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Abstracts

How Large Are Human Capital Externalities? Evidence from Compulsory Schooling Laws

DARON ACEMOGLU AND JOSHUA ANGRIST

Many economists and policymakers believe that education creates positive externalities. Indeed, average schooling in U.S. states is highly correlated with state wage levels, even after controlling for the direct effect of schooling on individual wages. We use variation in child labor laws and compulsory attendance laws over time and across states to investigate whether this relationship is causal. Our results show external returns to education around 1% and not significantly different from zero.

The Political Business Cycle after 25 Years

ALLAN DRAZEN

Research on the political business cycle since the mid-1970s is surveyed and assessed. We argue that models based on monetary surprises as the driving force are unconvincing explanations of either opportunistic or partisan cycles. Research should concentrate on fiscal policy as the driving force, with monetary effects being the result of accommodation of fiscal impulses. We present a model political business-cycle model (which we term the AFPM model) that combines active fiscal policy and passive monetary policy and that addresses a number of objections to earlier models.

Rethinking Multiple Equilibria in Macroeconomic Modeling

STEPHEN MORRIS AND HYUN SONG SHIN

Are beliefs as indeterminate as suggested by models with multiple equilibria? Multiplicity of equilibria arises largely as the unintended consequence of two modeling assumptions—the fundamentals are assumed to be common knowl-

edge, and economic agents know others' actions in equilibrium. Both are questionable. When others' actions are not known with certainty (as when actions rely on noisy signals), self-fulfilling beliefs lead to a unique outcome determined by the fundamentals and the knowledge that others are rational. This paper illustrates this approach in the context of a model of bank runs and other similar applications. Such an approach places comparative statics and policy analyses on a firmer footing. It also suggests that public information has a disproportionately larger influence on the outcome than private information.

Re-Examining the Contributions of Money and Banking Shocks to the U.S. Great Depression

HAROLD L. COLE AND LEE E. OHANIAN

This paper quantitatively evaluates the hypothesis that deflation can account for much of the Great Depression (1929–1933). We examine two popular explanations of the Depression: (1) the *high-wage* story, according to which deflation, combined with imperfectly flexible wages, raised real wages and reduced employment and output; (2) the *bank-failure* story, according to which deflationary money shocks contributed to bank failures and to a reduction in the efficiency of financial intermediation, which in turn reduced lending and output. We evaluate these stories using general-equilibrium business-cycle models, and find that wage shocks and banking shocks account for a small fraction of the Great Depression. We also find that some other predictions of the theories are at variance with the data.

Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence

FRANCISCO RODRIGUEZ AND DANI RODRIK

Do countries with lower policy-induced barriers to international trade grow faster, once other relevant country characteristics are controlled for? There exists a large empirical literature providing an affirmative answer to this question. We argue that methodological problems with the empirical strategies employed in this literature leave the results open to diverse interpretations. In many cases, the indicators of openness used by researchers are poor measures of trade barriers or are highly correlated with other sources of bad economic performance. In other cases, the methods used to ascertain the link between trade policy and growth have serious shortcomings. Papers that we review include those by Dollar (1992), Ben-David (1993), Sachs and Warner (1995), Edwards (1998), and Frankel and Romer (1999). We find little evidence that open trade policies—in the sense of lower tariff and nontariff barriers to trade—are significantly associated with economic growth.

*The Six Major Puzzles in International Macroeconomics:
Is There a Common Cause?*

MAURICE OBSTFELD AND KENNETH ROGOFF

The central claim in this paper is that by explicitly introducing costs of international trade (narrowly, transport costs, but more broadly, tariffs, nontariff barriers, and other trade costs), one can go far toward explaining a great number of the main empirical puzzles that international macroeconomists have struggled with over twenty-five years. Our approach elucidates J. McCallum's home-bias-in-trade puzzle, the Feldstein–Horioka saving–investment puzzle, the French–Poterba equity–home-bias puzzle, and the Backus–Kehoe–Kydland consumption–correlations puzzle. That one simple alteration to an otherwise canonical international macroeconomic model can help substantially to explain such a broad range of empirical puzzles, including some that previously seemed intractable, suggests a rich area for future research. We also address a variety of international pricing puzzles, including the purchasing-power-parity puzzle emphasized by Rogoff, and what we term the *exchange-rate disconnect puzzle*. The latter category of riddles includes the Meese–Rogoff exchange-rate forecasting puzzle and the Baxter–Stockman neutrality-of-exchange-rate-regime puzzle. Here, although many elements need to be added to our extremely simple model, trade costs still play an essential role.

