



APPLIES TO ACADEMIC YEAR
2002/2003

GRA 6634 Macroeconomic Theory and Policy

Program

Master of Science in Business Administration (MScBA), Specialization Course

Responsible for the course

Erling Steigum

Department

Economics

Term

Fall

ECTS Credits

Objective

This course offers a streamlined presentation of intermediate macroeconomics based on J. Bradford DeLong's recent textbook. It covers all the major areas of macroeconomics such as economic growth, business cycles, unemployment, inflation, interest rates, exchange rates, and macroeconomic policy. In several areas, there is a shift in emphasis compared to standard presentations of macroeconomics. These changes in focus are:

- Provide a more student-friendly way of learning growth theory.
- Provide sufficient coverage of *growth facts* so that students learn the how and why of both growth over time and growth across countries.
- Treat the economy as open from the beginning of the course.
- Deal with interest rates, not money stocks.
- Focus on rate of inflation and the dynamic Phillips curve, rather than a static supply-demand model of the price level.

These changes in emphasis bring the presentation of the theories and models closer to what the students will find when they read about macroeconomic policy issues in *The Economist* or *The Financial Times*.

Prerequisites

None

Compulsory literature

DeLong, J. Bradford. 2002. *Macroeconomics*. International ed. Boston, MA: McGraw-Hill.

Recommended literature

Will be ready at the start of the term.

Course outline

The course consists of the following five parts: Preliminaries, long-run economic growth, flexible-price macroeconomics, sticky-price macroeconomics, and macroeconomic policy.

- **Preliminaries.** In this introductory part, macroeconomic data and measurement issues are reviewed. We also address methodological questions such as: *Why do economists use formal models so much?*, *What patterns and habits of thought must be learned to think like an economist?*
- **Long-run economic growth.** This part of the course deals with long-run trends in

employment, productivity, gross domestic output and other variables. The study of long-run growth is a separate, but very important module that is not very closely connected to the study of business cycles, unemployment, inflation and stabilization policy the make up the bulk of the subject matter of macroeconomics. First, the main sources of long-run economic growth are discussed, and the Solow growth model is employed to analyze their interaction through the processes of capital accumulation and technological progress. Then the attention is turned to the empirics and history of economic growth. We discuss questions such as: *Why are productivity and income levels so different in different parts of the world? Why have some formerly poor countries succeeded to grow out of poverty, while many other poor countries have stagnated economically? Which institutions and economic policies promote long-run economic growth?*

- **Flexible-price macroeconomics.** In this part we look at the macroeconomy from a market equilibrium perspective. The economy is divided into four aggregate markets, 1) the market for output of goods and services, 2) labor, 3) money, and 4), the market for other financial assets and debts. Microeconomic theory is used to derive demand and supply in these markets, conditional on expectations about the future, for example how households and firms decide on consumption, investment, import and export. Market equilibrium in a given period determines average prices such as the wage, the price level, the interest rate and the exchange rate. Analyzing the interaction of the aggregate markets, we gain insights into how the market economy's equilibrium changes due to demand and supply shocks, changes in expectations about the future, or changes in fiscal and monetary policy. For example, the model is useful to discuss the quantity theory of money, i.e. the relation between money supply growth and inflation under conditions of full employment.
- **Sticky-price macroeconomics.** Flexible-price models do not explain cyclical unemployment and the short-run effects of monetary and fiscal policy in a satisfactory way. To understand why aggregate demand for goods and services fluctuates, why unemployment is increasing in recessions and why monetary and fiscal policy affect the business cycle, economists use macroeconomic models in which prices (and wages) are sticky. This means that prices and wages are slow to react to changing market conditions or changes in macroeconomic policy. We first explain why prices are sticky in practice. Then the short-run macroeconomic implications of sticky prices are analyzed using a model that captures the interactions among markets under various business cycle conditions. Special attention is given to the exchange rate and the role of international capital flows. Finally, we look at the implications of sticky prices for the behavior of unemployment and inflation (the Phillips curve).
- **Macroeconomic policy.** The final part of the course discusses the main goals and strategies of macroeconomic policy. We first look at the role of the central bank to promote monetary stability. Many central banks (including the Central Bank of Norway) have turned to inflation targeting as a new framework of monetary policy. By setting the interest rate such that low inflation is promoted, the central bank also contributes to a stabilization of aggregate demand and the business cycle. Next, we discuss the institutions of fiscal policy and the effects of fiscal deficits and surpluses on the business cycle and long-run economic growth. Finally, we address international economic policy issues in a historical perspective.

Computer-based tools

Blackboard

Course structure

Lectures (36 hours)

Evaluation

Written exam (3 hours)

Evaluation code(s)

GRA 66341

Aids at the examination

Calculator

Makeup exam

Next ordinary exam