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**Book Review — Digitized Version**

[Book Review of] Dornbusch, Rudiger: Open economy macroeconomics. New York 1980

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Auf Grund dieses Basismodells arbeitet Davies weitere Überlegungen zum Diffusionsprozeß heraus. Mit Hilfe einer »industriellen Engelkurve« zeigt er für einen bestimmten Zeitpunkt den Zusammenhang zwischen Firmengröße und der Wahrscheinlichkeit, daß eine gegebene Neuerung bereits eingeführt ist. Es ergibt sich ein positiver Zusammenhang. Die Engelkurve ist — für A- und B-Prozesse — kumulativ lognormal.

In einem weiteren Kapitel werden die Faktoren besprochen, die die Schnelligkeit des Diffusionsprozesses beeinflussen. Die geringe Größe der Stichprobe und die Lücken in den Daten führen hier allerdings zu einigen heroischen Vereinfachungen, und die Resultate sind eher trivial. Eine hohe Rentabilität einer Neuerung erweist sich als wichtigster Faktor für eine schnelle Diffusion. Daneben spielt die Informationsdichte eine Rolle, so daß die Diffusionsgeschwindigkeit mit der Zahl der Firmen abnimmt. Andererseits bremst eine hohe Unternehmenskonzentration infolge starker Größenvarianz den Diffusionsprozeß, so daß eine Kombination von wenigen, ungefähr gleich großen Unternehmungen am ehesten eine hohe Diffusionsgeschwindigkeit erwarten läßt. Dabei ist allerdings zu beachten, daß auch Konkurrenzsituation und Grad der Kapazitätsauslastung einen Einfluß ausüben, der aber aus Datengründen nur wenig durchleuchtet werden kann. Aus diesen Gründen bleibt auch der Einfluß des Konjunkturzyklus auf die Diffusionsgeschwindigkeit unbestimmt. Hier eröffnen sich Aufgaben für weitere Erhebungen.

Wie bereits eingangs erwähnt, stellt das Buch von Davies eine wertvolle Bereicherung eines ausbaufähigen Forschungszweiges dar. Dies um so mehr, als es ihm gelingt, die Problematik der Materie und den Aufbau seiner Argumente in sehr klarer Form zu präsentieren.

Kurt W. Rothschild

**Dornbusch, Rudiger**, *Open Economy Macroeconomics*. New York 1980. Basic Books, Inc. Publishers. IX, 293 pp.

No doubt, this is an outstanding book. While resembling Mundell's "International Economics" in spirit it is different in at least two respects. First, it has more of a textbook, as can be seen from the fact that Dornbusch starts with a short and usefull introduction into open-economy national accounting, and from the fact that now and then readers are encouraged to solve problems themselves. Second, it is not a volume of "greatest hits" but contains lots of fresh and inspiring work, although reference to earlier contributions by the author is made at several occasions.

The main appeal of the book is the ultimate elegance of the analysis. Here Dornbusch is second to none. Of course, elegance has its price. When the models are extended in one respect they are usually simplified in other respects. Thus Dornbusch does not offer one dress for all seasons but rather several dresses for several seasons.

After setting out some basic accounting identities in Part 1 the author embarks on an analysis of employment, trade and relative prices in Part 2, abstracting from asset market and monetary considerations. Dornbusch

starts with a Keynesian model (Chapter 3) but later introduces non-Keynesian elements such as real-wage resistance (Chapter 4). The analysis covers a wide range of topics including the effects of a devaluation and of commercial policies (Chapter 4) and the distinction between traded and non-traded, intermediate and final goods (Chapters 5 and 6).

The problem with Part 2 and (especially Chapter 3) is that while assets are not considered explicitly they still enter into the model as an implicit element. Thus, when the author addresses the question of unbalanced external trade assets must be in the model; since without asset accumulation or decumulation income always equals spending and the trade balance is in equilibrium by definition. If one takes a closer look at the implicit asset market, one finds that it is subject to highly implausible behaviour. For example, in the model a rise in taxes leads to a persistent trade surplus and, hence, implies a continuous inflow of assets from abroad. In the usual stationary-state framework with a given stock of assets, however, a persistent decumulation of foreign assets is not possible. Indeed, this has been the main message of the monetary or asset approach to exchange-rate analysis and one wonders why Dornbusch who was one of the proponents of that approach and who in other chapters of his book offers a very skillful treatment of asset markets, starts his analysis with such a dubious model. In my view, it would have been better to concentrate on models with balanced trade first and introduce unbalanced trade together with the introduction of money and other assets.

Money enters the discussion in Part 3 of the book. Chapter 7 contains a double-distilled elixir of the author's earlier work on money, prices and the balance of payments. Chapter 8 is one of the highlights of the book. Drawing on an article by Dornbusch, Fischer and Samuelson the author presents a very elaborate but still very manageable model which allows for a variety of effects — like changes in money, wages and productivity — on prices, employment and economic structure in a two-country setting. Chapter 9 contains an interesting analysis of stabilization policies; it is demonstrated, inter alia, that a monetary policy which offsets the employment effects of price disturbances may do so at the cost of additional price instability. On the whole the three chapters of Part 3 are among the most powerful of the book and a "must" for students of international monetary economics.

Part 4 introduces capital markets into the analysis. Chapters 10 and 11 contain an analysis of fiscal and monetary policy under fixed and flexible exchange rates in the Mundell-Fleming tradition. Here the author's genuine contribution has to be seen in the very elegant treatment of imperfect capital mobility (Chapter 10) and the integration of rational exchange-rate expectations (Chapter 11). In Chapter 12 the author looks at the mixed case of managed floating and addresses the question of an optimum disinflation policy for an open economy.

Part 5 of the book, finally, carries the message that exchange-rate changes may be explained by current account imbalances. The mechanism is as follows: a current account deficit leads to a decline in domestic wealth which in turn causes a reduction in the demand for domestic currency and, hence,

a depreciation. In Chapter 13 the argument is developed for a one-asset world without investment goods. In Chapter 14 the analysis is extended to a model with several assets and economic growth; this extension, however, comes at the price of two uncomfortable assumptions: first, it is postulated that the capital goods industry is more labour intensive than the consumer goods industry; second, the author assumes that investment goods are non-tradables, thus excluding the case of foreign direct investment (or equivalent portfolio investment) where a capital import (= current account deficit) does not imply a reduction in domestic wealth.

Nevertheless, the thesis that a current account deficit (surplus) has a negative (positive) effect on the demand for money is an interesting thesis that awaits empirical testing. To argue, however, that approaches emphasizing the current account would soon displace the asset market approach — as Dornbusch does in the introduction — is in my view exaggerated. If the current account will prove to be a significant element of the demand for money function, it is still only one of several determinants of the exchange rate. And the asset market approach should be understood in a sense that it is wide enough to incorporate asset adjustments via the current account as an additional element.

While the analytic and didactic qualities of the book are beyond question, the same cannot be said for the policy conclusions which the author offers in several chapters. Especially two points invite some critical remarks. The first concerns the fact that Dornbusch readily accepts the current account as a target of economic policy — a position which is difficult to share by those who regard current account balance (or the avoidance of large imbalances) neither as a private nor as a public good. The second point is that in some cases policy conclusions are based on short-run Keynesian models which neglect repercussions on wages and pay no attention to medium-run developments. This criticism applies for example to the recommendation that a country with unemployment and an undesiredly high current account deficit should pursue a more expansionary monetary policy (Chapter 11). It also applies to the uncritical presentation of the OECD-linkage model according to which an increase in autonomous (fiscal) spending leads to more real output (Chapter 3); here one misses at least a brief reference to the fact that this type of policy analysis is highly controversial. I should hasten to say that in other chapters Dornbusch goes beyond the short run of Keynesian economics and focuses also on long-term aspects; an outstanding example is Chapter 9 with its careful analysis of the interaction between monetary policy and wage policy and its explicit consideration of different adjustment processes over time.

Thus, the policy maker should make sure that the dress he chooses from Dornbusch's collection suits the season. It is no fun to wear a Keynesian summer dress (even a very elegant one) in a neoclassical snowstorm.

"Open Economy Macroeconomics" should be given a top priority on the reading list. It will certainly become one of the standard references of the eighties.

Harmen Lehment