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Review of *Monetary Economics* by N. Gregory Mankiw

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and notes how irregularities in the financial sector affect the operation of the real sector albeit with a lag. Terzi examines the differences between technical analysis and the economists' view of the stock market and concludes that markets are a social process through which information is transmitted continuously, a view held by both Keynes and Hayek, and not a system of mathematical equations. Zajicek examines the recent events in Poland where individuals have tried to move the economic system from a centrally planned economy to a decentralized market economy and concludes that many pitfalls exist.

At least two themes tie this collection of essays together. The first theme, that more attention must be paid to the different ways by which key terms are defined, may be found in Sawyer's essay. In contrast to the classical economists who state that full employment is the norm, Sawyer states that unemployment is the norm for the decentralized market economy. The "employment norm" for the decentralized market economy as seen by the classical economists and the Post Keynesian economists differ because these two groups define employment and unemployment differently. As a result of this difference agreement between these two groups is very unlikely.

The second theme, that more attention must be given to history of the discipline of economics, may be found in Darity's essay. After comparing the key postulates of the new growth theory and the classical theory of growth, Darity concludes that the only thing new about the new growth theory is its mode of expression: mathematics has taken the place of words. The study of the history of economic thought is important and should not be deleted from the curriculum is Darity's message.

As is the case with any collection of essays drawn from a group of conference papers a neat and complete articulation within and between the topical areas is lacking; but, having said that, the editors must be commended in forging the degree of articulating that does exist. An example of this articulation may be seen in the continuity of the essays by Minsky, Kregel and Cornford. Of the fourteen essays contained in this volume, this reviewer recommends Bunting's essay on the rate of saving, Shapiro's essay on the principal-agent problem, Darity's essay on the new growth theory, Kregel's essay on financial transitions, and Terzi's essay on stock market operation theories. Each essay is short and to the point, contains important insights into the issues which divide our discipline, and is a pleasure to read.

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Monetary Policy.

Edited by N. Gregory Mankiw. Chicago: The University of Chicago Press, 1994. *Pp. ix, 352. \$50.00.*

This book represents an impressive collection of a wide range of empirical research on monetary policy. Monetary authorities have multiple objectives which include, but are not limited to, stabilizing employment and prices and fostering economic growth. Their actions in attaining these objectives have powerful impact on the economy. The articles in this book provide new evidence on the timing, magnitude, and channels of these actions.

The volume consists of nine papers by prominent academicians and policy makers. Each paper, except one, is followed by a commentary. The papers address diverse topics. It is sometimes obvious that the authors do not always agree with one another. The extent of divergence and even sharp contradiction, especially in interpretation and conclusion, is revealing. What binds these papers together is a belief that monetary policy is important and hence serious research should be conducted in order to improve its effectiveness.

An interesting question in monetary economics is the amount of information contained in monetary aggregates and how a central bank might use that information. In the first paper in the volume, Martin Feldstein and James Stock use a vector autoregressive model to derive an optimal M2 rule. They argue that the Federal Reserve Bank could use M2 to reduce both the average inflation rate and the volatility in GDP growth. Using a battery of tests for parameter stability, the authors find a stable relationship between nominal GDP and M2. In contrast, the link between nominal GDP and more narrow monetary aggregates are found to be highly unstable.

Robert Hall and Gregory Mankiw argue that nominal income targeting is a reasonably good rule for the conduct of monetary policy. They compare three types of nominal income targets and suggest that the consensus forecast of future nominal income could play a role in preventing the central bank from deviating from its announced target. They use the results from a simulation model to point out that one of the primary

benefits of such a policy would be reduced volatility for the price level and the inflation rate. However, whether real economic activity would also be less volatile is unclear from these results. Hall and Mankiw's article leaves room for disagreement, and Kenneth West's commentary does a nice job of pointing out a number of problem areas.

In recent years, there have been numerous suggestions by policy makers and academicians that variables, such as, commodity prices, exchange rates, and interest-rate yield spreads could be useful in conducting monetary policy. Proponents of using such indicators refer to their improved forecasting performance. In his paper, Michael Woodford points out to the irrelevance of reduced-form forecasting regression in this regard and argues that structural econometric models should be used for evaluating various indicators of monetary policy.

It is widely accepted that, in the long run, inflation is determined primarily by monetary policy. However, the short-run behavior of prices is still a subject of intense debate. The next three papers in the volume by Alan Blinder, Laurence Ball, and Michael Bryan and Stephen Cecchetti raises various issues relating to the determination of the price level. Blinder reports on a survey conducted with the help of a group of graduate students at Princeton. In this survey, firms are asked about their behavior as well as their opinion about which particular theory of price adjustment best describes their behavior. An analysis of the responses confirm the presence of sticky prices in the United States. When considering price changes, the survey indicates that the firms are very concerned about coordination issues.

The central bank's effort to reduce inflation often results in high unemployment and low output. The cost of such a policy is often calculated using the sacrifice ratio: the ratio of the loss in output to the reduction in inflation. Ball calculates the sacrifice ratio for sixty-five individual disinflation episodes in the OECD countries. He finds that the ratio is usually smaller in more rapid disinflations. It is also smaller in countries with more flexible wage-setting institutions.

Policy makers and researchers have long searched for the appropriate measure of inflation which would help to distinguish short-term noise from long-term trend. Bryan and Cecchetti address this issue by considering alternative measures of core inflation. Based on the results from a model of asymmetric supply shocks with costly price adjustment, they suggest that the median rate of inflation provide a superior measure of core inflation. They find that, compared to average inflation as well as other measures of core inflation, the median inflation is more correlated with lagged money growth and offers a better forecast of future inflation.

The papers by Anil Kashyap and Jeremy Stein and by Jeffrey Miron, Christina Romer, and David Weil deal with the monetary transmission mechanism. Specifically, they provide alternative perspectives on a recently debated channel of monetary policy—the reduction in bank lending that must accompany a reduction in bank reserves—better known as the lending view of monetary policy. According to this view, when the central bank reduces reserves, it not only raises the interest rate on bonds, but also reduces the supply of bank loans. Kashyap and Stein survey the recent literature on the lending view, examining its theoretical foundation as well as reviewing the empirical evidence.

Miron, Romer, and Weil examine how the importance of the lending channel has evolved over time. However, their study raises more questions than it answers. For instance, their results indicate that the conventional indicators of the lending channel fail to predict the performance of this channel during both the pre- and post-Great depression period.

In a recent paper, Christina and David Romer have identified dates when the FED appeared to have shifted their policy towards reducing the inflation rate. In the last paper in this volume, Matthew Shapiro investigates the causes and effects of this decision. However, his results only indicate the obvious—the FED's decision regarding disinflation is influenced by the outlook for unemployment as well as inflation. Interestingly, Shapiro fails to find any reduction in the inflation rate after the Romer dates. Permanent reduction in the inflation rate is evident only after the Volcker disinflation; while, the disinflation after the 1973 oil crisis turns out to be temporary.

Those readers who approach this volume looking for a single, cohesive treatment of monetary policy will likely be disappointed. The nine selections in the book covers an enormous range of research and theory. A danger in such an endeavor is that the volume may end up scattered and cumulatively incoherent. Thanks to a good editorial job by Gregory Mankiw, this doesn't happen as the selections are tied so strongly to the central theme of monetary policy, ensuring its effectiveness as a policy tool.

This volume, in many ways, raises and indeed explores many intriguing issues faced by the monetary

policy makers. The contents of the volume leaves the reader partially satisfied. This may be attributed not to the limitations of the book, but rather to the dilemmas faced by the policy makers. Each article varies in focus and results, but taken in its entirety, the collection is successful in inspiring some of the researchers in this area to undertake further work on these important and exciting topics.

The volume represents an important contribution to our understanding of monetary policy and should appeal to a wide range of audiences well beyond the central bankers and academicians. It is a required reading for any serious student of monetary policy and its role as a stabilization tool.

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Capital and Wages: A Lakatosian History of the Wages Fund Doctrine.

By John Vint. London: Edward Elgar, 1994. Pp. x, 278. \$67.95.

Episodes in the history of economic thought are sometimes subjected to radical evaluations from those who wish to analyze past theory and theoretical developments from historiographic and methodological perspectives. Much of what attempts to pass as “analysis” revolves around the “paradigmatic” approach of Thomas Kuhn and the “methodology of scientific research programs” (MSRP) of Imre Lakatos. Unfortunately the application of this method has yielded little in the way of understanding the nature of particular episodes in the analysis of the “progress” of economics. This book on the wages fund—one of the key theoretical underpinnings of classical economics—and the “reasons” for Mill’s ostensible “recantation of it” is only one of the most recent in the genre. This comment is not meant to imply that Vint has not taken his subject seriously, for he has. He seeks to apply the Lakatosian “theory” to the wages fund alone and not to the classical “paradigm” of which the wages fund theory was an inextricable part. And in his workmanlike “review of the troops” strewn throughout the book Vint shows considerable attention to detail. Unfortunately Vint’s discussion is adrift in the sea of relativism that is part and parcel of attempts to apply such methodologies to the development of economic theory. Vint’s so-called discoveries simply do not stand up to better and more cogent alternative explanations.

The central problem is the following. Lakatosian concepts, which Vint adopts, include a hard core of theory (in this case wages fund theory), a protective belt (which, due to lack of empirical testing, are factors which protect the hard core) and “monsters”—mainly questions that the theory cannot answer. Unfortunately, identification of the hard core, the protective belt or “monsters” is totally vacuous exercise with equally vacuous results. It uses selective “facts” from history, selective historical interpretation and (in this case) selective “rational reconstruction” of classical wage theory as a research program [p. 29]. The exercise, in short, is subject to severe selection bias (other scenarios are reasonable and observationally equivalent). More importantly, such an exercise contains far more bias than any theoretical or empirical test in modern economics. The method, in effect, substitutes anarchical interpretation for motivations based on self-interested explanations founded on factors (some of them technological) internal to the discipline. It leads Vint [pp. 29–30] to “argue that the Classical economists were rational, in a Lakatosian sense, to subscribe to the wages fund doctrine and long run wage theory, despite the fact that these theories are regarded as erroneous in terms of modern theory.” Vint also argues that “Mill’s recantation was rational and so was the decision not to abandon the Classical wage theory research programme until a potentially more progressive theory came along. All of this is powerful evidence for MHRP” [methodology of historiographical research programs of Lakatos].

After much sweat and toil to make good on this promise, the method delivers little meaning and less insight. Vint concludes that the classicals were rational (in a Lakatosian sense to be sure) to hold to the wages fund idea. Further, he argues that Mill was rational to give it up to the extent that he did, but that he was also rational to maintain it as theory (he did not abandon it in the final edition of the *Principles*). Finally, we are all supposed to be rational (from a neoclassical perspective) to consider the wages fund an “erroneous and false theory” [p. 249]. Unfortunately, on the path to these “conclusions,” logic and common sense take a holiday.

Vint finds himself in numerous logical pickles as a consequence of his method. He argues [p. 177]