

# Applied Macroeconomics

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## • Course Description

This course will cover the basic topics in Macroeconomics. For each topic we will illustrate the basic theory, in order to provide the framework and the analytical tools necessary to understand the behaviour of the relevant empirical questions. We will then discuss to what extent the theory is successful in explaining the behaviour of aggregate economic variables. In particular, we will focus on the unsolved empirical puzzles and on the recent studies that attempt to solve them.

All students attending the courses are required to do a 40 minutes presentation (possibly in groups, depending on the attendance) where they illustrate the method employed and the results obtained by an applied macro paper. They will be allowed to choose this paper from a reading list which will be provided before the beginning of the course, but also they are encouraged to make their own suggestions outside this list.

## • Grading

Grades will be based on a final exam (60%), on a marked homework (10%), and on the class presentation and the class participation in general (30%).

## • Textbooks

The basic reading for this course is:

- – Romer, D. (2001), *Advanced Macroeconomics*, Second edition, McGraw-Hill.

Other economics textbooks that are useful for specific topics:

- – Blanchard, O. and Fisher, S.: "Lectures in Macroeconomics", MIT Press, 1989
- Barro, R.J. and Sala-i-Martin, X., *Economic Growth*, McGraw Hill, 1995
- Deaton, A.: "Understanding Consumption", Clarendon Press, 1992

A more advanced textbook, for those interested:

- – Ljungqvist, L. and Sargent, T.J., *Recursive Macroeconomic Theory*, MIT Press, 2000

# Syllabus

This is the list of topics. The list of readings is still incomplete. Some new readings will be added, and compulsory readings will be indicated with an asterisk (\*).

## 1 Growth and Development

The Solow Growth Model. The Ramsey Model. Growth and convergence. Economic development and income inequality.

### Readings

- Romer, 5-71
- Acemoglu, D., S. Johnson and J. Robinson (2001), "The colonial origins of comparative development: an empirical investigation," *American Economic Review*, 91, 5, 1369-1401.
- Barro, R.J. and X. Sala-i-Martin, 1992, "Convergence", *Journal of Political Economy*, 100, 223-251
- Easterly, W. and R. Levine (2003), "Tropics, germs and crops: how endowments influence economic development," *Journal of Monetary Economics*, 50.
- Frankel, J. and D. Romer (1999), "Does trade cause growth?," *American Economic Review*, 89, 3, 379-399.
- Hall, R. and C. Jones (1999), "Why do some countries produce so much more output per worker than others?," *Quarterly Journal of Economics*, 114, 83-116.
- Mankiw, G., Romer, D. and D. Weil (1992), "A contribution to the empirics of economic growth," *Quarterly Journal of Economics*, CVII, 407-437.
- Quah, D. (1993), "Galton's fallacy and test of the convergence hypothesis," *Scandinavian Journal of Economics*, 95, 4, 427-433.
- Quah, D. (1996), "Empirics for growth and distribution: stratification, polarization and convergence groups," *Journal of Economic Growth*, 2, 27-59.
- Quah, D.T., 1996, "Growth and Convergence in Models of Distribution Dynamics", *Economic Journal*, 106, 1045-1055
- Romer, P.M., 1990, "Endogenous Technological Change", *Journal of Political Economy*, 98, S71-S102 (S means part 2)
- Sala-i-Martin, X., 2004, "The World Distribution of Income: Falling Poverty and... Convergence, Period!"

## 2 Consumption

Optimal Consumption Under Uncertainty. The permanent income hypothesis. Consumption and asset pricing. Explaining aggregate consumption: liquidity constraints or precautionary saving?

### Readings

- Romer, chapter 7
- Deaton, chapters 1,2 and 3
- Mehra, R. and E.C. Prescott, 1985, "The Equity Premium, a Puzzle", *Journal of Monetary Economics*, Vol 15, 145-161.
- Hall, R.E., 1978, "Stochastic Implications of the Life Cycle-Permanent Income Hypothesis: Theory and Evidence", *Journal of Political Economy*, 1978, 86, 971-987
- Chang-Tai, H. (2003), "Do consumers react to anticipated income changes? Evidence from the Alaska permanent fund," *American Economic Review*, 397-405.
- Gross, D. and N. Souleles (2002), "Do liquidity constraints and interest rates matter for consumers behavior? Evidence from credit card data," *Quarterly Journal of Economics*, 149-185.
- Carroll, C. (1992), "The buffer-stock theory of savings: some macroeconomic evidence," *Brookings Papers on Economic Activity*, 1992:2, 61-165.
- Carroll, Christopher D. (2001), "A Theory of the Consumption Function, With and Without Liquidity Constraints", *Journal of Economic Perspectives*, 15(3), 23-46,
- Carroll, Christopher D., Karen E. Dynan, and Spencer S. Krane (2003), "Unemployment Risk and Precautionary Wealth": Evidence from Households Balance Sheets, *Review of Economics and Statistics*, 85(3)

### 3 Investment

Neoclassical Investment Theory. The q theory. Non-convex adjustment costs and capital markets imperfections: implications for aggregate investment fluctuations.

#### Readings

- Romer, 345-351
- Blanchard and Fisher, 291-301
- Caballero, R., (1999), "Aggregate Investment", Handbook of Macroeconomics.
- Caballero, R., Engel, E. and J. Haltiwanger (1995), "Plant level adjustment and aggregate investment dynamics," Brookings Papers on Economic Activity, 1995:2, 1-39
- SA Barnett, P Sakellaris, 1998, Non-linear response of firm investment to Q: testing a model of convex and non-convex adjustment costs, Journal of Monetary Economics.

### 4 Business Cycles

Classical and Keynesian models. Sources of economic fluctuations: RBC versus New Keynesian models. Consumption with heterogenous households and investment with heterogenous firm: implications for aggregate fluctuations.

#### Readings

- Romer, Chapters 4 and 5
- Blanchard and Fisher, Chapters 10.4-10.5
- Hansen, G.D., 1985, "Indivisible Labor and the Business Cycle", *Journal of Monetary Economics*, vol 16, 309-327.
- Hansen, G.D. And R. Wright, "The Labour Market in Real Business Cycle Theory", Federal Reserve Bank of Philadelphia Quarterly Review.
- Hodrick, R. and E. Prescott (1997), "Postwar US business cycles: an empirical investigation," *Journal of Money, Credit and Banking*, 29,1, 1-16.
- R. King, Plosser, Stock, J. and M. Watson (1991), "Stochastic trends and economic fluctuations," *American Economic Review*, 81, 819-840.
- Stock, J. and M. Watson (1988), "Variable trends in economic time series," *Journal of Economic Perspectives*, 147-174.
- Requiem for the Representative Consumer? Aggregate Implications of Microeconomic Consumption Behavior, Carroll, Christopher D. (2000), *American Economic Review, Papers and Proceedings*, 90(2), 110-115.