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DEPARTMENT OF ECONOMICS
UNIVERSITY OF TORONTO

ECO 325 Summer 2012

Course Outline

TEXT: J.A. Hynes. *Notes On Macroeconomic Theory*, Department of Economics, University of Toronto. These will be available online at the Blackboard course site.
　　　Problem sets will be distributed regularly on Blackboard. Selected answers will be distributed.

GRADE DETERMINATION: There will be a 1 hour Midterm test, and a 3 hour Final. The Midterm will count 40% and the Final will count 60%. There will be a midterm makeup. See below. You must have a medical note on the University form otherwise you will receive a zero. The Midterm will be on July 23. The makeup will be after class on July 25.

OFFICE HOURS: Office hours will be on Wednesdays 4-5 pm. I will also answer some questions sent by email.

PREREQUISITES: Prerequisites are strictly checked and enforced. You will be removed from the course if you do not satisfy the requirements. You must clear any questions with the Department, not with me. I do not grant exceptions. In addition, because this is a course primarily for Economic Specialists, it is assumed you have (and understand) one year of university calculus. It is also assumed that you have a good understanding of the material covered in intermediate macroeconomics: there will not be a review.
　　　This course is one of three that we use to judge a student's potential for success in graduate school. The difficulty of the material is approximately the same as the Masters macroeconomic theory course. It is not a course that should be used to "fill in" your program.

MATERIAL TO BE COVERED: The structure of the course is extensive rather than intensive. The course examines six topics. However, the lectures and the notes are closely integrated, and this makes it possible to "comfortably" cover a fairly large body of material.
　　　The first topic is the theory of economic growth, using the Solow model, in which diminishing returns has a key role, and economic policy has a limited role in setting the long run growth of per capita output. This is contrasted with a linear model in which diminishing returns

are absent, and economic policy becomes an important determinant of the long run growth rate.

In the Solow model, households' rates of savings are a constant proportion of real income. Therefore, the theory of optimal growth is examined. In this framework, households' saving-consumption choices are their intertemporal utility maximizing choices. Among other features, this approach makes possible a coherent dynamic welfare theory. For example, important questions relating to optimal tax and finance theory are examined.

The aforementioned analyses neglect the long run implications of money. The latter is initially considered by inserting real money balances into the utility function. This makes possible a relatively easy integration of long run monetary and value theory, even though the motivation for holding money is not derived from "first principles".

In the above models, there is no uncertainty. There are no stochastic, shocks and none of the key variables are random variables. Methods of analysis, relevant to a study of stochastic models are introduced in the context of two well understood models: Robert Hall's analysis of optimal consumption theory when income and consumption are random variables; and Robert Barro's analysis of the interrelationship of tax and debt finance when government expenditures and taxes are random variables.

The final topic is business cycle theory. The recent economic crisis has resulted in a revival of interest in business cycle theory. There has been a special interest in the relationship of rational expectations and the new classical economics, and Keynesian theory. Therefore, more time will be spent on cycle theory than in past years. For this part of the course it is assumed that you bring with you an understanding of the IS-LM model presented in intermediate macroeconomic courses.