Course Description

This course will deal with contemporary problems in macroeconomic policy. Drawing upon cutting-edge research in macroeconomic theory, we will discuss (1) welfare states and European unemployment, (2) reforming social security, (3) monetary and fiscal causes of inflation, (4) credibility and macroeconomic policy, (5) financial crises and government bailouts, and (6) optimal taxation of labor and capital.

We will study explanations to the outbreak of persistently higher European unemployment since the 1980s, and confront the puzzling fact that the welfare states of Europe had much lower unemployment rates than the United States in the 1950s until the early 1970s.

Social security it is a ticking time bomb that is financially unsustainable in many countries with aging populations such as the United States, Germany and Japan. Besides the solvency issue, we will study how the common practice of financing social security on a pay-as-you-go basis inflicts large efficiency losses on an economy and how the system can be reformed.

Fiscal policy in a wider meaning has implications for what constitutes feasible monetary policies. We will study classic principles for coordinating monetary and fiscal policies, and use dramatic historical episodes of hyperinflations to shed light on monetary and fiscal dilemmas facing many developing countries today.

Credibility and reputation are two related concepts that are of great importance in macroeconomic policy making. The theory will help us to understand the policy options facing the Federal Reserve Open Market Committee (FOMC) in the United States and the adverse dynamics that have lead to countries such as Argentina into currency and debt crises.

Banking crises can threaten the stability of payment systems and have often proven to be costly to taxpayers. We will study what is the proper role for governments in avoiding such crises and what are the effects of government bailouts.

Taxation is a contentious political issue. Using modern macroeconomic theory we will study what constitutes an optimal tax policy.
Prerequisites
A prior course in macroeconomics or microeconomics is recommended but it is not required. Concerning the level of challenge that this course offers, see the discussion below under “Background and philosophy of the course.”

Contact Information
Professor Ljungqvist is the primary contact for the course. He can be contacted via email at: lars.ljungqvist@stern.nyu.edu. Professor Sargent can be contacted at thomas.sargent@nyu.edu. Additional contact information will be given in class.

Course Materials
The course materials include:

1. a course packet of readings,
2. links to electronic downloads for free or from NYU libraries,
3. lecture slides that will be posted on Stern’s course management system one day after class,
4. Central Banking in Theory and Practice, by Alan S. Blinder (1998), Cambridge, MIT Press. (Professor Blinder is a former Vice-Chairman of the Board of Governors of the Federal Reserve Board.)

(1) and (4) will be available in the bookstore.

Grading and classroom participation
The final grade is based on the highest of two alternative calculations:

1. group problem sets (15%), mid-term exam (35%) and final exam (50%);
2. group problem sets (15%) and final exam (85%).

Both the mid-term and the final exam are compulsory. A student may under exceptional circumstances be excused from taking the mid-term exam, but everyone must take the final exam that will be given in the last class of the course. There will be no make-up exams. Classroom participation will be used to separate those on the borderline between letter grades.

Classroom interaction is vital for the learning experience in this course, so attendance is obligatory. Advance notification is required when family or professional reasons necessitate an absence. A student who is absent will be assigned a take-home exercise that is due one week after the missed class.

Honor Code
The Stern community believes that honesty and integrity are necessary for rewarding academic and professional experiences. These qualities form the basis for the strong trust among members
of the academic community (students, faculty, and administrators) that is essential for excellence in education. The Honor Code requires that each student act with integrity in all academic activities and endeavor to hold his or her peers to the same standard.

**Background and Philosophy of the Course**

This course was developed in cooperation with Professor Thomas Sargent. Professor Sargent is one of the world’s leading macroeconomists and is intimately associated with the “rational expectations revolution” in macroeconomics. He was awarded Sveriges Riksbank Prize in the memory of Alfred Nobel in 2011. He will share some of his many contributions and insights as a guest lecturer in the course.

We have offered this course in the business schools at Stanford University, the University of Chicago and several years here at Stern. Our concept of using cutting-edge research in macroeconomics to address contemporary problems in macroeconomic policy has been met with great enthusiasm from the participants.

It is helpful to have taken an earlier course in intermediate macroeconomics, but even then participants will find that modern macroeconomics is quite different from what is commonly taught at the undergraduate level. The following questions and average responses from the Chicago MBAs illustrate this point (where the scale is from 1 to 5):

- How much prior exposure did you have to the material in this course? 2.86
- Given the objectives of this course, did the course challenge you? 4.50

The course material is challenging but relies primarily on clear logical reasoning rather than mathematics. Mathematical arguments are kept to a minimum.

The philosophy of the course is to gain an understanding of central results in modern macroeconomics, and to acquire the insight and skills needed to apply that logical way of reasoning to important macroeconomic issues, not only to those discussed in the course.

One participant in Chicago captured the philosophy of the course quite well in his/her remark on the evaluation form:

> “Step-by-step and logical approach to discuss complex problems. Very rigorous and at the same time very practical. Makes you think in a different way.”

But in all fairness, behind the high average marks in the course evaluation there were a few dissenters. One of them offered the following comment:

> “Unfortunately, I thought that the course was too academic and abstract most times. As a worker who provides advice to clients, the language taught in this course does not do me or my clients any good.”

While we agree with the challenge that this course poses, we also believe that a thorough understanding of macroeconomics is of vital importance in the business world of today, and particularly important to people who work in financial markets. This course is designed to give you that understanding.