ECONOMIC POLICY

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Course Material Developed by Department of Economics,

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Syllabus

The course is a detailed account of the goals, tools and working mechanisms of the classical macoroeconomic policies, the monetary and the fiscal policy. The main goal of the course is, that students, who familiarized themselves with the basic modern macroeconomic models in previous courses, would be able to apply those strutures to analyze the most important macroeconomic policy problems raised by the cyclical nature of the modern exchange economy.
The basic keynesian, new-keynesian and flexible price inflation models are expended with new features that cover the specifics of the different policy questions.

We emphasize economic dynamics and forward looking expectations in particular. The assigned literature covers empirical estimates and helps students get practice in handling economic data in general. Case studies from recent macroeconomic history of selected countries are used to illustrate the workings and the predictive power of the models covered in the course.

The majority of the issues we discuss are monetary, they describe the influence of money and monetary policy on other macoeconomic variables. We connect them to the monetary policy regimes, contemporary developed and developing countries operate. Fixed price (keynesian) staggered price (new-keynesian) and flexible price (seigniorage) models are also covered.

As for fiscal policy we try and identify the specific features and adjusment channels, that determine the size of the reaction of output to a fiscal policy shock, the multiplier. Estimates on those reactions vary wildly, students will have elaborate knowledge about the difficulties how to estimate those indicators properly.

Student are signed specific topics, whose literature they are to cover individually and present their experience in front of the class. Guest lecturers are also to be invited to cover the specifics of the Hungarian economic policy.

Topics and reading assignments by weeks:

Week 1

Introduction. What have we learned on macroeconomic models in previous courses? Descriptive and normative (policy) aspects of macroeconomic models.

Literature:

- Mandatory:
- Mankiw (1989): Real Business Cycles: A New Keynesian Perspective**,** The Journal of Economic Perspectives, Vol. 3, No. 3
- Mankiw (2006):The Macroeconomist as Scientist and Engineer, The Journal of Economic Perspectives, Vol. 20, No. 4
- Suggested:
- Horváth Áron – Szilágyi Katalin: Konszenzusból nyugvópontra: elmélettörténeti áttekintés a makroökonómia viharos évtizedeiről, Külgazdaság 2004/11.
- Repetition:
- Williamson: Macroeconomics (any edition), Ch. 9–10.
- Krugman–Obstfeld: International Economics, Part 3. Any edition.

Week 2

Fixed price models. Flexible prices, hyperinflation and seigniorage models. The role of forward looking expectations and the credibility of policy.

Literature:

- Mankiw: Macroeconomics, any edition. Chapters covering aggregate demand and aggregate supply.
- Görömbey–Pete (1998): Makromodellek, egyetemi jegyzet, Debrecen
- Sargent (1992): Rational expectations and inflation, Chapter 3. Pearson 1992.

Week 3

Variants of inflation and seigniorage models by Sargent and Wallace. Dynamic relationship between the fiscal and the monetary policies.

Literature:

- Görömbey–Pete (1998): Makromodellek, egyetemi jegyzet, Debrecen
- Sargent. and Wallace. (198I). 'Some unpleasant monetarist arithmetic.' Federal Reserve Bank of Minneapolis Quuarterly Review, Vol. 5 (Fall), pp. I–I7.

Week 4

Presentations

Inflation and inflation expectations

Week 5

Sticky prices. Neoclassical synthesis. Interaction between nominal and real macroeconomic variables. The Philips curve. Monetary policy in the eighties.

Literature:

- Benjamin M. Friedman (1988): Lessons on Monetary Policy from the 1980s,The Journal of Economic Perspectives, Vol. 2, No. 3
- Marvin Goodfriend (2007): How the World Achieved Consensus on Monetary Policy, The Journal of Economic Perspectives, Vol. 21, No. 4

Week 6

The new-keynesian model. Basic features. Market structure, demand and supply. Calvo pricing. New-keynesian Philips curve. Log-linearization.

Literature:

- David Romer (1993): The New Keynesian Synthesis, The Journal of Economic Perspectives, Vol. 7, No. 1
- Clarida–Gali–Gertler (1999): The Science of Monetary Policy: A New Keynesian Perspective, Journal of Economic Literature, 1999. December

Week 7

Operation of the new-keynesian model. Responses to supply and to demand shocks. Interest rate policy, Taylor rule. Transparency and credibility

Literature:

- Gali–Gertler (2007): Macroeconomic Modeling for Monetary Policy Evaluation, The Journal of Economic Perspectives, Vol. 21, No. 4
- Bernanke–Mishkin (1997): Inflation Targeting: A New Framework for Monetary Policy? The Journal of Economic Perspectives, Vol. 11, No. 2

Week 8

Programming excercise. The impulse response functions of the new-keynesian model.

Week 9

The problem with the zero bound of interest. Liquidity trap. Nominal anchors. Case study: deflation in Japan.

Literature:

- Ozsvald–Pete: A japán gazdasági válság – likviditási csapda az új évezredben? Közgazdasági Szemle, L. évf., 2003. július–augusztus
- Hoshi–Kashyap (2004): Japan's Financial Crisis and Economic Stagnation, The Journal of Economic Perspectives, Vol. 18, No. 1

Week 10

Presentations:

Liquidity trap,

Exchange rate based stabilization.

The problem of the exchange rate choice.

Week 11

A framework for fiscal policy. Potential channels in between the budget and the macroeconomic variables. Estimates for fiscal multipliers. Empirical difficulties, endogenity and the ways to handle it.

Literature:

- Ilzetzki–Mendoza–Végh (2010): How big (small) are fiscal multipliers? NBER Working Paper 2010 október
- Alesina–Ardagna (Large changes in fiscal policy: Taxes versus spending, NBER Working Paper 2009 október
- Barro on fiscal stimulus
- http://online.wsj.com/article/SB123258618204604599.html
- Mankiw: Crisis Economics
- http://nationalaffairs.com/publications/detail/crisis-economics

Week 12

Fiscal policy, dynamics and forward looking expectations. The role and the empirical relevance of Ricardian equivalence. A dynamic IS-LM model.

Literature:

- Görömbey–Pete (1998): Makromodellek, egyetemi jegyzet, Debrecen
- Robert J. Barro (1989): The Ricardian Approach to Budget Deficits, The Journal of Economic Perspectives, Vol. 3, No. 2
- Douglas Bernheim (1989): A Neoclassical Perspective on Budget Deficits, The Journal of Economic Perspectives, Vol. 3, No. 2

Week 13

Fiscal policy, the workings of the dynamic IS-LM model. The difference between an announced, and an unannounced fiscal stimulus. Budget restrictions with expansionary effects.

Literature:

- Alesina–Perotti (1997): Fiscal Adjustments in OECD Countries: Composition and Macroeconomic Effects, Staff Papers – International Monetary Fund, Vol. 44, No. 2
- Giavazzi–Pagano (1995): Non-keynesian effects of fiscal policí changes, NBER Working Paper
- Vincent Hogan (2004): Expansionary Fiscal Contractions? Evidence from Panel Data, The Scandinavian Journal of Economics, Vol. 106, No. 4