis Quarterly Review*, , 1986.
- ⇒ Lawrence Summers, “Some Skeptical Observations on Real Business Cycle Theory,” *Federal Reserve Bank of Minneapolis Quarterly Review*,, 1986.
- ⇒ Rodolfo Manuelli, “Modern Business Cycle Analysis: A Guide to the Prescott-Summers Debate,” *Federal Reserve Bank of Minneapolis Quarterly Review*, 1986.



- ⇒ N. Gregory Mankiw, “Real Business Cycles: A New Keynesian Perspective,” *Journal of Economic Perspectives* 3(3), 1989.
- ⇒ Christina Romer, “Changes in the Business Cycle: Evidence and Explanations,” *Journal of Economic Perspectives*, 13(2), 1999.
- ⇒ Stock, James H. and Mark W. Watson, “Has the business cycle changed?,” Proceedings, Federal Reserve Bank of Kansas City, 2003.
- ⇒ Davis, Steven J., and James A. Kahn. “Interpreting the Great Moderation: Changes in the Volatility of Economic Activity at the Macro and Micro Levels.” *Journal of Economic Perspectives*, 22(4), 2008.
- ⇒ Lee E. Ohanian, “The Economic Crisis from a Neoclassical Perspective”, *Journal of Economic Perspectives*, 24(4), 2010.
- ⇒ Ricardo J. Caballero, “Macroeconomics after the Crisis: Time to Deal with the Pretense-of-Knowledge Syndrome”, *Journal of Economic Perspectives*, 24(4), 2010.
- ⇒ (***) Jose Ursúa, “Long-Run Volatility”, Working Paper, Harvard University, 2010.

5. Unemployment

(1-2 weeks)

- Efficiency Wages.
- Search Models.

Readings:

- ⇒ Romer, chapter 9.
- ⇒ Olivier Blanchard; Lawrence F. Katz, “What We Know and We Do Not Know about the Natural Rate of Unemployment”, *Journal of Economic Perspectives*, 11(1), 1997.
- ⇒ Richard Rogerson, “Theory ahead of Language in the Economics of Unemployment,” *Journal of Economic Perspectives*, 11(1), 1997.

6. Investment

(1-2 weeks)

- The cost of capital approach.
- q -theory with an application to the housing market.
- Credit rationing.
- Investment and financial markets.

Readings:

- ⇒ Romer, chapter 8.
- ⇒ Avinash Dixit, “Investment and Hysteresis,” *Journal of Economic Perspectives*, 6(1), 1992.



- ⇒ Robert Pindyck, “Irreversibility, Uncertainty, and Investment,” *Journal of Economic Literature*, vol. XXIX, 1991.
- ⇒ (**) Topel, Bob and Sherwin Rosen, “Housing Investment in the United States”, *Journal of Political Economy*, 96(4), 1988.
- ⇒ (**) Joe Gyrouko, “Housing Supply”. *Annals of Economics*, 2008.
- ⇒ (**) Davis, Morris and Jonathan Heathcote, “Housing and the Business Cycle”, *International Economic Review*, 46(3), 2005.

[COMPREHENSIVE FINAL]

TENTATIVE SCHEDULE

(dates may be subject to change)

WEEK	TUESDAY	FRIDAY
Week 1- Jan. 11	Introduction	Consumption
Week 2- Jan. 18	Consumption	Consumption
Week 3- Jan. 25	Consumption	Consumption
Week 4- Feb. 1	Consumption	Consumption
Week 5- Feb. 8	Growth	Growth
Week 6- Feb. 15	Growth	Exam 1
Week 7- Feb. 22	Growth	Growth
Week 8- Mar. 1	Spring Break	Spring Break
Week 9- Mar. 8	Growth	Growth
Week 10- Mar. 15	Growth/Business Cycles	Business Cycles
Week 11- Mar. 22	Business Cycles	Business Cycles
Week 12- Mar. 29	Business Cycles	Exam 2
Week 13- Apr. 5	Business Cycles/Unemployment	Unemployment
Week 14- Apr. 12	Unemployment	Investment
Week 15- Apr. 19	Investment	Investment/Review
Week 16- Apr. 26	Final	