

6E:206 Macroeconomics II

Spring 2005

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Course Outline

Prerequisites 6E:203 and 6E:204.

Texts

The texts below contain background material that will be useful throughout this course.

Thomas Cooley, ed. *Frontiers of Business Cycle Research*. Princeton University Press, 1995.

Lars Ljungqvist and Thomas Sargent. *Recursive Macroeconomic Theory*. MIT Press, 2000.

Additional journal articles are listed below. We will not cover all the articles. Some of them are listed here in case you want to dig deeper into the topic.

We will rely on formal recursive methods to analyze some of the models. The following books may be useful in providing the mathematical and computational background:

Dimitri Bertsekas. *Dynamic Programming and Stochastic Control*. Academic Press, 1976.

Kenneth Judd. *Numerical Methods in Economics*. MIT Press, 1998.

Ramon Marimon and Andrew Scott, eds. *Computational Methods for the Study of Dynamic Economies*. Oxford University Press, 1999.

Nancy Stokey and Robert Lucas with Edward Prescott. *Recursive Methods in Economic Dynamics*. Harvard University Press, 1989.

Grade

Your grade for the course will be based on homeworks, 1 midterm, and a comprehensive final exam. The homeworks will account for 50 percent of the grade, the midterm 20 percent, and the final exam 30 percent.

Topics

I. Review: One-Sector Growth Model

II. Economic Development

Lucas, R. E., Jr. "On the Mechanics of Economic Development." *Journal of Monetary Economics* 22 (1988): 3-42.

McGrattan, E. R. and J. A. Schmitz. "Explaining Cross-Country Income Differences." Manuscript. Federal Reserve Bank of Minneapolis, 1998. (<http://woodrow.mpls.frb.fed.us/research/sr/sr250.html>)

Parente, S. and E. C. Prescott. "Changes in the Wealth of Nations." *Federal Reserve Bank of Minneapolis Quarterly Review*, Spring 1993.

Romer, P. "Increasing Returns and Long-Run Growth." *Journal of Political Economy* 94 (1986): 1002-1037.

The following two texts will provide additional material on economic development.

Robert Lucas. *Lectures on Economic Growth*. Harvard University Press, 2002.

Stephen Parente and Edward Prescott. *Barriers to Riches*. MIT Press, 2000.

III. Consumption, Saving, and Asset Prices

- Constantinides, G. C. "Habit Formation: A Resolution of the Equity Premium Puzzle." *Journal of Political Economy* 98 (1990): 519-43.
- Hansen, L.P., and R. Jagannathan, "Implications of Security Market Data for Models of Dynamic Economies." *Journal of Political Economy* 99 (1991): 225-262.
- Hakansson, N. H., "Optimal Investment and Consumption Strategies under Risk for a Class of Utility Functions." *Econometrica* 38 (1970): 587-607.
- LeRoy, S. F. and R. D. Porter. "The Present-Value Relation: Tests based on Implied Variance Bounds." *Econometrica* 49 (1981): 555-574.
- Levhari, D. and T. N. Srinivasan. "Optimal Savings under Uncertainty." *Review of Economic Studies* 36 (1969): 153-163.
- Lucas, R. E. Jr. "Asset Prices in an Exchange Economy." *Econometrica* 56 (1978): 1429-1445.
- Mehra, R. and E. C. Prescott. "The Equity Premium: A Puzzle." *Journal of Monetary Economics* 15 (1985): 145-162.
- Shiller, R. J. "Do Stock Prices Move Too Much to be Justified by Subsequent Changes in Dividends." *American Economic Review* 71 (1981): 421-436.
- Weil, P. "The Equity Premium Puzzle and the Risk-Free Rate Puzzle." *Journal of Monetary Economics* 24 (1989): 401-421.

IV. Real Business Cycles

- Boldrin, M., Christiano, L. J. and J. D. M. Fisher, "Habit Persistence, Asset Returns, and the Business Cycle," *American Economic Review* 91 (2001): 149-166.
- Brock, W. A. and L. J. Mirman. "Optimal Growth under Uncertainty: The Discounted Case." *Journal of Economic Theory* 4 (1972): 479-513.
- Cooley, 1995. Chapter 1.
- Colley, 1996. Chapter 6.
- Cooley, 1995. Chapter 11.
- Jermann, U. J., "Asset Pricing in Production Economies," *Journal of Monetary Economics* 41 (1998): 257-276.
- Kydland, F. and E. C. Prescott. "Time to Build and Aggregate Fluctuations." *Econometrica* 50 (1982): 1345-1370.
- Lucas, R. E. Jr. *Models of Business Cycles*. New York: Basil Blackwell, 1987.
- Rouwenhorst, K. G., "Asset Pricing Implications of Equilibrium Business Cycle Models," in Cooley, T.F. ed. *Frontiers of Business Cycle Research*, Princeton: Princeton University Press (1995).
- Tallarini, T. D., Jr., "Risk-Sensitive Real Business Cycles," *Journal of Monetary Economics* 45 (2000): 507-532.

V. Money

- Kiyotaki, N. and R. Wright. "On Money as a Medium of Exchange." *Journal of Political Economy* 97 (1989): 927-954.
- Lucas, R. E., and N. L. Stokey. "Money and Interest in a Cash-in-advance Economy." *Econometrica* 55 (1987): 491-514.
- Samuelson, P. A. "An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money." *Journal of Political Economy* 66 (1958): 467-482.

VI. Search and Unemployment

- Jovanovic, B. "Job Matching and the Theory of Turnover." *Journal of Political Economy* 87 (1979): 972-990.

Lucas, R.E. Jr., and E.C. Prescott. "Equilibrium Search and Unemployment." *Journal of Economic Theory* 7 (1974): 188-209.

Rogerson, R. and R. Wright. "Search-Theoretic Models of the Labor Market: A Survey." Penn Institute for Economic Research working paper 02-041. (<http://www.econ.upenn.edu/Centers/pier/Archive/02-041.pdf>)

VII. Dynamic Policy

Chari, V. V., Kehoe, P. J., and E. C. Prescott. "Time Consistency and Policy." in Barro, R. J. ed. *Modern Business Cycle Theory*. Cambridge: Harvard University Press, 1989.

Kydland, F. E. and E. C. Prescott. "Rules Rather than Discretion: The Inconsistency of Optimal Plans." *Journal of Political Economy* 85 (1977): 473-491.

Lucas, R. E. and N. Stokey. "Optimal Monetary and Fiscal Policy in an Economy without Capital." *Journal of Monetary Economics* 12 (1983): 55-94.

VIII. Incomplete Markets

Aiyagari, S. R. "Uninsured Idiosyncratic Risk and Aggregate Saving." *Quarterly Journal of Economics* 109 (1994): 659-684.

Huggett, M. "The Risk-Free Rate in Heterogeneous-Agent Incomplete-Insurance Economies." *Journal of Economic Dynamics and Control* 17 (1993): 953-969.

Ljungqvist and Sargent, Chapters 14, 15.

Telmer, C. I., "Asset Pricing Puzzles and Incomplete Markets." *Journal of Finance* 48 (1993): 1803-32.

Townsend, R. M. "Optimal Multiperiod Contracts and the Gain from Enduring Relationships under Private Information." *Journal of Political Economy* 90 (1982): 1166-86.

If you have a disability that may require some modification of seating, testing, or any other class requirement, please let me know as soon as possible so that appropriate arrangements can be made. Similarly if you have any emergency medical information about which I should know, or if you need special arrangements in the event the building must be evacuated, please let me know. Please see me after class hours or schedule an appointment. I would also remind you that the Office of Student Disability Services (335-1462) is available to assist you.

The administrative home for this course is the Tippie College of Business. General class policies on matters such as requirements, grading, adding and dropping after the official deadline, sanctions for academic dishonesty and appeals etc. are governed by the Tippie College of Business. Details of the University policy on cross enrollments may be found at: <http://www.uiowa.edu/~provost/deos/crossenroll.doc>.

It is my sincere hope that no student in this class does work which is not his or her own. If the TA and the Professor determine that the homeworks or the midterms or the final exam were not written solely by the student whose name appears on the document, the student's semester grade will be an F. All incidents of cheating will be reported to the Senior Associate Dean in the College of Business and the student may be placed on disciplinary probation for the remainder of his or her duration at the University of Iowa. The Honor Code for the Tippie College of Business will determine the appropriate appeal process.

If you have a complaint about the TA or the instructor of this course that you are unable to resolve by speaking first with the instructor, you should contact the Economics DEO (Professor Beth Ingram, W210 PBB). If she is unable to resolve your concerns, you may contact the Senior Associate Dean in the Tippie College of Business (Professor Robert Forsythe, C120 PBB).