



Macroeconomics of Depressions

Econ 418 – Spring 2020

Middlebury College Department of Economics

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Office Hours: Tuesdays 3-4:30pm, Wednesdays 1:30-3pm, and by appointment

Seminars: 1:30–2:45pm Tuesdays and Thursdays, Twilight Hall 204

*“Macroeconomics was born as a distinct field in the 1940s, as a part of the intellectual response to the Great Depression. The term then referred to the body of knowledge and expertise that we hoped would prevent the recurrence of that economic disaster. My thesis in this lecture is that macroeconomics in this original sense has succeeded: **Its central problem of depression prevention has been solved, for all practical purposes, and has in fact been solved for many decades.**”*

– Robert E. Lucas. 2003. *American Economic Review*, 93(1): 1–14.

Course Description: In this course we will develop a framework for analyzing liquidity traps, economic depressions, and failures of macroeconomic stabilization policy. We will contrast the causes of and policy responses to the Great Depression, Japan’s “Lost Decade(s),” the Great Recession, and the ongoing depression in Greece. We will also study the international transmission of the Great Depression through the gold standard and the transmission of the Great Recession through financial linkages. Throughout, we will track the evolution of views on stabilization policy, austerity, and the opportunity costs of depressed demand.

Prerequisites: ECON 0240 or ECON 0250.

Course Rationale and Objectives: In introductory and intermediate macroeconomics courses we learn that the government should, in theory, be able to cushion economic shocks and stabilize output and employment back to potential. Yet the historical record is rife with failures of policy to ameliorate prolonged spells of depressed aggregate demand and cyclical unemployment—particularly within our lifetime. Encouragingly, economic thought on stabilization policy has evolved as dominant theories of the day failed to explain prolonged downturns or monetary policy losing traction at the zero lower bound of nominal interest rates. Our first objective is to understand how stabilization policies can be constrained, or worse, why monetary and fiscal policy regimes have periodically impeded recoveries. To do so, we will use a combination of macroeconomic theory and four historical case studies of economic depressions. Our second objective is to understand the learning curve (or lack thereof) of policymakers and economists from these downturns, particularly the reexamination of stabilization policy after the Great Depression and then the Great Recession.

Seminar Structure: This is a seminar, not a class. Our seminar will primarily be oriented around reading and discussion, although I will occasionally give mini lectures or seminar talks. The course will also involve a fair amount of analytical writing, and likely less math or statistical analysis than other upper-level economics courses. There is no textbook. Readings will be drawn from chapters of a number of required core books (below) interspersed with supplemental readings of shorter journal articles and papers (also below).

Required Core Books:

- **Krugman, Paul.** 2009. *The Return of Depression Economics and the Crisis of 2008*. New York, NY: W. W. Norton & Company. ISBN-13: 978-0393337808.
- **Galbraith, John Kenneth.** 2009. *The Great Crash: 1929*. New York, NY: Houghton Mifflin Harcourt Publishing Company. ISBN-13: 978-0547248165.
- **Temin, Peter.** 1991. *Lessons from the Great Depression (The Lionel Robins Lectures for 1989)*. Cambridge, MA: The MIT Press. ISBN-13: 978-0262700443.
- **Koo, Richard C.** 2009. *The Holy Grail of Macroeconomics: Lessons from Japan's Great Recession*. Hoboken, NJ: John Wiley & Sons. ISBN-13: 978-0470824948.
- **Blinder, Alan S.** 2013. *After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead*. New York, NY: Penguin Books. ISBN-13: 978-0143124481.
- **Wessel, David.** 2009. *In FED We Trust: Ben Bernanke's War on the Great Panic*. New York, NY: Three Rivers Press. ISBN-13: 978-0307459695.
- **Papaconstantinou, George.** 2016. *Game Over: The Inside Story of the Greek Debt Crisis*. ISBN-13: 978-1530703265.

Supplemental Readings — Journal Articles, Working Papers, and Reports:

- **Dao and Loungani (2010):** Dao, Mai and Prakash Loungani. 2010. "The Human Cost of Recessions: Assessing It, Reducing It." IMF Staff Position Note No. 2010/17
- **Romer (1993):** Romer, Christina D. 1993. "The Nation in Depression." *Journal of Economic Perspectives*. 7(2): 19–39.
- **Romer (1990):** Romer, Christina D. 1990. "The Great Crash and the Onset of the Great Depression." *Quarterly Journal of Economics*. 105(3): 597–624.
- **Bernanke (1983):** Bernanke, Ben S. 1995. "Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression." *American Economic Review*. 73(3): 257–276.
- **Romer (1992):** Romer, Christina D. 1992. "What Ended the Great Depression?" *The Journal of Economic History*. 52(4): 757–784.
- **Vernon (1994):** Vernon, J.R. 1994. "World War II Fiscal Policies and the End of the Great Depression." *Journal of Economic History*. 54(4): 850–868.

- **Krugman (1998)**: Krugman, Paul R. 1998. “It’s Baaack: Japan’s Slump and the Return of the Liquidity Trap.” *Brookings Papers on Economic Activity*. 29(2): 137–183.
- **Bivens (2016)**: Bivens, Josh. 2016. “Why is recovery taking so long—and who’s to blame?” Economic Policy Institute Report, August 2016.
- **IMF (2016)**: Independent Evaluation Office of the International Monetary Fund. 2016. “The IMF and the Crises in Greece, Ireland, and Portugal.” IMF Evaluation Report.
- **Blanchard and Leigh (2013)**: Blanchard, Olivier J. and Daniel Leigh. 2013. “Growth Forecast Errors and Fiscal Multipliers.” IMF Working Paper 13/1.
- **Blanchard and Summers (2017)**: Blanchard, Olivier J. and Lawrence H. Summers. 2017. “Rethinking Stabilization Policy: Evolution or Revolution?” NBER Working Paper No. 24179.

All of these supplemental readings are available on our Canvas website.

Winter Reading: You are expected to have read *The Return of Depression Economics and the Crisis of 2008* by Paul Krugman **before our second seminar on February 13**. The book is a relatively quick read and does a great job setting the scene for this course. Krugman also covers several jarring economic crises in emerging markets that you should be familiar with but which are not emphasized in this course, notably the Latin American debt crisis of the 1980s and the Asian financial crisis of 1997–98.

Expectations on Seminar Readings: This is a reading heavy seminar. But we are all juggling a lot during the semester, and I do not expect you to carefully read everything I assign. Be strategic and read critically. Skim what you can, particularly in the core books. (We will also discuss strategic reading for economics early in the semester.) But you should try to get through a good chunk of the reading for each seminar. That said, everyone gets one free pass on seminar reading and participation: If you are unable to get through any of the reading for a particular seminar—for whatever reason—you can send me an email before class and you will get a discrete pass on being asked questions that day, no questions asked.

Overview of Assessment and Grade Determination:

Take-home Midterm	15%	Due: March 5
Essay on the Great Depression	5%	First draft due: TBD
	5%	Return/receive peer feedback: TBD
	15%	Final submission due: TBD
Final Term Paper		Proposal due: TBD
	5%	Outline and bibliography due: TBD
	5%	First draft due: TBD
	20%	Final submission due: May 7
Reading Response Posts	15%	Due periodically
Seminar Participation	15%	Expected regularly

Take-home Midterm (15%): We will have one take-home midterm assigned on February 25 and due at the start of seminar on March 5. I want everyone in the seminar to have a working model of the macroeconomy and stabilization policy at their disposal—an analytical framework that should improve seminar discussion and your essay arguments alike. With that in mind, the midterm will cover macroeconomic theory and analysis of liquidity traps, credit crunches, and failures of stabilization policy through the lens of the *IS-LM-PC* macro model. I will provide you with the take-home midterm from a previous semester (but not the solutions) as a study reference ahead of the exam. The midterm is open note and you are encouraged to work collaboratively, but you must submit your own copy of the midterm.

Essay on the Great Depression and Policy Implications (25%): You will have a first essay on the Great Depression and its policy implications, in which you can choose to analyze the myriad of explanations and forces either (1) causing or (2) putting an end to the depression. The verdict is still out: economists still debate both questions today, giving you plenty of leeway to explore which explanations and what evidence you find more or less compelling. Before the final essay is due on April 14, you must submit a draft for peer feedback on March 31. You will have one week to turnaround your feedback to a classmate, due April 7, and then one week to incorporate feedback on your paper and make revisions. A timely, good-faith effort at the first draft and your peer feedback are each worth 5% of your course grade, while the assessment of your final submission is worth 15%. The full prompt is available on our Canvas website.

Final Term Paper (30%): You will have a final term paper due at the start of seminar on May 7 (in lieu of a final exam). You again have a choice of topics. The first option is to analyze to what extent the U.S. policy responses to the Great Recession succeeded or failed, and to what degree there was a learning curve from the experiences of the Great Depression and Japan's Lost Decade(s). The second option is to propose your own research paper topic on any economic depression other than the Great Depression or Great Recession; if you choose this option, email me a rough paper proposal by April 18. A draft outline and annotated bibliography for your paper are due on April 23, and are worth 5% of your course grade. A first draft of your term paper is due on April 30, and a timely, good-faith effort at the draft is worth another 5% of your course grade. The final submission of your term paper is worth 20% of your course grade. The full prompt is available on our Canvas website.

Reading Response Posts (15%): There will be roughly six reading response prompts posted to our Canvas website over the semester. The prompts and your response posts are intended to help focus your seminar reading and stimulate our seminar discussions. I will also provide you with constructive feedback throughout the semester, but response posts will only be collectively graded at the end of the semester. As with seminar readings, you get one free pass: Your worst reflection post (or one missing/late post) will not be factored into your course grade.

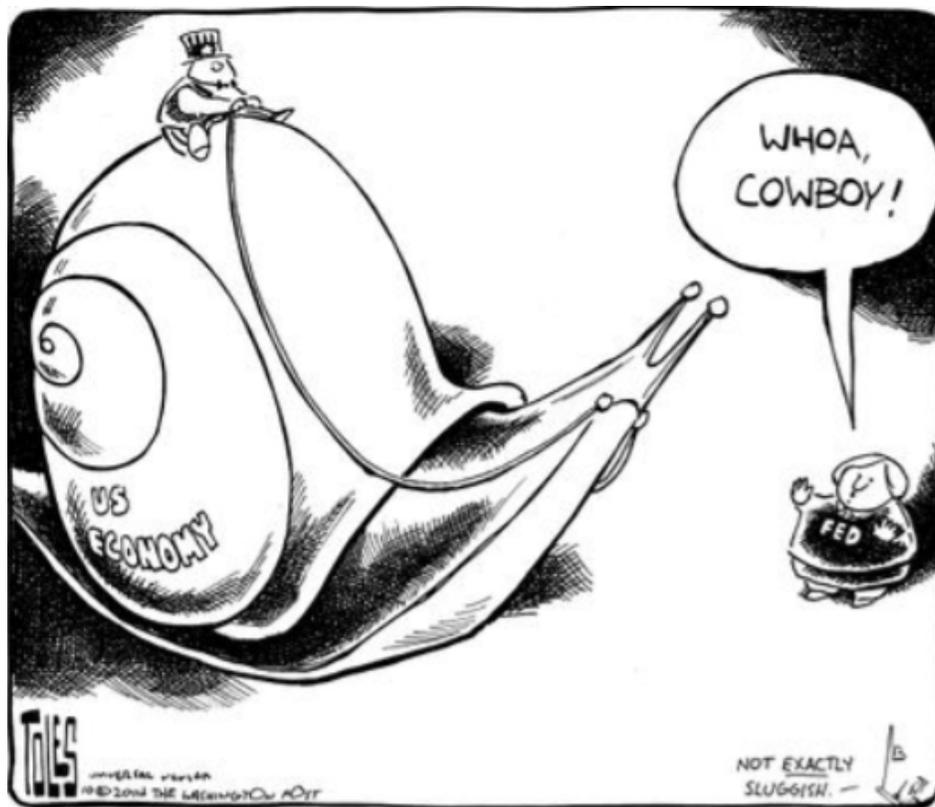
Seminar Participation (15%): Attendance and participation in seminars is expected and somewhat subjectively factored into your course grade. Send me an email ahead of time if you will not be able to attend a seminar for a legitimate reason, such as illness or an away athletic event. Similar to seminar readings, you get one free pass with unexcused absences.

Each subsequent unexcused absence will substantially reduce your participation grade, and five or more unexcused absences will result in zero credit for seminar participation (i.e., setting a significantly lower ceiling of a B for your highest possible course letter grade).

Grading Policies: Your grade on the take-home midterm and the final submission of both essays will be marked down by half a letter grade for each day past being due (i.e., A- to B+). There is no partial credit for missing the deadlines to turn in a first draft for peer feedback or to return feedback to a peer—it is disrespectful to your classmates to miss these deadlines, so don't miss them. Late reading response post submissions will not be counted—your reflection is a useful exercise *ahead* of our seminar discussions. But as noted above, one reading response post will not be factored into your grade, to account for any extenuating circumstances. Lastly, it is a violation of college policy and FERPA for me to discuss grades via email. If you have a question about your grade, please make an appointment to meet with me during office hours.

All of your work must adhere to Middlebury's [Academic Honesty and Honor Code Policies](#).

Movie Night: We will watch the film adaptation of Michael Lewis's excellent book *The Big Short* as a lively introduction to the U.S. subprime mortgage crisis and the Great Recession. I will organize a viewing party on campus one evening and provide dinner for those able to attend. (Possibly 7:30-9:30pm on Wednesday, April 1?) Attendance is encouraged as opposed to required, but you should watch the film on your own if you cannot make the seminar viewing (the DVD is on course reserves).



Tentative Course Outline

Note: Weekly coverage might change slightly depending on the pace of the seminars.

Week	Content
1: 2/11, 2/13	<ul style="list-style-type: none"> • Introduction: Depression Economics • Reading: <i>The Return of Depression Economics and the Crisis of 2008</i>
2: 2/18, 2/20	<ul style="list-style-type: none"> • Liquidity Traps, Credit Crunches, and Failures of Neoclassical Theory • Reading: Dao and Loungani (2010) pp. 1-13, Romer (1993)
3: 2/25, 2/27	<ul style="list-style-type: none"> • The Onset of the U.S. Great Depression • Reading: <i>The Great Crash: 1929</i>, Romer (1990)
4: 3/3, 3/5	<ul style="list-style-type: none"> • Domestic and Global Propagation of the Great Depression • Reading: Bernanke (1983), <i>Lessons from the Great Depression</i> Ch. 1–2
5: 3/10, 3/12	<ul style="list-style-type: none"> • What Ended the U.S. Great Depression? Fiscal vs. Monetary Policy? • Reading: <i>Lessons from the Great Depression</i> Ch. 3, Romer (1992)
6: 3/17, 3/19	<ul style="list-style-type: none"> • The Return of the Liquidity Trap: Japan’s Lost Decades • Reading: <i>The Holy Grail of Macroeconomics</i> Ch. 1–3
7: 3/31, 4/2	<ul style="list-style-type: none"> • Lessons from Japan’s Lost Decades? • Reading: Krugman (1998) • The U.S. Subprime Fiasco • Viewing: <i>The Big Short</i> • Reading: <i>After the Music Stopped</i> Ch. 1–3
8: 4/7, 4/9	<ul style="list-style-type: none"> • The Financial Crisis of 2007–09 • Reading: <i>After the Music Stopped</i> Ch. 4–6 • Reading: <i>In FED We Trust</i> Ch. 5, 7–10
9: 4/14, 4/16	<ul style="list-style-type: none"> • The Great Recession: U.S. Policy Responses and Anemic Recovery • Reading: <i>In FED We Trust</i> Ch. 1, 11–14 • Reading: <i>After the Music Stopped</i> Ch. 8-9, Bivens (2016)
10: 4/21, 4/23	<ul style="list-style-type: none"> • The Great Recession: Global Propagation • Reading: <i>After the Music Stopped</i> Ch. 16 • The Making of the Greek Debt Crisis • Reading: <i>Game Over</i> Ch. 1-9
11: 4/28, 4/30	<ul style="list-style-type: none"> • The Greek Debt Crisis and Lessons from Greece’s Ongoing Depression • Reading: <i>Game Over</i> Ch. 10-17, 20-21 • Reading: IMF (2016) Ch 2., 4B, Blanchard and Leigh (2013)
12: 5/5, 5/7	<ul style="list-style-type: none"> • Rethinking Macro: Fiscal Policy, Hysteresis, and Secular Stagnation • Viewing: Larry Summer’s Secular Stagnation Speech at IMF Forum • Reading: DeLong and Summers (2012), Blanchard and Summers (2017)

Readings for each seminar meeting are listed and available in the weekly Canvas modules.