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Abstracts

The Evolution of Unemployment in the United States: 1968–1985

KEVIN M. MURPHY AND ROBERT H. TOPEL

Unemployment rates in the United States and other Western economies have shown a pronounced secular increase over the past twenty years. This article studies the determinants of unemployment dynamics in the United States since 1968. The primary goal is to document the empirical facts about the evolution of unemployment that theory must accommodate. Our key empirical findings are in four areas: (1) The secular increase in unemployment in the United States is surprisingly evenly distributed across subcategories of the labor force, including industries, regions, and demographic groups; (2) Most of the increase is accounted for by a pronounced shift toward long-term unemployment; (3) Based on the observed characteristics of workers, the occurrence of unemployment is now much more evenly distributed than it was in the recent past; (4) Interindustry mobility and fluctuations in the pace of labor reallocation among sectors have played only minor roles in affecting observed unemployment. These points challenge theories that rely on the characteristics or fortunes of particular sectors of the economy to generate unemployment. The main factors influencing unemployment over this period have been economywide and broadly based.

The New Keynesian Microfoundations

JULIO ROTEMBERG

This article surveys some recent efforts at deriving the standard Keynesian effects of money on output from models in which individual agents maximize their welfare. While other models with continua of equilibria are considered, most attention is spent on models with costs of changing prices. Models of the latter type also turn out to have multiple equilibria because, when a firm increases its price, it creates an incentive for its competitors to raise their own. These multiplicities are discussed in both two-period and infinite-horizon models. The multiplicities affect both the qualitative features of the equilibria and

their welfare properties. I also analyze the extent to which small costs of changing prices can generate large (or costly from a welfare viewpoint) business cycles. Aggregate data and data on individual prices are used to discuss the empirical strengths and weaknesses of existing models.

"Are Exchange Rates Excessively Variable?"

JEFFREY A. FRANKEL AND RICHARD MEESE

"Unnecessary variation" is defined as variation not attributable to variation in fundamentals. In the absence of a good model of macroeconomic fundamentals, the question "are exchange rates excessively variable?" cannot be answered by comparing the variance of the actual exchange rate to the variance of a set of fundamentals. This article notes the failure of regression equations to explain exchange rate movements even using contemporaneous macroeconomic variables, as well as the statistical rejections of the unbiasedness of the forward exchange rate as a predictor. It then argues that, given these results, there is not much to be learned from the variance-bounds tests and bubbles tests. The article then discusses recent results on variation in the exchange risk premiums arising from variation in conditional variances, both as a source of the bias in the forward rate tests and as a source of variation in the spot rate. It ends with a discussion of whether speculators' expectations are stabilizing or destabilizing, as measured by survey data. The conclusion is that it is possible that exchange rates have been excessively variable—as, for example, when there are speculative bubbles—but that if policy makers try systematically to exploit their credibility in order to stabilize exchange rates, they may see their current credibility vanish.

Crazy Explanations for the Productivity Slowdown

PAUL M. ROMER

This article argues that to understand the behavior of productivity statistics, it is necessary to reexamine the basic assumptions underlying growth accounting. In particular, it offers theoretical and empirical support for the assertion that the elasticity of output with respect to an input like capital or labor might differ from the share of the input in total factor income. The theories offered in support of this possibility allow for spillovers of knowledge, specialization with monopolistic competition, and endogenous accumulation of labor-saving technological change. Evidence on the form of aggregate production is drawn from data for many countries and for long historical time periods. The specific interpretation of the productivity slowdown that is offered is that a low elasticity of output with respect to labor causes labor productivity growth rates to fall when labor growth speeds up.

The Macroeconomics of Successful Development: What are the Lessons?

KEMAL DERVIS AND PETER A. PETRI

Recent work on development strategy emphasizes export-based approaches in contrast to industrialization based on domestic markets. This paper explores the evidence for the new paradigm from both cross-sectional and case-study perspectives. The cross-sectional data suggest that high-performing economies have had relatively high rates of growth (although not necessarily high levels) of exports, high rates of investment, and low rates of government expenditure. The success of high-performers cannot be attributed, however, to an easier external climate or aggressive devaluation. A case study of Korean development identifies three factors as particularly important: bold but sound macroeconomic management, innovative export promotion, and an unusually responsive economy. A case study of Turkey's export drive in the 1980s reveals similar policy measures; Turkey's outward-oriented adjustment program reestablished access to commercial credit despite the fact that debt increased relative to GDP. Turkey's borrowing from international financial institutions permitted adjustment without a decline in income; it is a model for the "Baker Plan"—that is, the strategy of accelerating adjustment and growth in debtor countries through the provision of additional international credit to complement and support vigorous domestic adjustment.

Ricardian Equivalence: An Evaluation of Theory and Evidence

B. DOUGLAS BERNHEIM

In evaluating the existing theory and evidence on Ricardian equivalence, it is essential to distinguish between the short-run effects of government borrowing (primarily the potential for stimulating aggregate demand) and the long-run effects (primarily the potential for depressing capital accumulation). I argue that the theoretical case for long-run neutrality is extremely weak, in that it depends upon improbable assumptions that are either directly or indirectly falsified through empirical observation. In contrast, the approximate validity of short-run neutrality depends primarily upon assumptions that have at least an aura of plausibility. Nevertheless, even in this case behavioral evidence weighs heavily against the Ricardian view.

Efforts to measure the economic effects of deficits directly through aggregate data confront a number of problems which, taken together, may well be insuperable. It is therefore not at all surprising that this evidence has, by itself, proven inconclusive.

Taken together, the existing body of theory and evidence establishes a significant likelihood that deficits have large effects on current consumption, and there is good reason to believe that this would drive up interest rates. In addition, I find a complete lack of either evidence or coherent theoretical argument to dispute the view that sustained deficits significantly depress capital accumulation in the long run.