

Midterm Review

We have covered four topics

1. Social Security, Medicare, Govt. budget constraint.
2. Fiscal Policy
3. Time Inconsistency
4. Evidence of Monetary Policy

Social Security, Medicare, Govt. Budget Constraint

1. Understand the historical and current trends for government taxes and expenditures.
2. The implications that entitlement programs have for govt. finances.
3. Be able to use the government budget constraint to demonstrate
 1. Why inflation acts as a tax.
 2. What determines if the debt/gdp ratio is stable or not.

Fiscal Policy

1. Ricardian Equivalence

If taxes are lump sum, then the only thing that matters about tax policy is the present discounted value of taxes. But this must be equal to the present discounted value of government expenditures.

A deficit financed tax cut will have no impact on consumption and interest rates.

2. The Ramsey problem

When taxes are distortionary, the timing of taxes does indeed matter. When agents value consumption at different dates equally, the optimal tax policy is one of tax smoothing. This minimizes the welfare costs of taxes.

Fiscal Policy - Associated Terms and Concepts.

1. Intertemporal budget constraint.
2. Permanent income hypothesis – Keynesian consumption function.
3. Interest rate is the price of current consumption relative to future consumption.
4. Testing Ricardian equivalence – difficulties.
5. Indirect utility function.

Time Inconsistency

1. Understand basic intuition.
2. Explain why this result has led to optimal policy being described as rules rather than actions.
3. In Fischer model, be able to identify endogenous and exogenous elements at each decision stage.
4. Know the difference between time consistent equilibrium and time inconsistent solution.
5. Come prepared to give examples.

The Evidence of Monetary Policy

Christina Romer article

1. Similarities of 20th century business cycles.
2. Differences between 20th century business cycles.
3. Evidence of monetary policy's effects on business cycles.
4. Phillips curve.

Marvin Goodfriend article

1. History of Fed Policy post-WWII.
2. Go-stop policy.
3. Inflation during the 1970's

Conclusion

1. Bring blue book for exam.
2. Most important is the intuition behind the results.
3. Remember to use terms and definitions precisely – think like an economist not like a journalist.
4. When relevant, stay within the context of the model – this will stop you from going astray.

Good luck - and do the reading.