



AMBROSE
UNIVERSITY COLLEGE

FACULTY OF
ARTS & SCIENCE

ECO 203 – Intermediate Macroeconomics (3 cr) Winter 2008

Class Schedule:

Mondays 4:00 PM – 6:30 PM
Class Location: Room 2141

Instructor Information:

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Course Description:

Building on the basic principles covered in ECO 101, this course explores the national economy in terms of the determination of national output, the general price level, the rate of interest, and employment. This course also analyzes the effectiveness of fiscal and monetary policies in achieving their stated goals.

Course Objectives:

This course has been designed to provide students with a preliminary background for intermediate level macroeconomics related questions concerning any economy. The purpose of the course is to learn the macroeconomics concepts and theories covered in the Principles of Macroeconomics with a more detailed approach. The subject matter of the course is intended to help students understand several applications of theoretical concepts using real life data with special emphasis on Canadian macroeconomic numerical indicators. The focus of this course is on detailed analysis of the concepts related to National Income, GDP measurement, Money and Inflation, Unemployment theories, Open Economy Macroeconomics, Keynesian and Classical macroeconomic models with policies at an intermediate level.

Required Textbook:

Macroeconomics, 2nd Edition, Dornbusch, Fischer, Startz, Atkins, Sparks; McGraw-Hill Ryerson, 2005.

Students are also expected to utilize the various features of the text website:
www.mcgrawhill.ca/college/dornbusch

Course Requirements:

This course will be presented using a variety of methods including lectures, application problems and discussions. Students are expected to be familiar with the basic concept of economics particularly the Principles of Macroeconomics). It is also expected that the students have understanding of the use of internet and desktop applications i.e. Microsoft Office suit. Students of economics should be lovers of graphs and graphical analysis. This course will make extensive use of graphical analysis. A term project

will be required to be presented in groups towards the end of the semester. The topics will be purely application issues. Details on the project requirements will be provided later.

The quizzes, assignments, tests and final exam will be designed to test the conceptual understanding and procedural application of the material covered during the course. The following is a summary of all evaluation methods and relative weights for the course:

Evaluation Method	Weight
Quiz #1	10%
Quiz #2	10%
Assignments #1	10%
Assignments #2	10%
Test	10%
Term project	20%
Final exam	30%

Examinations:

Final examinations are held during a scheduled time at the end of the semester for regular semester classes and are scheduled by the Registrar. Graded final examinations will be available for supervised review at the request of the student.

Grading Scale:

The available letters for course grades are as follows:

<u>% Grade</u>	<u>Letter Grade</u>	<u>Description</u>
95% to 100%	A+	
90% to 94%	A	Excellent
85% to 89%	A-	
80% to 84%	B+	
76% to 79%	B	Good
72% to 75%	B-	
68% to 71%	C+	
64% to 67%	C	Satisfactory
60% to 63%	C-	
55% to 59%	D+	
50% to 54%	D	Minimal Pass
0% to 49%	F	Failure

Other Information:

Students, who are unable to write a quiz or test, will have its weighting added to that of the final exam, provided they have a valid reason supported with proper documentation; otherwise, they will receive a mark of zero.

It is the responsibility of all students to become familiar with and adhere to the academic policies as stated in the current Student Handbook and Academic Calendar. In particular, students are to note academic regulation #34 - Academic Dishonesty.

COURSE OUTLINE & SCHEDULE

Intermediate Macroeconomics

INTRODUCTION

- Introduction to macroeconomics
- How Economists Think: Markets, Models and Time Frames
 - Flexible and Sticky Prices
 - Market Clearing, Non -Market Clearing and Time
- The Data that Our Models are Trying to Explain
 - Gross Domestic Product
 - The Price Level and the Inflation Rate
 - Money and Interest Rates
 - The Unemployment Rate
 - The International Economy
- What's Next

MEASURING THE PERFORMANCE OF THE CANADIAN ECONOMY

- Measuring Gross Domestic Product
 - Measuring Supply: Factor Payments Approach
 - Measuring Demand: Components of Spending
- Allocation of Income and Savings
- Real and Nominal GDP and Inflation
 - Price Indexes and Inflation
- Inflation and Real and Nominal Interest Rates
- The Unemployed and the Unemployment Rate
 - Measuring the Unemployment Rate
 - The Relationship between Unemployment and GDP: Okun's Law

THE ECONOMY IN THE LONG RUN: THE CLASSICAL MARKET CLEARING MODEL

- The Supply of Goods and Services: The Production Function and the Labour Market
 - The General Form of the Production Function
 - The Production Function in the Long Run: Fixed Capital and Technology
 - The Marginal Product of Labour and Labour Demand
 - The Supply of Labour
 - Equilibrium on the Labour Market
 - The Classical Aggregate Supply Curve
- The Demand for Goods and Services
 - Consumption and Savings
 - Investment
 - Government and Net Export Spending
 - The Effects of Fiscal Policy Since the Mid-1970s
- The Money Stock, the Price Level and the Inflation Rate
 - Money
 - Money Growth and Inflation
 - The Quantity Theory of Money in Canada
 - The Real Interest Rate in the Long Run

THE ECONOMY IN THE VERY LONG RUN: THE ECONOMICS OF GROWTH

- Growth Accounting

- Growth Theory: the Neo-Classical Model
 - Steady State Equilibrium
 - The Growth Process
 - An Increase in the Savings Rate
 - Population Growth
 - The Golden Rule Steady State
 - Growth With Exogenous Technological Change
 - Endogenous Growth
 - Convergence
 - Reform and Growth in Eastern Europe
 - The Truly Poor Countries
 - Natural Resources: Limits to Growth?
- Growth Policy
 - Different Forms of Capital
 - Technological Innovation

INTERNATIONAL TRADE AND EXCHANGE RATES

- The Balance of Payments Accounts
 - Current Account
 - Capital and Financial Account
- Savings and Investment in a Small Open Economy
 - The Role of the World Real Rate of Interest
 - Fiscal Policy and the Twin Deficits
- Exchange Rates
 - Exchange Rate Determination
 - Exchange Market Intervention
 - The Evolution of the Canadian Exchange Rate
 - Alternative Measures of the Exchange Rate
- The Exchange Rate in the Long Run: Purchasing Power Parity

BUSINESS CYCLES AND THE AGGREGATE DEMAND-AGGREGATE SUPPLY MODEL

- Business Cycles
- Introduction to Aggregate Demand and Aggregate Supply
 - Aggregate Demand
 - Aggregate Supply
- Aggregate Demand and Aggregate Supply Under Alternative Policy Assumptions
 - The Keynesian Case
 - The Classical Case

WAGE AND PRICE ADJUSTMENT: THE PHILLIPS CURVE AND AGGREGATE SUPPLY

- The Phillips Curve
 - The Phillips Curve
 - The Role of Expectations
 - Does the Augmented Phillips Curve Fit the Data?
- From Phillips Curve to Aggregate Supply
 - Short Run Aggregate Supply Derived From the Phillips Curve
 - Short Run Aggregate Supply Derived From the Classical Model
 - Adjustment under the Static Expectations Assumption

Adjustment under Rational Expectations

THE ANATOMY OF INFLATION AND UNEMPLOYMENT

- The Anatomy of Unemployment
 - The Unemployment Pool
 - Variation in Unemployment across Groups
 - Cyclical and Frictional Unemployment
- Full Employment
 - Determinants of the Natural Rate
 - Estimates of the Natural Rate of Unemployment
 - Hysteresis and the Rising Natural Rate of Unemployment
 - Reducing the Natural Rate of Unemployment
 - Employment Insurance
- The Costs of Unemployment
 - Costs of Cyclical Unemployment
 - Distribution Impact of Unemployment
 - Other Costs and Benefits
- The Costs of Inflation
 - Perfectly Anticipated Inflation
 - Imperfectly Anticipated Inflation
- Inflation and Indexation: Inflation-Proofing the Economy
 - Inflation and Interest Rates
 - Indexation of Wages
 - Why Not Index?

INTERNATIONAL ADJUSTMENT: AGGREGATE DEMAND AND SUPPLY IN AN OPEN ECONOMY

- Aggregate Demand, Aggregate Supply and Net Exports
 - External Equilibrium
 - The Effects of Expansionary Monetary Policy
 - Do Net Exports respond to Changes in the Real Exchange Rate?
- The Monetary Approach to the Balance of Payments
 - Sterilization
 - The Monetary Approach and the IMF
 - The Monetary Approach and Depreciation
- Exchange Rate Fluctuations and Interdependence
 - Interdependence
 - Policy Coordination

INCOME AND SPENDING

- Aggregate Demand and Equilibrium Income
- The Consumption Function
- The Consumption Function and Aggregate Demand
- Equilibrium Income
- The Multiplier
- Fiscal Policy in the Very Short Run
 - Automatic and Discretionary Fiscal Policy
- The Government Budget in the Very Short Run
 - Effects of Government Purchases and Tax Changes on the Budget Surplus

- The Full Employment Budget Surplus
- The Foreign Sector

MONEY, INTEREST, AND INCOME

- The Goods Market and the IS Curve
- Investment and the Interest Rate
- The Slope of the IS Curve
- The Role of the Multiplier
- The Position of the IS Curve
- A Summary of the IS Curve
- The Money Market and the LM Curve
- The Demand for Money
- The Supply of Money, Money Market Equilibrium and the LM Curve
- The Slope of the LM Curve
- Shifts in the LM Curve
- A Summary of the LM Curve
- Equilibrium in the Goods and Money Markets
- Changes in the Equilibrium Income and Interest Rate: A First Look at Policy
- Deriving the Aggregate Demand Curve

MONETARY AND FISCAL POLICY IN THE VERY SHORT RUN

- Monetary Policy
- Is There a Situation Where Monetary Policy Cannot Lower Interest Rates?
The Case of the Liquidity Trap
- Can the LM Curve Be Vertical? Classical Economics Again
- Fiscal Policy and Crowding Out
- An Increase in Government Spending
- Crowding Out
- Is Crowding Out Important?
- Monetary Policy and the Interest Rate Rule
- Money Supply Rule and Interest Rate Rule:
When Would Policymakers Choose one over the Other?
- Goods Market Shocks Only
- Money Market Shocks Only

CAPITAL MOBILITY AND THE EXCHANGE RATE IN THE IS-LM MODEL

- Capital Mobility and Interest Parity
- Capital Flows and Interest Parity
- The Mundell-Fleming Model With Flexible Exchange Rates
- A Change in the Foreign Price Level
- Fiscal Policy
- Monetary Policy
- Beggar Thy Neighbor and Competitive Depreciation
- Perfect Capital Mobility and Fixed Exchange Rates
- Fiscal Policy With a Fixed Exchange Rate
- The Endogenous Money Stock
- Interest Differentials and Exchange Rate Expectations

- Exchange Rate Expectations
- Speculative Capital Flows

CONSUMPTION AND SAVING

- The Keynesian Consumption Function
- Consumption, Savings, and the Real Interest Rate: Intertemporal Choice
 - Maximizing Utility: Indifference Curves
 - The Budget Constraint
 - Equilibrium: Utility Maximization Subject to the Budget Constraint
 - Consumption and Changes in Income
 - Consumption, Savings and the Real Interest Rate
- The Life-Cycle-Permanent Income Theory of Consumption and Saving
 - Life Cycle Theory
 - Permanent Income Theory
- Consumption Under Uncertainty: The Modern Approach
 - The LC-PIH: The Traditional Model Strikes Back
 - Liquidity Constraints and Myopia
 - Uncertainty and Buffer Stock Saving

INVESTMENT SPENDING

- The Stock Demand for Capital and the Flow of Investment
 - The Desired Capital Stock: an Overview
 - Expected Output
 - Taxes and the Rental Cost of Capital
 - The Effects of Fiscal and Monetary Policy on the Desired Capital Stock
 - The Stock Market and the Cost of Capital
 - The q Theory of Investment
 - From Desired Capital Stock to Investment
 - Capital Stock Adjustment
- Investment Subsectors – Business Fixed, Residential and Inventory
 - Business Fixed Investment
 - The Timing of Investment
 - Irreversibility and the Timing of Investment Decisions
 - Residential Investment
 - Monetary Policy and Residential Construction
 - Inventory Investment
 - The Accelerator Model
 - Anticipated versus Unanticipated Inventory Investment
 - Inventories in the Business Cycle
 - Just in Time Inventory Management
- Investment and Aggregate Supply
 - Investment Around the World

THE DEMAND FOR MONEY

- The Components of the Money Stock

- Financial Innovation
- The Functions of Money
- The Demand for Money: Theory
 - Transactions Demand
 - The Precautionary Motive
 - The Speculative Demand for Money
 - Empirical Results for M2 Demand
- The Income Velocity of Money

POLICY

- Lags in the Effects of Policy
 - The Recognition Lag
 - The Decision and Action Lags
 - Automatic Stabilizers
 - The Outside Lag
 - Monetary versus Fiscal Policy Lags
- Expectations and Reactions
 - Reaction Uncertainties
 - Changes in Policy Regime
 - Econometric Policy Evaluation Critique
- Uncertainty and Economic Policy
 - The Policy Portfolio Under Uncertainty
- Dynamic Policy and Information Feedback
 - Targets, Instruments and Indicators: A Taxonomy
- Activist Policy
 - Rules versus Discretion
- Dynamic Inconsistency and Rules versus Discretion

THE MONEY SUPPLY AND MONETARY POLICY

- How is the Money Supply Determined?
 - Open Market Operations
 - The Money Supply and the Monetary Base
 - Bank Lending and the Money Supply
 - The Money Multiplier
 - The Value of the Multiplier
- Short Run Control of the Money Supply
 - Policy Implementation With Minimum Required Reserve Ratios
 - The Zero Reserve Requirement
 - Government Deposits and Settlement Balances
 - The Overnight Rate and the Transmission of Monetary Policy
- Targets and the Implementation of Monetary Policy
 - The Current Implementation of Monetary Policy

DEFICITS, DEBT, AND FISCAL POLICY

- Revenue, Expenditures and Deficits
- Revenues and Expenditures for All Levels of Government
- Federal Government Revenues and Expenditures
- Measuring the Federal Deficit
- The Burden of the Debt
- Debt, Growth and Instability
- Deficits and the Inflation Tax
- The Government's Budget Constraint
- The Bank of Canada's Dilemma
- The Canadian Evidence
- The Inflation Tax
- Inflation Tax Revenue
- Intergenerational Accounting
- The Size of Government Debate
- The Barro-Ricardo Problem
- The Canada Pension Plan
- CPP/QPP as Intergenerational Transfer
- Social Security and Economic Efficiency

STUDY TIPS FOR IMPROVING YOUR GRADE

- a. Write out answers to Review Questions
- b. Study groups
- c. Study each week, rather than cram at the end
- d. Highlight notes, and reduce to cards important concepts
- e. Review previous days' class note before the next class
- f. Copies of old tests in Library, use as practice tests