PRINCETON UNIVERSITY
Department of Economics
ECONOMICS 101 THE NATIONAL ECONOMY
Fall term 2013

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Office Hours:
   Wednesdays: 3:40 - 4:10 p.m.
   Thursdays: 3:40-5:30 p.m.
   Fridays: 1:00 - 2:00 p.m.
Additional hours available by appointment

I am also available in the lecture hall to answer questions immediately following lectures on Tuesdays and Thursdays.

Organizer: Phyllis Sun psun@Princeton.EDU All precept section changes or additions must be done through Ms. Sun.

Required Text:
William J. Baumol and Alan S. Blinder, Macroeconomics: Principles and Policy, Twelfth Edition (South-Western Cengage Learning)
(Referred to below as B & B) I've ordered the paperback of the 12th edition for the bookstore. The hard back is OK too, but the pages are different. The text is available at Labyrinth Books or can be used in the library.

You are required to purchase a packet for the course. (It is not the same as previous packets) The packet is available from Pequod Copiers in the U-Store. The Packet has all the assignments for the semester.

As a source of current events, you are asked to read The Economist. Several articles will be assigned from The Economist each week and you will be tested on the assigned articles. The Economist is available online for free for all Princeton students. http://faq.econlib.princeton.edu/recordDetail?id=12844&action=&library=princeton_economics&institution=princeton

The PowerPoint slides used in lectures will be added to the course page under course materials on Blackboard on the WEB before each class.

Course requirements and grading

The course requirements are weighted as follows in determining your grade:

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Weight</th>
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<tbody>
<tr>
<td>Final examination</td>
<td>50%</td>
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<tr>
<td>Mid-term</td>
<td>35%</td>
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<tr>
<td>Problem sets &amp; participation in precepts</td>
<td>15%</td>
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The purpose of the problem sets is to enhance your understanding of economics and to raise your analytical skills in general. Of course, they are also part of your preparation for exams. You are encouraged to discuss the problem sets with classmates (or anyone else), but the work you hand in must be your work. If you work together, then think about your answers and put them into your own words. Searching the WEB for former answer sheets is cheating. Getting help from tutors is OK, but be certain to work on the problem sets alone first so that you gain the needed analytical skills to perform on the exams. Any student caught cheating on any component of the course may receive a failing grade for the entire course. (I don’t expect to see this at Princeton)

Reading Period: January 6-14, 2014

Review Session: Thursday, January 9, 2014, 1:30-3:00pm McCosh 50

Precepts begin Thursday, September 19. Precepts meet Thursdays, Fridays and Mondays. If you have a Monday precept please note that your last precept will be held on Thursday Dec 12th or Friday Dec 13th at a time chosen by your preceptor or Friday Dec 13th at 1:30pm with Prof. Bogan in McCosh 50, which means you have two precepts that week (on Monday and then Thursday or Friday). You will receive more details as it gets closer from your preceptor.

For written assignments and additional readings and discussion questions, see the PRECEPT/CLASS ASSIGNMENTS section of this Course Outline.

LECTURE TOPICS AND READING ASSIGNMENTS FOR LECTURES
Please read the assignments before the lectures. (You will understand and enjoy the lectures much more if you come prepared. Being prepared is the best way to get your money’s worth.)

Week 0
Thursday, September 12
Lecture 1:
I. Introduction: The Great Recession 2007-2009 and still not back to full employment, Budget Crises
   The government's role: monetary & fiscal policy.
   B&B CH 3 The Fundamental Economic Problem: Scarcity and Choice
   Speech by Janet Yellen, President and CEO of The Federal Reserve Bank of San Francisco, June, 2009 (in packet)
      (Note the date of the speech and the accuracy of her predictions. Janet is now on the Board of Governors of the Federal Reserve)
Week 1
Tuesday, September 17

Lecture 2:

II. Political Economy
A. Theoretical Socialism (Planned Economies) vs. Theoretical Capitalism (Market Economies)
   (or Karl Marx vs. Adam Smith)
B. Political dimension - elite group government vs. democracy.
C. The welfare state compromise –
D. How much regulation?

{Your first precept, September 20, 21 or 24, is on Supply and Demand. You will need to read B&B CH 4. See Precept/class assignments under that section heading later in this course outline. Each week there are assignments for lecture and separate assignments for precept/class}

Thursday, September 19

Lecture 3: The realm and tools of economic analysis: Models, Theories and Evidence
   Why do economists disagree?
   Schools of Economic Thought
   Akerlof and Shiller, Animal Spirits, PP. 34-39 (in packet)

   B&B CH 1 What is Economics? (optional) If you are weak on graphs, read the appendix to Chapter 1
   B&B CH 5 An Introduction to Macroeconomics

Week 2
Tuesday, September 24

Lecture 4:

National Income Accounting The measurement of GDP, GNP, and their components (mostly covered in precept)
B&B Appendix to Chapter 8; also one page summary of calculations in packet
Economic Growth

B&B Chapter 6 The Goals of Macroeconomic Policy pp 105-111 (Part 1: The Goal of Economic Growth)
B&B Chapter 7 Economic Growth: Theory and Policy
Thursday, September 26

Lecture 5: Economic Growth continued
Frank and Bernanke, *Principles of Macroeconomics* 3rd edition, Chapter 9 Saving and Capital Formation (in packet)

**Week 3**

Tuesday, October 1

Lecture 6: China and South East Asia
(slides)

Thursday, October 3

Lecture 7: Economic Growth: Lessons from around the world
Problems in Macroeconomics in the Short Run - Unemployment and Inflation


**Week 4**

Tuesday, October 8

Lecture 8: Keynesian Model of the determination of national income
(It is really a model of aggregate demand.)

B&B CH 8 Aggregate Demand and The Powerful Consumer

Thursday, October 10

Lecture 9: B&B CH 9 Demand-Side Equilibrium: Unemployment or Inflation? including Appendix A and Appendix B

**Week 5**

Tuesday, October 15 and Thursday, October 17

Lecture 10 and Lecture 11: Adding AS to AD to determine equilibrium output.

B&B CH 10 Bringing in the Supply-Side: Unemployment and inflation
B&B CH 11 Managing Aggregate Demand: Fiscal Policy, including Appendix A and Appendix B

**Week 6**

Tuesday October 22 class is mostly review
EXAM TUESDAY EVENING  October 22, 7:30-9:30 p.m.

Thursday, October 24
(Yes we have a lecture after the midterm and before Fall break, but no precepts)
Lecture 13: Fiscal Policy and Taxation

FALL BREAK October 26-November 3

Week 7
Tuesday, November 5

Lectures 14: Surpluses, Deficits and Fiscal Policy

- B&B CH 16  Budget Deficits in the Short and Long Run

Thursday, November 7

Lectures 15:
Money and Banking and the Fed

- B&B CH 12  Money and the Banking System

Week 8
Tuesday, November 12 and Thursday, November 14

Lectures 16 and 17: Keynesian, Monetarist and New Classical Theories of how changes in money supply and demand affect the economy.

- B&B CH 13  Monetary Policy: Conventional and Unconventional

- B&B CH 15  The Debate over Monetary Policy pp-295-307 [up to the section, “Debate: Should the Government Intervene?”]

On your computer browser go to www.federalreserve.gov On the Fed opening page find The Federal Reserve and the Financial Crisis follow links to “The Federal Reserve’s Response to the Financial Crisis” which is the 3d of the 4 lectures. Watch Ben’s lecture or if you prefer to read it, a transcript is available on the site. If you prefer you can also go directly to Youtube for Bernanke lectures
Week 9
Tuesday, November 19 and Thursday, November 21

Lecture 18: Phillips Curves, Expectations, and Business Fluctuations
B&B CH 17 The Trade-off between Inflation and Unemployment

Lecture 19: Recent US Economic History in a Macro Framework

Week 10  (No Thursday class as it is Thanksgiving)
Tuesday, November 26

Lecture 20: Stabilization Policy and the Great Recession

One more look at stabilization policy - Rules vs. Discretion and the post August 2007 role of the Fed
Finish B&B CH 15 The Debate over Monetary and Fiscal Policy
Remarks by Governor Ben Bernanke (in Packet)
Packet readings on Monetary Policy since August 2007
(We opened the course with B&B CH 14: The Financial Crisis of 2007-2009. You may want to re-read that chapter in light of the whole course to date.)

If you like the debate over optimal Monetary and Fiscal Policy you will want to read John B Taylor’s First Principles, a book written for the intelligent layman. Taylor (a Princeton grad) is at Stanford and in the simple freshwater vs saltwater categories is a freshwater economist, meaning he is very pro-markets and in favor of well defined rules for the conduct of monetary and fiscal policy rather than ad hoc adaptation of policy to changing events. (My problem with his approach is that I believe policy has to vary with the phase of the business cycle, although it might be possible to define what constitutes a credit boom and how MP and FP would react and also some early recession measures and the policy reactions. That would be a kind of flexible rule based approach. I do think it is important to economic growth that businesses can predict what MP and FP will do. Businesses need to have some vision of the future to make investment decisions. Erratic government policy no doubt reduces growth)

Week 11
Tuesday, December 3

Lecture 21: International Trade
B&B CH 18 International Trade and Comparative Advantage and Appendix

Thursday, December 5

Lecture 22: Fixed and Fluctuating Exchange Rates
B&B CH 19 The International Monetary System: Order or Disorder?
The US dollar and the Chinese yuan
Week 12
Tuesday, December 10

Lecture 23: Monetary & Fiscal Policy in an Open Economy

B&B CH 20 Exchange Rates and the Macro Economy

Thursday, December 12
Lecture 24: Recent Issues in the Chinese, Japanese and US economies
PRECEPTS/CLASSES

PREPARATION FOR PRECEPTS INCLUDES READING THE LECTURE ASSIGNMENTS AND THE SHORT ARTICLES ASSIGNED IN THE PACKET AS WELL AS DOING THE PROBLEM SETS. Precepts have several purposes. Some new material will be presented in precepts, but more often the emphasis is on discussing the topics and readings listed on your Precept assignments, answering your questions, and reviewing the more difficult portions of the problem sets.

PRECEPTS/CLASSES

Thursday September 19, Friday September 20 and Monday September 23
(Nothing to turn in, but prepare B&B Chapter 4 and the other packet reading)

B&B CH 4 Supply and Demand

Topics: Supply and Demand
Price Ceilings and Floors

Discussion Questions:

• What factors shift a demand curve?

• What factors shift a supply curve?

• How are prices determined in competitive markets? Why are market prices important to the efficient allocation of resources?

• Are higher minimum wages good for young workers?

• How does rent control affect the availability of low cost housing?

• Why do mortgage interest rates affect the demand for housing? What did NINJA loans do to the demand for housing in 2003-06?

Thursday September 26, Friday September 27 and Monday September 30

“National Economic Trends” (graphs in packet)

Problem Set #1 due at the beginning of precept.

B&B Appendix to Chapter 8 National Income Accounting (also summary page in packet)

Topic: National Income and Product Accounting
Discussion Questions:

- What are 3 different ways of accounting for GDP?
- How does GNP differ from GDP?
- What is the difference between GNP and NNP?
- What is the difference between Net National Product and National Income at Factor Cost?
- What is Disposable Income and how do you get there from National Income at Factor Cost?
- If GDP rises, is a nation necessarily better off?
- What is meant by the underground economy?

Thursday October 5, Friday October 6 and Monday October 9

**Problem Set #2 due in precept.**

“Economic Growth is Reducing Global Poverty” NBER, October 2002 (in packet)
“Development finance in Africa,” The Economist, May 7, 2013 (in packet)
“Fertility Rates Around the World" CIA data (in packet)

Topics: Economic Growth, Globalization

Discussion Questions:

- Why do we care about growth in labor productivity?
- What initial condition was helpful in agricultural growth in China in the 1980s?
- Have globalization and economic growth helped the world’s poorest? (in packet)
- What are some of the problems and possibilities for economic development in Africa? (in packet)
- What does Robert Gordon say about the future of U.S. economic growth? Do you think he is right?
- Is democracy bad for growth? (Some might argue that China’s growth without democracy sets a new model. What do you think?)
Thursday October 10 and Friday October 11 and Monday October 14

**Problem Set #3 due in precept.**

“The Cause of Wealth Dispersion at Retirement: Choice or Chance?” *AEA Papers and Proceedings*, (in packet enlarged key graphs follow article)


Investment graphs from *National Economic Trends*

Topics: Determination of Consumption (and Saving), Investment, and Net Exports

Discussion Questions:

- How would you expect a sustained decrease in the S and P stock market index to affect the consumption function? (such as 2008)

- How would you expect a fall in the price of houses to affect the consumption function?

- If people develop a new expectation that inflation will rise in the near future, what happens to the consumption function today?

- What is Venti and Wise’s main point about wealth dispersion and what does it have to do with motives to save? (Packet and Blackboard)

- Why do changes in expectations about the future strength of the economy affect investment spending? What happened to investment in 2008? (in packet)

- Why are our imports more sensitive to the state of the U.S. economy than our exports?

- How does a fall of the dollar against foreign currencies affect US exports?

Thursday October 17 and Friday October 18 and Monday October 21

**Problem Set #4 due in precept.**

*Macroeconomics* "Real Wage Rigidity"(in packet)

Topics: Wage rigidity, inflationary and recessionary gaps
The algebra of equilibrium income and the multipliers. Go over highlights of this problem set as this material is covered on the midterm

Discussion Questions:

- Under what conditions will an inflationary gap not self-correct?

- Under what conditions will a recessionary gap fail to self-correct?
• How does the efficiency wage model explain sticky real wages? (packet)
• How do you think wages are determined?

MIDTERM EXAM TUESDAY EVENING –October 22 7:30-9:30pm
(We do have lecture the Thursday after the midterm but no precepts)

No precepts October 24, 25 or 28  No precepts October 31 November 1, or 4

FALL BREAK – October 26-November 3

Precepts resume
Thursday November 7 and Friday November 8 and Monday November 11

Problem Set 5 due in precept

Government Budgets from “National Economic Trends” (in packet)
“Cumulative Shares of Adjusted Gross Income compared to Shares of Federal Income Taxes Paid” (in packet)
“Income Tax Fact of the Day” (in packet)
"High Income Taxes Inhibit the Growth of Small Firms" The NBER Digest (in packet)
Graph of US projected spending and the problem of Medicare (in packet)
Dartmouth Atlas of Health Care: End of life care (in packet)
Kessler, Jim and Brown, David, “Is Social Security Regressive?”
 www.thirdway.org/publications/718 (in packet)
“Straight Talk on Social Security Reform” by Michael Boskin The Economist’s Voice (in packet)
“Saving Social Security: The Diamond-Orszag Plan” The Economist’s Voice (in packet)
“Entitlements in America” The Economist, May 25, 2013 (in packet)

Topics:  Taxes; Social Security, Medicare

Discussion Questions:

• What was the main economic argument for Clinton's Omnibus Budget Reconciliation Act in 1993? Why did these tax increases help the economy? What happened to the deficits from 1994 to 2000?

• What are the major issues in estate taxation?
• How do marginal income taxes affect small businesses and individual work effort? (in packet)

• Are public employees’ pensions similar to those in the private sector? (in packet)

• Why does the National Debt matter? (in packet) Should governments run surpluses in strong years?

• What are the long term budget issues with Social Security and Medicare? (packet)

• Compare Boskin’s views on Social Security with those of Diamond and Orszag. (packet)

• What policy changes would you make with Social Security? With Medicare?

• Discuss the packet article, “Entitlements in America.”

Thursday November 14, Friday November 15, Monday November 18

Problem Set #6 due in precept

Chairman Ben Bernanke on the Federal Reserve’s Balance Sheet, April 3, 2009 (in packet)
Graphs of Interest rates from Monetary Trends (in packet)
Graphs of Monetary Base, Commercial Bank Reserves, M1, and Velocity (in packet)

OPTIONAL: Frederic Mishkin, “Over the Cliff: From the Subprime to the Global Financial Crisis,” Journal of Economic Perspectives, Vol 25, Number 1 Winter 2011 pages 49-70. In studying monetary policy in more detail, we have returned to the Great Recession and the Fed’s response. This article is a good summary.
{If you would like to read a non-technical description of what the Fed did under Ben Bernanke, I recommend, “The Villain” by Roger Lowenstein in The Atlantic, April 2012 pp 49-60}

Topics: The Stimulus Package, Banking, T accounts, and U.S. monetary policy

Discussion Questions:

• Did the stimulus package of February 2009 work? (packet)

• Does the Fed directly control the money supply?
• How do open market operations affect the money supply?

• What is the difference between the Fed Funds Rate and the Target Fed Funds Rate? How does the Fed influence the Federal Funds Rate? Why has the Fed announced it will keep the FFTR near zero until 2014?

• What new programs did the Fed introduce between August 2007 and March 2009? Why were they introduced?

Thursday November 21, Friday November 22 and Monday November 25

Problem Set #7 due in precept.

G. K. Shaw Rational Expectations, pp. 1-8 (in packet)
“Leverage, Business Cycles and Crises” The NBER Digest, March 2012
"The Great Depression" from Bogan and Kiernan\'s Macroeconomics (in packet)
Remarks by Governor Ben S Bernanke, “Constrained Discretion and Monetary Policy” (in packet)
“Briefing: The Dodd Frank Act” The Economist, February 18, 2012 (in packet)
Stout, Lynn, “Regulate OTC Derivatives by Deregulating Them” Regulation, fall 2009 (in packet)
Kirkegaard, Jacob, “U.S. High-Skilled Immigration Policy” (in packet)

Topics: Government Policy Toward Inflation, Unemployment and Economic Stability
Reform of Financial Regulation

Discussion Questions:

• According to Shaw under what conditions would rational expectations imply that monetary policy couldn't stimulate real output? How did the economic situation in the U.S. in 2008 differ from Shaw’s assumptions?

• What were the major causes of the Great Depression of 1930-1933? (packet) What lessons did macroeconomics learn from the Great Depression that were important to recent economic policy? (Does everyone agree?)

• How does credit affect business cycles?
• How does credibility that the Fed is committed to controlling inflation help monetary policy? (Bernanke article on constrained discretion)

• What does Mishkin mean by “The Lean Versus Clean Debate”? (packet)

• What is the difference between Microprudential regulation and Macroprudential regulation and supervision? (in packet)

• Discuss the reform of Financial Regulation passed in 2010. Dodd-Frank bill (packet)

• What is Lynn Stout’s main point about OTC Derivatives and systemic risk? (packet)

• Do immigrants reduce the number of jobs available to those already living in the U.S.? (packet)

Thanksgiving is November 28  No precepts November 28, 29 or December 2

Thursday December 5, Friday December 6 and Monday December 9

Problem Set #8 due in precept.


Trade graphs from National Economic Trends (in packet)

“How Rebalancing the world economy: America--Dropping the shopping,” Economist, July 23, 2009 (in packet)

“How many jobs are onshorable?” By Richard Baldwin of VOX June 15, 2009 (in packet)

Topics:
International Trade and Offshoring
America and China in the World Economy

Discussion Questions:

• According to Jagannathan, Kapoor and Schaumburg what was the underlying cause of the Great Recession in the U.S.? (in packet)

• What is the theory behind the North American Free Trade Association (NAFTA)? Are regional free trade zones a step toward world free trade?

• What happened to world trade in 2008? Why? (in packet)

• Discuss some of the ways that China’s and America’s economies are interwoven.

• What does the Economist say the US must do to rebalance the world economy? (in packet)

• Where does a nation's comparative advantage come from? (in packet) Could a nation design policies to gain a comparative advantage in some desirable product?

• What is meant by onshorable jobs? How do onshoring and offshoring increase efficiency? (in packet)

• What interest groups in the U.S. oppose quota-free and duty-free imports from sub-Saharan Africa?

• Is a trade deficit bad?

**Thursday December 12 and Friday December 13** PLEASE NOTE THAT IF YOUR REGULAR PRECEPT DAY IS MONDAY, YOU NEED TO CHOOSE A RESCHEDULED PRECEPT AT 1:30 PM ON FRIDAY, DECEMBER 13 in McCosh 50 OR go to any regularly scheduled precept on Thursday, December 12 or Friday, December 13th. {Your preceptor may offer another option too}

**Problem Set #9 due in precept.**

“The Consequences of the Euro,” Challenge, (in packet)
“Japan’s debt: The Domino that never falls,” The Economist, July 7, 2011 (in packet)

Topics:
The euro, the yuan
Japan and China
and changing the world’s financial regulations

Discussion Questions:

• What is the Euro?

• What are the advantages of the Euro compared to separate currencies with floating exchange rates? Compared to separate currencies with fixed exchange rates? What are the disadvantages of the euro from the perspective of nationalism? What is Greece’s problem? What makes an optimal currency area? Do these criteria fit Europe?

• Why is China reluctant to float the yuan? What are the possible disadvantages to China from an undervalued currency?

• What could China do with its $2 trillion of foreign reserves? (in packet)

• What is the overview of Japan’s post 1990 economy? What happened to its debt/GDP ratio?
• Who owns most of the Japanese Government’s debt obligations? Why does that matter?