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Book Review — Digitized Version


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The task of this book is to bring together the early literature on monetary integration, which was developed in the 1960s and the early 1970s, and the more recent work on the subject which reflects discussion on the European Monetary System and the transition to the European Monetary Union.

The first part of the book addresses the theory of optimum currency areas. The author gives a very clear and complete account of the costs and benefits of a monetary union, which covers the traditional criteria developed by Mundell, McKinnon, Kenen and Vaubel, as well as the more recent political-economy arguments as pioneered by, inter alia, Barro-Gordon and Alesina. From his comparison of the costs and benefits in the European case, De Grauwe concludes that it is unlikely that the EC as a whole constitutes an optimal monetary union. In his opinion, a monetary integration that proceeds with different speeds for different countries is, therefore, preferable to establishing an EC-wide monetary union in one large step.

In the second part of the book, the author analyses the European Monetary System and discusses its transformation into a European Monetary Union. The emphasis here is on the conceptual issues rather than presenting a detailed account of the provisions which has been laid out in the Maastricht treaty. De Grauwe finds that the disciplining effects in the EWS were weak in the first half of the 1980's, but have strengthened in the second half. Nevertheless, inflation in some countries, in particular Italy, remained relatively high so that, with exchange rates virtually fixed since 1987, the author sees "an unsustainable situation as it jeopardizes the Italian economy". The events of September 1992, which came about after the completion of the book, have in the meantime confirmed the validity of this assessment.

In the chapter on the European Central Bank (ECB), the author stresses the differences between a system of irrevocably fixed exchange rates, which will be brought about by the transition to stage III, and a common currency, the introduction of which may take substantially longer. With respect to the design of the European Central Bank, De Grauwe questions whether the explicit recognition in the statutes of the ECB of political independence and price stability as the primary objective is sufficient to prevent inflation: "The individuals who are going to make monetary policy are subject to social and cultural influences. Some come from countries where abhorrence vis-à-vis inflation is not as intense as in Germany. They may therefore act differently from the individuals sitting on the board of the Bundesbank, even if the statutes of the ECB have been copied from the Bundesbank statutes." (pp. 161–162).

The book closes with a very interesting chapter on the role of fiscal policies in a monetary union. As the author shows, the traditional view has been to combine a monetary union either with a centralization of the national budgets (as in the US) or – if that is politically not possible (as in the EC) – with substantial flexibility of national fiscal policies to absorb possible regional shocks. Such flexibility, however, does not exist when the national budget deficit has already reached an unsustainable level. This
allows the conclusion that high-deficit countries in their own interest should not join the monetary union, for the irrevocable fixing of exchange rates would deprive them of the only shock-absorber which is left.

Harmen Lehment


The use of Computable General Equilibrium (CGE) models has gained much popularity among policy analysts in developing countries (LDCs). This phenomenon is consistent with the overall observation that policy-makers are increasingly relying on the working of market forces and incentives rather than putting their faith in the outcome of centrally-planned allocation procedures. Given their theoretical framework, CGE models are indeed better suited to simulate decentralized economic policies than alternative forms of modelling, such as input-output or linear programming models, which have traditionally constituted the mathematical underpinnings of central economic planning.

In its purest form, a CGE model provides a numerical implementation of Walras' model of the competitive economy. However, in their attempt to simulate the workings of LDCs' economies, modelers have moved far from the Walrasian ideal and have incorporated a variety of "structuralist" features that explicitly recognize the existence of institutions, interest group activities, rigidities and imperfections in these countries. This is essentially what the book under review is about. It presents a sample of work from the "structuralist" (as opposed to "neoclassical") tradition in formulating and applying CGE models for LDCs. The book consists of a comprehensive overview essay by Lance Taylor on "Structuralist CGE Models", followed by twelve chapters consisting of applications to individual countries by various authors. The overview essay provides a useful description of the structuralist perspective, and step by step, shows how macro structuralist models work and how they contrast with neoclassical models.

Taylor identifies structuralism with a variety of hypotheses that lead to adjustment problems and links between changes in nominal macro aggregates and real aggregate output and employment. These include: (i) markup pricing instead of profit maximization in some sectors, resulting in rationing in product markets; (ii) fixed nominal wages, leading to unemployment; (iii) non-competitive imports of intermediate and capital goods, with foreign exchange becoming a binding constraint; (iv) macro-causality runs from demand "injections", such as investment, exports, and government spending, to "leakages", such as imports and saving under conditions of passive money supply; (v) the structure of the financial system may affect macroeconomic results; and (vi) private investment may be "crowded in" or "crowded out" by public investment. Although developing country economists would agree on many of these hypotheses, empirical support for some of these specifications is weak. For example, assuming that aggregate real investment is fixed is convenient when tracing out the implications of some structuralist specifications. In an applied model, however, it is empirically untenable to assume that real investment does not change as part of a process of macro-structural adjustment. Similarly, the assumption of non-competitive intermediate imports is useful to focus attention on the effect of devaluation on costs. In applied models, this assumption is empirically inappropriate.

The macroeconomic story of structuralist models is straightforward. Total investment is exogenous, and the general equilibrium adjustment mechanism that guarantees