

## U3 „Applied Economics“

### Syllabus

#### 1. General Information

|              |  |
|--------------|--|
| Class        | Monday 14-16 (first session: 12.09)  |
| Venue        | Hausvogteiplatz  |
| Convener     | Henrik Enderlein   |
| Office       | Breite Straße, Room 2.12   |
| Telephone    | (030) 212 312 303  |
| E-Mail       | <a href="mailto:enderlein@hertie-school.org">enderlein@hertie-school.org</a> |
| Office Hours | Monday, 16-18 (Hausvogteiplatz)  |
| Lab Course   | Tuesday 14-15 (first session: 13.09)   |
| Venue        | Hausvogteiplatz  |
| Tutors       | Katri Kemppainen-Bertram, Joachim Schmitz                                    |
| Office       | Hausvogteiplatz  |
| E-Mail       | tba  |

#### 2. Aim of the Course

Most of you are unlikely to become professional economists. All of you, however, will have to interact with economists and to make choices on the basis of information provided by economists. Against this background, the goal of the two core classes in economics within the MPP is to provide you with:

- a thorough understanding of professional economists' way of thinking;
- a complete overview of the most important topics and approaches in micro- and macro-economics;
- a passive knowledge of the most relevant models and concepts for the understanding of economic issues in public policy-making;
- a hands-on approach to the application of state of the art research in economics.

The two core classes use different approaches to reach this goal. In the first semester the course U3 "Applied Economic Analysis" will focus on the core topics of micro- and macroeconomics. Theories and models will have to be learned and understood. Applications will mainly be used as illustrations. In the second semester (U4 "States and Markets") the starting point of teaching will be a concrete policy problem. Research and theoretical elements will be studied to come to concrete policy options.

The two approaches can be illustrated as follows:

1<sup>st</sup> Semester (U3 “Applied Economic Analysis”) → **TACKLE** the problem:

- **Topic** → textbook style topics
- **Analysis** → overview of standard theories and approaches
- **Case** → basic applications, mainly as illustrations
- **Keywords** → concepts, catchwords, models to be remembered
- **Lab & Exercises** → working through textbook chapters, selected articles and exercises.

Example:

|  | Topic                          | Analysis   | Case                           | Keywords  | Lab and Exercises |
|--|--------------------------------|--|--------------------------------|---|-------------------|
|  | Externalities and public goods | Externalities<br>Types of goods<br>Property rights | Transferable emissions trading | Free-Rider<br>Prisoners' Dilemma<br>Tragedy of the Commons<br>Coase-Theorem<br>Rivalrous and excludable goods | PR 18             |

2<sup>nd</sup> Semester (U4 “States and Markets”) → **CRACK** the problem

- **Case** → concrete policy challenge or problem
- **Research** → review of state of the art research on the issue (academic & policy papers)
- **Assessment** → group discussions on concrete questions to solve the case
- **Choice** → preparation of policy recommendations (briefings) discussion of alternatives
- **Keywords** → concepts, catchwords, models to be remembered

Example:

|     | Case                              | Research  | Assessment   | Choice   | Keywords   |
|-----|-----------------------------------|---|--|--|--|
| #12 | Fiscal policy coordination in EMU | JCMS symposium on the SGP (Dec 04)<br>IMF: WEO chapter on fiscal policies (2004)<br>Bayoumi/Eichen green 1993 | Does EMU trigger domestic destabilization?<br>Is there a collective action problem in EMU?<br>Can domestic fiscal stabilization be successful? | Briefing to the FM of Germany: “Economic considerations on breaching the SGP in 2001”<br>Briefing to the DG-ECFIN of the EU-COM: “Why to play hard on the SGP” | Optimum Currency Area<br>Real interest rate effect<br>Real exchange rate effect<br>Automatic Stabilizers<br>Political Business Cycle |

### 3. Teaching

There are three main elements:

- 1) Lectures in class will provide an overview of the different topics and provide some illustrations. However, since the class is rather small, you are all encouraged to raise questions and to contribute actively to discussions.
- 2) Depending on your background-knowledge in economics, the Lab will allow you to deepen your understanding or to do catch-up work.
- 3) There will be a course website on Blackboard with additional study material.

### 4. Requirements & Grading

You are all required to prepare classes, to participate actively in class discussions, and to attend the Lab sessions. I will ask questions when lecturing (in particular on topics already covered). There will be a mid-term exam (mainly on micro issues) and a final exam (mainly on macro issues).

|               |     |
|---------------|-----|
| Participation | 20% |
| Mid-term Exam | 40% |
| Final Exam    | 40% |

### 5. General Readings:

I will draw on two main textbooks: Pindyck & Rubinfeld and Burda & Wyplosz (see below). If needed, photocopies of the relevant chapters will be provided. However, you may want to consider buying them. You will probably find used copies on the internet. There are some other good books that you may want to consult from time to time (take into account your personal preferences concerning style, exposure, level of math, etc.). They are standard books in micro- and macroeconomics and cover broadly the similar material.

Micro:

- Robert S. Pindyck & Daniel L. Rubinfeld: Microeconomics, 6<sup>th</sup> ed., Prentice Hall (→ a typical US textbook, extremely well presented, little math background required).
- Hal R. Varian: Intermediate Microeconomics: A Modern Approach, 6<sup>th</sup> ed., W.W. Norton (→ more sober than the above, more maths and equations)
- Robert H. Frank: Microeconomics and Behavior, McGraw Hill (→ somewhere in between the two above, adopts a perspective from behavioral economics)

Macro:

- Michael S. Burda & Charles Wyplosz: Macroeconomics, A European Text, 4<sup>th</sup> ed., Oxford University Press (→ textbook style, extremely well presented).
- Olivier Blanchard: Macroeconomics, 3<sup>rd</sup> ed., Prentice Hall (→ textbook style, extremely well presented).

Additional readings (mainly state of the art economics papers) will be provided in pdf format in Blackboard.

Moreover, I strongly encourage all of you to subscribe to either the FT or the WSJ Europe. You may also want to have a look at the Economist every week.

## 6. Overview

Please note that this schedule is indicative only. Depending on the time needed to wrap-up a topic, I will adjust the schedule as appropriate.

| <b>Week</b> | <b>Date</b> | <b>Topic</b>   |
|-------------|-------------|--|
| #1          | 12.09.2005  | Markets and Prices (PR 2)  |
| #2          | 19.09.2005  | Production and Consumption (PR 8&9)                                    |
| #3          | 26.09.2005  | Market Structure and Competition (PR 9&10)                             |
| #4          | 10.10.2005  | Market failure and Government Intervention (PR 17)                     |
| #5          | 17.10.2005  | Externalities and Public Goods (PR 18)                                 |
| #6          | 24.10.2005  | Game Theory, Bounded Rationality and Uncertainty (F 8)<br>(→ MID-TERM) |
| #7          | 31.10.2005  | Money and Financial Markets (BW 8&9)                                   |
| #8          | 07.11.2005  | Macroeconomic Equilibrium (BW 10&11)                                   |
| #9          | 14.11.2005  | Aggregate Demand and Supply (BW 12-14)                                 |
| #10         | 21.11.2005  | Government and Fiscal Policy (BW 15-17, B 26)                          |
| #11         | 28.11.2005  | Monetary Policy (B 26, Mishkin)  |
| #12         | 05.12.2005  | Labor Markets (BW 4, 17)   |
| #13         | 12.12.2005  | Economic Growth – Theory and Policy (BW 18)                            |
| #14         | 19.12.2005  | Trade and Exchange Rates (BW 7, 19, 20)<br>(→ FINAL)                   |

## 7. Detailed Schedule

The references in the Lab & Exercises column refer to the following books:

PR = Robert S. Pindyck & Daniel L. Rubinfeld: Macroeconomics, 6<sup>th</sup> ed., Prentice Hall

F = Robert H. Frank: Microeconomics and Behavior, McGraw Hill

V = Hal R. Varian: Intermediate Microeconomics: A Modern Approach, 6<sup>th</sup> ed., W.W. Norton

BW = Michael S. Burda & Charles Wyplosz: Macroeconomics, A European Text, 4<sup>th</sup> ed., Oxford University Press

B = Olivier Blanchard: Macroeconomics. 3<sup>rd</sup> ed., Prentice Hall

### MICROECONOMICS

|            | Topic  | Analysis  | Case   | Keywords  | Lab and Exercises |
|------------|--|---|--|---|-------------------|
| 12.09.2005 | Markets and prices                                 | Basic supply and demand curves<br>Types of competition<br>Market failure<br>Market structures | How do taxes affect equilibrium prices and quantities? (F, 2ap2)<br>Oil pricing (PR 2) | Competitive markets<br>Noncompetitive markets<br>Arbitrage<br>Elasticity<br>Durables<br>Nondurables | PR 2+3            |
| 19.09.2005 | Production and consumption                         | Consumer and producer surplus<br>Price controls<br>Price supports<br>Price discrimination     | Airline regulation (PR 9)<br>Production quotas (PR 9)                                  | Quotas<br>Subsidies   | PR 9              |
| 26.09.2005 | Market structure and competition                   | Types of competition<br>Antitrust regulations   | US vs. Microsoft (PR 10)   | Monopoly<br>Monopsony<br>Oligopoly  | PR 10+11          |
| 10.10.2005 | Market failure and government intervention (PR 17) | Asymmetric information<br>Moral Hazard<br>Adverse Selection<br>Signaling<br>Principal Agent   | Acceptance and efficiency wage   | Market for Lemons   | PR 17             |

|                |   |  |                                |   |              |
|----------------|---|--|--------------------------------|---|--------------|
| 17.10.<br>2005 | Externalities and public goods                    | Externalities<br>Types of goods<br>Property rights   | Transferable emissions trading | Free-Rider<br>Prisoners' Dilemma<br>Tragedy of the Commons<br>Coase-Theorem<br>Rivalrous and excludable goods           | PR 18        |
| 24.10.<br>2005 | Game theory, bounded rationality, and uncertainty | Strategic decisions<br>Repeated Games<br>Sequential Games<br>Preferences<br>Utility<br>Choice under uncertainty<br>Behavioural Economics | Boeing vs. Airbus              | Tit for Tat<br>Nash Equilibrium<br>Maximin<br>Stackelberg Leader<br>Bounded rationality<br>Opportunity costs<br>Framing | PR 13<br>F 8 |

+++ MIDTERM EXAM +++

→ Date and venue to be announced

#### MACROECONOMICS

|                | Topic                       | Analysis  | Case   | Keywords   | Lab & Exercises |
|----------------|-----------------------------|---|--|--|-----------------|
| 31.10.<br>2005 | Money and Financial Markets | Money Market<br>Demand for money<br>Central Banking                           | Stopping hyperinflation<br>Money growth in EMU | M1, M2, M3<br>Fisher Effect<br>PPP   | BW 8+9          |
| 07.11.<br>2005 | Macroeconomic Equilibrium   | Money Market<br>Demand for money<br>Central Banking<br>Open Market Operations | Keynes vs. Neoclassics                         | Mundell-Fleming model<br>General equilibrium<br>Demand multiplier<br>Policy mix<br>IS-LM | BW 10+11        |

|                |                                     |  |   |   |                |
|----------------|-------------------------------------|--|---|---|----------------|
| 14.11.<br>2005 | Aggregate Demand and Supply         | General Macroeconomic Equilibrium<br><br>IS-LM framework<br><br>Neoclassical and Keynesian approaches      | Reacting to oil shocks                      | IS-LM-BP<br><br>Philips curve<br><br>Output gap<br><br>Okun's Law   | BW 12-14       |
| 21.11.<br>2005 | Government and Fiscal Policy        | Provision of public goods<br><br>Redistribution<br><br>Debt<br><br>Demand management                       | The stability and growth pact               | Tax smoothing<br><br>Automatic stabilizers<br><br>Lucas critique<br><br>Laffer curve<br><br>Golden rule                     | BW 15-17, B 26 |
| 28.11.<br>2005 | Monetary Policy                     | Institutional foundations of central banking<br><br>Monetary policy strategies<br><br>Rules vs. discretion | Is the Fed more accommodating than the ECB? | Taylor rule<br><br>Inflation targeting  | B 26, Mishkin  |
| 05.12.<br>2005 | Labor Markets                       | Wage-setting<br><br>Theories of unemployment   | European unemployment                       | Insiders / Outsiders<br><br>Frictional Unemployment<br><br>Beveridge curve  | BW 4, 17       |
| 12.12.<br>2005 | Economic growth – theory and policy | Growth theories<br><br>Production functions<br><br>Productivity<br><br>Endogenous growth                   | Can the developing world grow?              | Solow growth model<br><br>Cobb-Douglas production function  | BW 18          |
| 19.12.<br>2005 | Trade and exchange rates            | Basic exchange rate theories<br><br>Fixed vs. Floating<br><br>Currency Board                               | China and the US Dollar                     | Comparative Advantage<br><br>Heckscher-Ohlin-Model<br><br>Brander-Spencer-Model<br><br>REER<br><br>Balassa-Samuelson Effect | BW 7, 19, 20   |

+++ FINAL EXAM +++