Marquette University
e-Publications@Marquette

Economics Faculty Research and Publications | Economics, Department of

1-1-1987

Review of *Advances in Monetary Economics* by David Currie

Abdur Chowdhury
Marquette University, abdur.chowdhury@marquette.edu

Published version. *Southern Economic Journal*, Vol. 53, No. 3 (January1987): 794-795. DOI. © 1987 Southern Economic Association. Used with permission.
Abdur R. Chowdhury was affiliated with Bentley College at the time of publication.

overpredicts usage by 5 to 6%. Their model could have been sold more effectively if they would have shown that a simple model predicted significantly worse, while a more sophisticated model did not predict significantly better.

Overall, this is a fine volume which students of transportation will want to add to their bookshelves.

Douglas M. Brown
Georgetown University

Advances in Monetary Economics.
Edited by David Currie. Dover, New Hampshire: Croom Helm Ltd., 1985. *Pp. 228. $34.50.*

Advances in Monetary Economics is a compendium of ten papers presented at various conferences organized by the Money Study Group at Oxford University in 1984. The collection consists of carefully reasoned and balanced essays on the theoretical, empirical and institutional aspects of monetary economics. The need for an increased awareness of various monetary phenomenon and for analysis of appropriate policy responses are important, especially in view of recent experience. The papers in this book provide a stimulating and thoughtful discussion of important and controversial monetary issues. Opinions may differ, of course, as to the relative merit of these papers. The focus and style is somewhat different as well, but this is a minor shortcoming true of virtually all edited collections from several different authors. One does come away from the effort in reading this book with a sense that though starting from slightly different points of view, these papers pull together like a team with a common goal—promoting research into monetary economics.

The volume opens with a theoretical paper by Backus and Driffill in which they argue that the skepticism over government's commitment to stabilization goals is partly responsible for high unemployment and low manufacturing output in the U.K. in late seventies. They explain these issues in a game-theoretic framework and argue that governments have an incentive to carry out previous policy commitments in order to maintain credibility of policy rules. In the second paper, the reader is treated to an interesting digression. Here author Neil Rankin attempts to re-examine the issue of debt-neutrality in a disequilibrium framework. Bonds are no longer considered to be neutral if they perform functions other than as a store of value. However, this does not imply that bond-financed tax cuts can lead to a long-run convergent expansion of the economy. Rankin's demonstration that conditions may exist under which this can occur may provide some reassurances for Keynesians.

In recent years the real exchange rates have experienced considerable fluctuations. The paper by Giavazzi and Sheen uses a simple fixed output model to demonstrate that fiscal policy can be a source of real exchange rate fluctuations while also trying to disprove Mundell's assertion that fiscal expansion always leads to a real exchange rate appreciation. They argue that a short-run appreciation is possible even though the wealth asset-demands may lead to a depreciation in the long run.

The problem of model uncertainty in policy design is very important. In the next paper, Becker et al. deal with the design of optimal policy in the presence of a number of rival models for the economy in their paper. However, it is very difficult to ascertain what the authors are actually trying to prove. If they had been more clear in developing the simultaneous optimization algorithm in deriving a Pareto optimal policy, they might have accomplished more towards clarifying their point.

The problems of constructing large-scale financial models are well understood. In the next two papers, Keating and Van Loo develop a highly disaggregated sectoral model for the British monetary and the Dutch banking sector respectively. Careful analysis of the instruments of monetary policy available to the monetary authorities is allowed by the high degree of disaggregation. However, in both papers, a priori restrictions are imposed on the models. (e.g., Keating assumes diagonal covariance matrices and single period optimization.) There is no way to test whether these restrictions are true or not. In recent years, many economists have expressed suspicion that a priori restrictions used in structural models are not always based on correct economic theory. If the model is specified according to a set of incorrect laws, the parameter estimates will be biased and possible inconsistent and the statistical inference based on it will be meaningless.

Gallais-Hamonns uses a Markowitz risk-return framework to empirically analyze the effect of three legal guidelines on the portfolio decisions of French open mutual funds. These guidelines try to reduce the choice of fund managers in diversifying their portfolios internationally, as well as requiring them to hold a certain portfolio of government liabilities in order to reduce risk. The results suggest that certain guidelines have only limited effect while others severely constrain portfolio decisions.

In contrast to the earlier papers in the book, the last three papers deal with empirical issues relating to the financial sector of the U.K. and Germany. Hoggarth and Ormerod model the determination of sales of long maturity government debt to the U.K. non-bank private sector. This study confirms earlier work concerning the importance of expectations of capital gains on gilt holdings. The emphasis on monetary control and the crucial role of gilt sales in controlling monetary aggregates gives this study an important policy dimension. Finally, Hammond and Kay perform a comparative study of the methods of insurance regulation in the U.K. and Germany while Cable and Turner combine theory and institutional analysis to describe the arguments concerning bank provision of finance for industry in the U.K.

Although each paper has its own hypothesis, methodology, and data, they share some common strengths and weaknesses. A unifying thread running through these papers is their concern with policy in the monetary field, both in terms of broad macro questions of monetary and fiscal management and the policy issues at the micro level towards financial institutions and markets. Most of the papers are long and elaborate and thus include more discussion of the rationale for the approach used and the potential policy relevance. The diversity of analytical techniques employed is impressive. Each paper is based upon a considerable body of existing literature and the policy discussions tend to assume substantial knowledge about the relevant topic.

Most economists and policy makers are of the opinion that theoretical analysis can be better understood when it is supplemented by empirical work. The papers in this book have tried to do just that, thus making the book a significant contribution to our knowledge in the area of applied monetary economics. The readers will find interesting papers and will understand the many problems associated with such a dynamic field. Moreover, by specifying where additional research is required, these papers have encouraged future work in this area.

Abdur R. Chowdhury
Bentley College

Macroeconomic Thought: A Methodological Approach.
By Sheila C. Dow. Oxford and New York: Basil Blackwell, Ltd., 1985. *Pp. ix, 278. $29.95.*

Many people consider the field of macroeconomics to be in total disarray primarily because of the numerous schools of macroeconomic thought. The author believes that economists and the public alike would benefit from improved communication between the members of the various macroeconomic schools of thought. Members of different schools are unable to communicate with one another because of differences in underlying world view, or differences in methodology. The author believes this book, designed to be a textbook for intermediate and advanced students in either macroeconomics or methodology, contributes to improved interschool communication by explaining the different methodological approaches of the Neo-Austrian, Mainstream, Post-Keynesian, and Marxian schools of thought. The idea of a textbook-level discussion is appealing to this reviewer for at least two reasons. Firstly, most economists are relatively unfamiliar with the field of methodology (or philosophy of science). Secondly, members of alternate schools of thought are generally unfamiliar with one another's work.

But to this reviewer the book is not capable of improving interschool communication, nor is it suitable as a textbook simply because too much ground is covered in too few pages. After discussing methodological issues and their relationship to economic thought in Chapters 2 and 3, the author devotes the 162 pages in chapters 4 through 8 to five important features of macroeconomic thought. In order of appearance they are the relationships between methodology and each school of thought's treatment of microfoundations, equilibrium, expectations, money, and macroeconomic policy. It would be difficult enough to contrast the different treatments of these items within only one of these schools of thought in 162 pages, let alone cover four schools of thought adequately.

Be that as it may, Dow's basic thesis is that each school of thought is held together by explicit agreement on methodology. For example, on the one hand mainstream economists accept the traditional Cartesian/Euclidean methodology according to which the only acceptable scientific arguments are those