

Prof. Bryan Caplan

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Econ 311

Fall, 1999

# Macroeconomics Syllabus

## Course Focus:

The course provides a comprehensive survey of modern macroeconomics. It covers the determination of output and the price level, labor markets and unemployment, savings and investment, financial markets, monetary economics, the public sector, macroeconomic policy, and international economics. More generally, students will learn to extend simple supply-and-demand models to understand the history of the world, current global trends, and popular economic fallacies.

## Prerequisites:

I assume that you are familiar with introductory economics, algebra, and very basic calculus.

## Texts:

Most of the course material will consist in detailed notes that will be handed out in class. There will also be required readings in each of the following:

Julian Simon, ed., *The State of Humanity*

Frederic Bastiat, *Economic Sophisms*

Frederic Bastiat, *Selected Essays on Political Economy*

Steven Landsburg, *The Armchair Economist*

Steven Landsburg, *Fair Play*

## Grading and Exams:

There will be one midterm and a final exam. The midterm counts 30%; the final exam is 45%; homework counts for the remaining 25%. These weights are fixed - improvement on later exams will not retroactively raise your grades on earlier exams.

There is no formal grade for participation, but if you are one of the students who (in my judgment) contributes most to the quality of class discussion your grade will be raised if you are on the borderline between two grades.

### **Homework:**

There will be approximately six homework assignments during the semester. Depending upon how good a job you do, your homework will receive a check-plus (4 points), a check (3 points), or a check-minus (2 points) if you turn it in; otherwise you receive 0 points. Late homework loses one point. *Late homework is no longer accepted after I pass out my suggested answers for a given assignment.*

### **Office Hours**

The best way to contact me is by email at [bcaplan@gmu.edu](mailto:bcaplan@gmu.edu). Many questions and requests can be satisfied by going to my homepage at <http://www.gmu.edu/departments/economics/bcaplan>. My office is in 8 Carow Hall; my office number is 3-2324. My official office hours are MWF 2:30-3:30, but you can also schedule an appointment or just drop by and see if I'm available.

### **Tentative Schedule:**

My proposed schedule for the semester follows. If it proves too ambitious, I will try to *simply say less about each topic* rather than cut the topics for the final weeks.

## **PART I: Classical Macroeconomics: The Long-Run**

### **Weeks 1-3: Aggregate Demand and Aggregate Supply**

- The explosions of population and per-capita income
- A short history of economic growth
  
- Growth statistics: what they capture and what they don't; real versus nominal variables

- Basics of aggregate demand and aggregate supply
- Classical AS: why it's vertical and what this implies
- Classical AS and the PPC
- Basic determinants of AS: quantity and quality of labor, labor/leisure tradeoff, natural resources, prior investments, and the quality of the economic system
- Basic determinants of AD: money supply and money demand
- Fallacies: the broken window; buy-back-the-product...
- Application: Comparative advantage, free trade, and free immigration

### Readings:

Simon chapter 2: "Human Mortality Throughout History and Prehistory"

chapter 13: "The Standard of Living Through the Ages"

chapter 14: "Long-Term Trends in the US Standard of Living"

chapter 24: "How 'Poor' Are America's Poor?"

chapter 28: "Trends in the Price and Supply of Oil"

chapter 35: "Agricultural Productivity Before the Green Revolution"

Bastiat, *Economic Sophisms*, (First Series) chapters 1, 7, 17

Landsburg, *The Armchair Economist*, chapter 21: "The Iowa Car Crop"

### **Weeks 4-5: Labor and Unemployment**

- Real wages and the labor/leisure trade-off: the income and the substitution effects
- Aggregate labor supply as approximately vertical
- Aggregate labor demand and marginal productivity
- Involuntary unemployment as a product of regulation
- Voluntary unemployment as a process of search
- The natural rate of unemployment
- Fallacies: make-work; subsistence wages
- Application: Labor income taxation; welfare and the negative income tax

### Readings:

Simon, chapter 12: "Trends in the Agricultural Labor Force"

Bastiat, *Economic Sophisms*, (First Series) chapters 2, 3, 20

### **Week 6: Savings and Investment**

- Real interest rate determination in the market for loanable funds: The supply and demand for present goods vs. future goods
- Consumption smoothing and the permanent income hypothesis
- Present discounted values and investing
- Investments in physical capital, human capital, and ideas; private vs. social returns
- Basics of financial markets: return and risk; fundamentals and the random walk; diversification
- Fallacies: Under-consumption, usury, financial journalism
- Application: Is your portfolio optimal?

### Readings:

Simon, chapter 21: "Trends in the Quantities of Education - USA and Elsewhere"

Landsburg, *Fair Play*

chapter 13: "People Wanted"

chapter 15: "The Arithmetic of Government Debt"

Landsburg, *The Armchair Economist*

chapter 14: "The Policy Vice: Do We Need More Illiterates?"

chapter 20: "Random Walks and Stock Market Prices: A Primer for Investors"

### **Week 7: Money Supply and Money Demand**

- Money supply as vertical
- Nominal money demand and prices
- Real money demand and nominal interest rates
- Money substitutes; banking and financial market regulation
- Inflation, nominal interest rates, and the market for loanable funds
- Seigniorage
- Inflationist fallacies
- Application: Post-socialist hyperinflations

### Readings:

Bastiat, *Economic Sophisms*, (First Series) chapter 11

Landsburg, *The Armchair Economist*, chapter 7: "Why Taxes are Bad: The Logic of Efficiency"

## **Week 8: Government Spending, Taxation, Levels, and Growth**

- Government spending, government regulation, taxation, and the Classical model
- Deficit vs. tax finance of government expenditure, the market for loanable funds, and crowding out
- The theory of public goods vs. the practice of government expenditure
- The theory of market failure vs. the practice of government regulation
- Government, the level of wealth, and the rate of growth
- The fallacy of the multiplier

### Readings:

Bastiat, *Selected Essays on Political Economy*, chapter 1: "What Is Seen and What Is Not Seen"

## **MIDTERM**

## **PART II: Keynesian Macroeconomics: The Short-run**

### **Week 9: Nominal Rigidities and Short-run Aggregate Supply**

- Involuntary unemployment without regulation?
- Menu costs
- Money illusion: the psychological evidence
- How stubborn is money illusion?
- Keynesian AS: why it's upward-sloping and what this implies
- Keynesian AS and the PPC
- Keynesian AS as Classical AS with price controls in the labor market
- Interaction between short-run and long-run AS
- How long is the long run?
- Application: Do you have money illusion?

### Readings:

Simon, chapter 19: "Trends in Unemployment in the United States"

### **Week 10: Monetary Policy, Fiscal Policy, and Aggregate Demand**

- Nominal rigidities and the market for loanable funds
- Aggregate demand policy and lags
- Monetary policy, interest rates, demand, and output
- Fiscal policy, interest rates, demand, and output
- Interest-rate targeting and the interaction of fiscal and monetary policy
- Application: The U.S. experience in WWII

Readings:

None

**Week 11: Aggregate Demand Policy and Expectations**

- Trying to push unemployment below its natural rate
- Rational expectations
- Time consistency
- Switching from levels to rates of change
- The simple vs. the expectations-augmented Phillips curve
- Stagflation
- Application: COLAs

Readings:

Landsburg, *The Armchair Economist*, chapter 23: "New, Improved Football: How Economists Go Wrong"

**PART III: Topics**

**Week 12: The International Economy**

- Comparative advantage
- Purchasing power parity
- Current and capital accounts
- Short-run exchange rate fluctuations
- Fallacies of international trade

Readings:

Bastiat, *Economic Sophisms*, (First Series) chapters 4, 6, 12, 13, 18, 19; (Second Series) chapters 13, 14, 15

**Week 13: The Macroeconomics of Laissez-Faire and Interventionism: The Great Depression and European Unemployment**

- The Great Depression: basic facts
- Fixing blame: laissez-faire vs. intervention
- The AD puzzle
- The AS puzzle
- European unemployment: basic facts
- The obvious explanation
- Objections to the obvious explanation; replies

Readings:

*FDR's Fireside Chats, "Government and Modern Capitalism"*

### **Week 14: The Macroeconomics of Socialism**

- Capitalism and socialism
- A short history of the Soviet economy
- Incentive vs. knowledge problems of socialism
- Collectivization and famine
- Industrialization, militarization, and the PPC
- Slave labor and the socialist macroeconomy
- State ownership and AS
- Rationing and AS-AD
- The black market

#### Readings:

Hedrick Smith, *The Russians*, chapter 9.

### **Week 15: The Future of Progress**

- Growth: post-war trends of developed and less-developed economies
- Growth statistics revisited
- Explaining the growth slowdown in the developed world
- Explaining growth dispersion in the developing world
- The decline of socialism and the rise of privatization and deregulation
- The choice between laissez-faire and intervention
- The future: what to expect for yourself and the world

#### Readings:

Bastiat, *Economic Sophisms*, (First Series) Conclusion

Landsburg, *The Armchair Economist*, chapter 24: "Why I Am Not an Environmentalist"

Simon chapter 9: "The History of Accident Rates in the United States"

chapter 53: "The Carcinogen or Toxin of the Week Phenomenon: The Facts Behind the Scares:"

chapter 58: "What Does the Future Hold? The Forecast in a Nutshell"

## **FINAL EXAM**