

PRINCETON UNIVERSITY  
 Department of Economics  
**ECONOMICS 101 THE NATIONAL ECONOMY**  
 Fall term 2017

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Office Hours:

Wednesdays 3:40 - 4:10 p.m.

Thursdays 4:40-5:30 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. (I enjoy answering questions.)

Organizer: Michael Dobrew <mdobrew@princeton.edu>

All precept section changes or additions must be done through the organizer.

**Required Text:**

William J. Baumol and Alan S. Blinder, Macroeconomics: Principles and Policy, 13<sup>th</sup> Edition (South-Western Cengage Learning)

(Referred to below as B & B) I've ordered the paperback of the 13<sup>th</sup> edition for the bookstore.

The hardback is OK too, but the pages are different. The 12<sup>th</sup> edition is also fine.

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.library.princeton.edu/econ/faq/10985>

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:

Final examination	50%
Mid-term	35%
Problem sets & participation in precepts	15%

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, but I'm supposed to remind students of the rules.)

Reading Period: January 8-16, 2018

Review Session: Thursday, January 11, 2018 1:30-3:00pm McCosh 50

**Precepts begin Thursday, September 21.** Precepts meet Thursdays, Fridays and Mondays. If you have a Monday precept please note that your last precept will be held on Thursday Dec 14<sup>th</sup> or Friday Dec 15<sup>th</sup> at a time chosen by your preceptor, or Friday Dec 15<sup>th</sup> at 1:30pm with Prof. Bogan in Mc Cosh 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 14

Lecture 1:

- I. Introduction: The Great Recession 2007-2009 and the slow recovery  
The government's role: monetary & fiscal policy.  
B&B CH 3 The Fundamental Economic Problem: Scarcity and Choice

### **Week 1**

Tuesday, September 19

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 – how much redistribution?
  - D. How much regulation?

“Capitalism and its critics: A Modern Marx,” The Economist, May 3, 2014 (in packet)

{ Your first precept, September 21, 22 or 25, 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 21

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. 167-176 (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 26

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 (It is easier to memorize the definitions if you understand the logic behind the accounting.)

Economic Growth

B&B Chapter 6 The Goals of Macroeconomic Policy (Part 1: The Goal of Economic Growth)

B&B Chapter 7 Economic Growth: Theory and Policy

Thursday, September 28

Lecture 5: Economic Growth continued

## Week 3

Tuesday, October 3

Lecture 6: Growth in China and South East Asia

Thursday, October 5

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

B&B Chapter 6 The Goals of Macroeconomic Policy and the Appendix

**Week 4**

Tuesday, October 10

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 12

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

**Week 5**

Tuesday, October 17 and Thursday, October 19

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 24 class is mostly review**

**EXAM TUESDAY EVENING October 24, 7:30-9:30 p.m.**

Thursday, October 26

*(Yes we have a lecture after the midterm and before Fall break, but no precepts)*

Lecture 13: Fiscal Policy and Taxation

**FALL BREAK October 28- November 5**

**Week 7**

Tuesday, November 7

Lectures 14: Surpluses, Deficits and Fiscal Policy

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

Thursday, November 9

Lectures 15: Money and Banking and the Fed

B&B CH 12 Money and the Banking System

**Week 8**

Tuesday, November 14 and Thursday, November 16

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 [up to the section, "Debate: Should the Government Intervene at All?"]

**Week 9** Tuesday, November 21

Lecture 18: Phillips Curves, Expectations, and Business Fluctuations

B&B CH 17 The Trade off between Inflation and Unemployment

**(No Thursday, November 23, class as it is Thanksgiving)**

**Week 10**

Tuesday, November 28 and Thursday, November 30

Lecture 19: Recent US Economic History in a Macro Framework  
B&B, CH 14 The Financial Crises and the Great Recession

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, "Constrained Discretion" and Monetary Policy (in Packet)

**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 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 5

Lecture 21: International Trade

B&B CH 18 International Trade and Comparative Advantage and Appendix

Thursday, December 7

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 12

Lecture 23: Monetary & Fiscal Policy in an Open Economy

B&B CH 20 Exchange Rates and the Macro Economy

Thursday, December 14

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 21, Friday September 22 and Monday September 25

(Nothing to turn in, but prepare B&B Chapter 4)

B&B CH 4 Supply and Demand

Minimum Wages: A Reckless Wager, The Economist, June 25, 2015 (in packet)

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?
- Critique Maduro's Venezuelan government actions in terms of the allocation of goods and services.
- Are higher minimum wages good for young workers?
- How does rent control affect the availability of low cost housing?

Thursday September 28, Friday September 29 and Monday October 2

**Problem Set #1 due at the beginning of your precept to your preceptor.**

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.**

“How did the global poverty rate halve in 20 years?” The Economist, June 2, 2013 (in packet)

“African Economic Growth,” The Economist, January 10, 2015 (in packet)

“Fertility Rates Around the World” CIA data. (in packet)

Gordon, Robert J. “Secular Stagnation: A Supply-Side View,” 2015 (in packet)

“The Number of High-Growth, Job-Creating Young Firms is Declining” NBER Digest, February, 2016 (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? (packet)
- What are some of the problems and possibilities for economic development in Africa? (packet)
- What does Robert Gordon say about the future of U.S. economic growth? Do you think he is right? (packet)
- Is democracy bad for growth? (Some might argue that China’s growth without democracy sets a new model. What do you think?)

Thursday October 12 and Friday October 13 and Monday October 16

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

“New Estimates of the Housing Wealth Effect,” NBER Digest, May 2012



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?
- 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 19 and Friday October 20 and Monday October 23

**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 24, 7:30-9:30pm**

**(We do have lecture the Thursday after the midterm, but no precepts)**

**No precepts October 26, 27 or 30 No precepts November 2, 3 or 6**

**FALL BREAK – October 28-November 5**

**Precepts resume**

Thursday November 9 and Friday November 10 and Monday November 13

**Problem Set 5 due in precept**

“The Alternative Maximum Tax,” The Wall Street Journal, (in packet)

“Cumulative Shares of Adjusted Gross Income compared to Shares of Federal Income Taxes Paid” (in packet)

“IRS Statistics: Individual Income Tax Rates and Shares 2009” (in packet)

"High Income Taxes Inhibit the Growth of Small Firms," The NBER Digest. (in packet)

“State pensions in America – Ruinous Promises,” The Economist, June 15, 2013 (in packet)

Dartmouth Atlas of Health Care: End of life care (in packet)

“Health Care in America Shock Treatment,” The Economist, March 7, 2015 (in packet)

Kessler, Jim and Brown, David, ‘Is Social Security Regressive?’

[www.thirdway.org/publications/718](http://www.thirdway.org/publications/718) (in packet)

Feldstein, Martin, “Dealing with Long Term Deficits,” American Economic Review: Papers and Proceedings 2016,106(5) (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)

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?
- How do marginal income taxes affect small businesses and individual work effort? ( packet)
- Are public employees’ pensions similar to those in the private sector? (packet)
- Discuss changes in the delivery of health care and health care costs. (packet)
- Discuss the packet article by Martin Feldstein, “Dealing with Long Term Deficits”
- Why does the National Debt matter? Should governments run surpluses in strong years?
- 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?

Thursday November 16, Friday November 17, Monday November 20

**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.

{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? How might the multiplier to fiscal policy vary over the business cycle?
- 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 did the Fed announce in 2013 that it would keep the FFTR near zero until 2015? Summarize monetary policy in 2017.
- What new programs did the Fed introduce between August 2007 and March 2009? Why were they introduced?

**Thanksgiving is November 23 No precepts November 23, 24 or November 27**

Thursday November 30, Friday December 1 and Monday December 4

**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)  
 Blinder, Alan, "The Financial Crises, The Response, and The Work Ahead," After the Music Stopped, pp. 322-333. (in packet)  
 Remarks by Governor Ben S Bernanke, "Constrained Discretion and Monetary Policy" (in packet)  
 Excerpts from Frederic Mishkin, "Monetary Policy Strategy: Lessons from the Crisis," NBER working paper 16755 Feb 2011 (in packet)  
 "Regulating America's Banks The Treasury publishes Proposals to cut red tape" (in packet)

Stout, Lynn, “Regulate OTC Derivatives by Deregulating Them,” Regulation, fall 2009 (in packet)

Giovanni Peri, “The Effect of Immigration on Productivity: Evidence from U.S. States,” NBER Digest, 2010 (in packet)

“H-1B Visas do mainly go to Indian Outsourcing Firms” (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? (packet)
- How does credit affect business cycles?
- 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 economic policy in 2008-2010? (Does everyone agree?)
- What was the Home Owners Loan Corporation? (packet)
- How does credibility that the Fed is committed to controlling inflation help monetary policy? (Bernanke article on constrained discretion in packet)
- What does Mishkin mean by “The Lean Versus Clean Debate”? (in packet)
- Discuss the reform of Financial Regulation passed in 2010. Dodd-Frank bill (in packet)
- What is Lynn Stout's main point about OTC Derivatives and systemic risk? (in packet)
- Do immigrants reduce the number of jobs available to those already living in the U.S.? (packet)
- Would the U.S. be better off with more restrictions on immigration?

Thursday December 7, Friday December 8 and Monday December 11

**Problem Set #8 due in precept.**

Excerpts from Jagannathan, Kapoor and Schaumburg, “Causes of The Great Recession 2007-09: The Financial Crisis Is the Symptom not the Disease!” NBER working paper 15404 (in packet)

“Offshoring: Welcome home,” The Economist, January 19, 2013 (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.? (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 is Brexit?
- What happened to world trade in 2008? Why?
- Discuss some of the ways that China's and America's economies are interwoven.
- Where does a nation's comparative advantage come from? 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? (packet) What has changed in offshoring in recent years? (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 14 and Friday December 15** PLEASE NOTE THAT IF YOUR REGULAR PRECEPT DAY IS MONDAY, YOU NEED TO CHOOSE A RESCHEDULED PRECEPT AT 1:30 PM ON FRIDAY, DECEMBER 15 in McCosh 50 OR go to any regularly scheduled precept on Thursday, December 14<sup>th</sup> or Friday, December 15<sup>th</sup>. {Your preceptor may offer another option too}

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

“Europe Must Seize the Chance to fix the Euro” The Economist, June 1, 2017 (in packet)  
“Free Exchange: The Japanese solution,” The Economist, November 7, 2015

## Topics:

The euro, the yuan  
Japan and China

## Discussion Questions:

- What is the euro? (in packet) Can a nation leave 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?
- How did China maintain an undervalued yuan for many years? Why did it want and undervalued yuan? What are the possible disadvantages to China from an undervalued currency?
- 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? (packet)