Economics 120: Principles of Macroeconomics
Spring 2009, Sections 03 and 04 [REVISED*]

Professor: Jon Bakija
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Classroom: Clark 105
Section 03: 1:10-2:25PM Mon., Thu.
Section 04: 2:35-3:50PM Mon., Thu.

Office hours:
Tuesdays, 1:30-4:00,
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Course description

Economics 120 introduces you to the world of macroeconomics—the study of the economy at the national and international levels. There could not be a better time to take this course. The extraordinary stresses in the U.S. housing and financial markets have spilled over to the global economy, affecting worldwide trade, employment, production, and asset prices. In this class we will explore the origins of the current crisis and develop the tools required to evaluate the recovery proposals put forth by the new Obama administration, Congress, and the Federal Reserve Board. But understanding the crisis is just one facet of the course. In addition, we will investigate the determinants of long-run economic growth, the solvency of entitlement programs such as Social Security and Medicare, international movements in financial assets and traded goods, and the tradeoffs involved in maintaining low rates of unemployment and inflation.

The course begins by introducing basic concepts such as gross domestic product and inflation that are useful for measuring what is happening in the economy, and which are necessary for understanding the issues addressed in the rest of the course. We next address the question of how economic growth, globalization, and technological change affect the well-being of different types of people, and consider possible explanations for dramatic changes in income inequality that have occurred over time in the U.S. and other nations and what it might imply for public policy. We then move on to some of the most important questions in economics: Why are some countries rich and other countries poor? Why do some countries, such as China and India, grow fast, while others, such as Zimbabwe, grow slowly? Are there policy measures countries can take to increase standards of living? In attempting to understand the determinants of economic growth, we will analyze the importance of legal and financial institutions, colonial origins, geography, saving and investment decisions, government policies, education, and knowledge externalities. We will also take a look at the long-run growth prospects of the U.S. and see how they are affected by taxes, rising budget deficits, and the future costs of Social Security and Medicare.

The next part of the course examines financial markets and their role in the current economic crisis. We will learn how to value stocks, bonds, and real estate. In addition, we will study how the arcane world of mortgage-backed securities, collateralized debt obligations, and credit default swaps have played a central role in freezing global credit markets and converting a broad decline in U.S. housing prices into a global financial crisis.

We will conclude by turning to the short-run economy and will focus on the temporary fluctuations in output and unemployment that compose the business cycle. Here we will develop the tools necessary to understand what governments can do to prevent recessions or at least mitigate their severity. Central to this is the role of the Federal Reserve Board and its rapidly expanding sphere of economic activities. The semester wraps up with a close look at the current and developing financial crisis and what can be done to limit its impact.

Prerequisites

Econ 120 requires that you have taken the equivalent of Economics 110 (Principles of Microeconomics). If you do not have this background, please see me IMMEDIATELY.

* Note: this version of the syllabus was revised at the end of the semester to reflect what we actually did.
Course Materials

The textbook:
The textbook for this course is *Principles of Macroeconomics* by Robert Frank and Ben Bernanke, 4th Edition (McGraw-Hill, 2009) which is available at Water Street Books. Earlier editions of the textbook are imperfect substitutes for the 4th edition, but should be OK if necessary. You should be aware that the numbering of chapters and pages is significantly different in earlier editions. The textbook reading assignments listed on the syllabus are from the 4th edition, but I’ve tried to indicate approximately the corresponding parts of the textbook from earlier editions.

Thanks to the college council, there are five copies of the current edition of the textbook for this course available on reserve at Sawyer Library. The reserve copies can be checked out by a student for four hours at a time.

Other readings:
All readings aside from the textbook will be made available on the class Blackboard web site. Readings for the first few classes will only be made available on Blackboard. Readings for later classes will be provided both on Blackboard and in printed course reading packets. Course packets will be made available in the Makepeace Room in Greylock Dining Hall some time early in the semester – I will let you know as soon as they are available. The readings in the course packets are pulled from various books, newspapers, periodicals, and academic journals. These should not be viewed as optional supplements to the textbook, but rather important and testable material that will inform lectures and our class discussions. While you are not responsible for every little detail in these readings, and are not expected to memorize authors’ names, you are accountable for understanding the general ideas, empirical evidence, and arguments.

Read the news
I also urge you to read a newspaper such as *The New York Times* or *Wall Street Journal* or a periodical such as *The Economist*. These often have excellent articles on issues relevant to what we are covering in class. Electronic editions of these are available for free through the Williams library web site.

Study guide and website for textbook
An optional study guide that goes along with the Frank and Bernanke textbook is also available at the bookstore. It provides a review of key concepts and numerous practice exercises that you may find useful, particularly in studying for tests. I will not assign questions out of the study guide – whether you buy it and use it is completely up to you. Additional learning resources are available at the textbook’s website: <http://www.mhhe.com/fb4e.com>

Course web page
There will be a course web page that can be accessed through the site <http://blackboard.williams.edu>. All course materials, including readings (aside from the textbook), handouts, homework, etc., will be posted there as they become available.

Course Requirements

Grades will be determined by the following formula:

- Problem sets: 10%
- Policy memos (2): 10%
- Class participation / attendance: 5%
- First midterm, evening of Tuesday March 10: 20%
- Second midterm, evening of Tuesday April 21: 20%
- Final exam: 35%
Problem sets: There will be approximately 7 to 10 problem sets. They are due at the beginning of the class indicated on the problem set. Late problem sets will not be accepted. This is necessary because I plan to make the answers available on Blackboard shortly after the class hands them in. I will drop the lowest score among your problem sets in the grade calculation, so that should take care of any legitimate excuses. Problem sets will be graded by your teaching assistant. Although problem sets count for only 10% of your grade, completing and understanding them will be crucial to your success on exams.

Policy memos
Policy memos are short (approximately 2 - 3 page) writing assignments designed to get you thinking critically about an economic policy issue, and to give you practice at concise analytical writing. You will be required to write two of them. We will then have a class discussion on the policy issue addressed in the memos on the day you hand in the memos. Detailed instructions for the policy memos will be distributed in an upcoming class. Each policy memo must be submitted electronically via the class Blackboard web site by a time and date that will be indicated in the policy memo instructions. Late policy memos will lose one grade step for each day or part of a day that they are late (for instance, an A- drops to a B+ if the paper is submitted after the deadline but within 24 hours, to a B if handed in 24-48 hours late, etc.).

Exams
There will be two midterms and a final exam in this class. The first one will be on Tuesday March 10th, and the second one will be on Tuesday April 21st. The midterms will take place in the evening, and you will have the choice of taking them from 6-7:45 PM or from 8-9:45 PM. Both midterm exams will take place in the Physics 203 classroom. Please let me know as soon as possible if you have a conflict with either of these evening exams. Our final exam will be scheduled some time during the regular final exam period at the end of the term. The exact time and date will be announced later in the course.

Class participation
Attendance is necessary (but not sufficient) for mastering the material in this course. Simply reading the textbook WILL NOT be enough. Midterms and the final exam will draw heavily on class discussions. At the same time, it is not enough just to come to class. I expect you to all participate constructively in class. This requires reading the assigned readings before coming to class, thinking about the material, and engaging in class discussions. This is worth 5% of your total grade, but low participation will likely affect how well you do on assignments and exams.

I understand that some absences are unavoidable, so up to two unexcused absences will not count against your class participation grade. If you have to miss more than that but have a legitimate excuse, please let me know. Students are strongly encouraged to ask questions and participate constructively in class discussions, but talking just for the sake of talking will not be rewarded. I will reserve the right to call on particular students in class to answer questions, in an effort to keep students actively engaged. I may also experiment in class with the use of “clickers,” which are a technology that enables students to answer questions electronically in class to test their own understanding or serve as a jumping-off point for class discussion. The technology would be provided for free by OIT. Your participation in the clicker experiments would count positively (but a small amount) towards your class participation grade – the contribution would depend mainly on your participation, not so much on whether you get the questions right. Should we undertake these experiments, I will provide further information on how they will work in an upcoming class.

Office hours
My office hours during the spring semester will be 1:30PM-4:00PM on Tuesdays. No appointments are necessary during office hours, you can just drop in. If you have a schedule conflict that prevents you from meeting with me during the regular office hours, you are of course welcome to make an appointment to meet with me at a different time, just e-mail me at jbakija@williams.edu, let me know a broad range of times when you’d be available to meet, and I’ll get back to you with a specific appointment time.
Honor code issues

Economics 120 involves three types of written graded material: tests, policy memos, and problem sets. All of the usual Williams honor code conditions apply. Particular issues with each type of assignment are highlighted below.

Tests:
(1) It is a violation of the honor code to look at another person’s test when taking an exam, to allow another person to look at your test during an exam, to ask another student for assistance with a test (or to give such assistance) during the test, or to bring notes or economics texts with you to a test.

(2) Sometimes you will be taking a particular test after other students have taken it. I view it as an equally serious violation of the honor code as the conduct described above in (1) to ask for, or to receive, any information regarding the content of a test prior to your taking it. This includes asking students in other sections of the course about their tests. Similarly, it is a violation of the honor code to offer or to give information regarding a test to another student who has not yet taken it.

Writing Assignments (policy memos)
Each policy memo is an opportunity for you to give your views on a particular policy issue. I encourage you to read what others have written on the subject and to discuss the issue with other students. However, each of you must write your own policy memo, and you must provide a citation in the text (and a complete source on your references page) for any and all sources of information or ideas. Try to avoid using too many direct quotations, but any words that are not entirely your own original writing must be enclosed in quotes as well as being accompanied by a citation. We use the Chicago author-date style of citation in economics.

Please review the online tutorial on the rules of citation, quotation, and paraphrasing available at: http://www.williams.edu/resources/acad_resources/survival_guide/CitingDoc/CitingContents.php
Guidelines for the Chicago author-date approach to citation are explained at: http://www.williams.edu/resources/acad_resources/survival_guide/CitingDoc/ChicagoAD1.php
Once you have reviewed these, please take the short quiz on these subjects posted at: http://www.williams.edu/resources/acad_resources/survival_guide/CitingDoc/QuizCh2.php

Further details will be included in the instructions for the policy memos, which will be distributed in an upcoming class.

Problem Sets
I encourage you to work together in small groups on your problem sets. However, two restrictions apply. First, I regard it as a violation of the honor code to simply copy the answers of other students without actively participating in the efforts to solve the problems. You must write up your own answer in your own words. Second, I regard it as a violation of the honor code to hand in as your own work answers that you have received during TA or review sessions. Finally, please list the names of other people you worked with at the end of the problem set.

Teaching assistants
The teaching assistant for section 03 is Liz Zhu lyz1@williams.edu, and the teaching assistant for section 04 is Zach Miller <Zachary.C.Miller@williams.edu>. They will grade your problem sets, and will offer review sessions almost every week, where you can get help with problem sets or anything else in the course.

Disabilities
Students with disabilities who may need disability-related classroom accommodations for this course are encouraged to set up an appointment to meet with me as soon as possible and to contact the Dean's Office at x4262 to better insure that accommodations are provided in a timely manner.
Course Outline
“F&B” is the Frank and Bernanke textbook. The rest of the readings will either be available in the course packet or posted on Blackboard in advance of the class. You will note that some of the readings and material have been marked “optional.” This means simply that you will not be tested on this information. But you should consider the optional readings as a strongly recommended resource for deepening your understanding of key economic concepts. My hope is that the economically curious among you will find these readings optional only in a nominal, or course-contractual, sense. Given that this course emphasizes current events in the economy (among other things), this reading list may be significantly revised during the semester.

Class 1: Wednesday, February 4
Measuring the size of the economy
• F&B Ch. 4: “Defining and Measuring GDP” (Ch. 5, pp. 115–137 in 3rd ed.; Ch. 5, pp. 109–130 in 2nd ed.; Ch. 6 in 1st ed.)

Class 2: Monday, February 9
Measuring the price level and inflation
• F&B Ch. 5: “Inflation and the Price Level” (Ch. 6 in the 2nd and 3rd eds.; Ch. 7 in 1st ed.)

Class 3: Thursday, February 12
Labor productivity, wages, and income inequality
• F&B Ch. 6: “Wages and Unemployment”, pp. 153-171 (First half of Ch. 8 in the 2nd and 3rd ed.; or of Ch. 9 in 1st ed.)

Class 4: Monday, February 16
Economic growth I: Introduction; Root causes of growth and development
• F&B Ch. 7 “Economic Growth” (Ch. 8 in 1st ed.)
Class 5: Thursday, February 19
Economic growth II: Market failures, government failures, and policies
• William Easterly, “Governments Can Kill Growth,” Ch. 11 from The Elusive Quest for Growth, MIT Press, 2001, [excerpt].

Class 6: Monday, February 23
Economic growth III: Debate over limited government vs. activist government
• Policy debate on economic growth

Class 7: Thursday, February 26
Saving and investment I: framework
• F&B Ch. 8: “Saving, Capital Formation, and Financial Markets” (Ch. 9 in 2nd and 3rd eds.; Ch. 10 in 1st ed.)

Class 8: Monday, March 2
Saving and investment II: government spending, taxes, and entitlement programs
• Andrew Eschtruth and Robert Triest. “National Saving and Social Security Reform” Just the Facts on Retirement Issues #18, Boston College Center for Retirement Research, April 2005.

Class 9: Thursday, March 5
The financial system: money and banking

Class 10: Monday, March 9
The financial system: banks, bonds, stocks, and mortgages

Thursday, March 12
Class cancelled in exchange for an evening midterm exam on Tuesday, March 10
Class 11: Monday, March 16

The stock market


Class 12: Thursday, March 19

Saving and investment in the global economy


Spring Break: March 21 to April 5

Class 13: Monday, April 6

The current financial crisis

- Listen to a May, 2008 episode of *This American Life* on the mortgage crisis:

Class 14: Thursday, April 9

The current financial crisis, continued

- Baseline Scenario, “Financial Crisis for Beginners,”
- Listen to an October, 2008 episode of *This American Life* on the credit crisis:
- Listen to the February, 2009 *This American Life* episode “Bad Bank”:
Class 15: Monday, April 12

Introduction to the short-run economy

- F&B Ch. 6: “Wages and Unemployment”, pp. 171-180 (Second half of Ch. 8 in the 2nd and 3rd ed.; or of Ch. 9 in 1st ed.)
- F&B, Ch. 10: “Short-Term Fluctuations” (Ch. 12 in other editions)

Class 16: Thursday, April 16

Short-run economics I: a Keynesian view of recessions and booms

- F&B, Ch. 11, “Spending and Output in the Short Run” (Ch. 13 in other editions)
- “Sticky Situations,” The Economist, Nov. 9, 2006.

Monday, April 20

Class cancelled in exchange for an evening midterm exam on Tuesday, April 21

Class 17: Thursday, April 23

The Federal Reserve

- F&B, Ch. 12, “Stabilizing the Economy: The Role of the Federal Reserve” (Ch. 14 in other editions)

Class 18: Monday, April 27

Fixing the financial system

What is the problem?


Why is pricing banks’ troubled assets a problem we have to solve?


The Geithner Plan (Public-Private Investment Plan, or PPIP)


Nationalization of banks
• Kwak, James. 2009. “Nationalization for Beginners.” from the web site The Baseline Scenario
• Fama, Eugene F. 2009. “Government Equity Capital for Financial Firms,” From the website Fama / French
  financial-firms.html.

Class 19: Thursday, April 30
Aggregate supply and demand: equilibrium inflation, interest rates, and output
• F&B, Ch. 13, “Aggregate Demand and Aggregate Supply” (Roughly Ch. 15 in earlier editions)

Class 20: Monday, May 4
Aggregate supply and demand: macroeconomic policy
• F&B, Ch. 13, continued.
• F&B, Ch. 14, “Macroeconomic Policy”, pp. 413–425 (Roughly Ch. 16 in earlier editions)
• Paul Krugman, “Japan’s Trap,” Ch. 3 from The Return of Depression Economics, (2008).

Class 21: Thursday, May 7
Fiscal stimulus or bridges to nowhere?
  What’s in the Stimulus Plan?
• Hook, Janet. 2009. “Here’s what’s on Congress’ $800-billion to-do list: the stimulus includes jobs, tax cuts
  and energy investments.” Los Angeles Times. Feb 1, pg. A1
Arguments in Favor of Obama-Style Stimulus
Arguments Against Obama-Style Stimulus
  http://wwwbepresscom/ev/vol6/iss2/art5
Arguments in Favor of Tax Cuts
• N. Gregory Mankiw, "Is Government Spending Too Easy an Answer?" The New York Times, January 11,
  2009.
Long-Term Costs of Stimulus


Class 22: Monday, May 10

The global economy and exchange rates

- F&B, Ch. 15, “Exchange Rates and the Open Economy” (Ch. 18 in the 3rd ed., Ch. 17 in 1st and 2nd ed.)

Class 23: Thursday, May 13

The global economy and economic crises

- F&B, Ch. 15, continued.