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Abstracts

Hysteresis and the European Unemployment Problem

OLIVIER J. BLANCHARD AND LAWRENCE H. SUMMERS

European unemployment has been steadily increasing for the last fifteen years and is expected to remain very high for many years to come. In this paper, we argue that this fact implies that shocks have much more persistent effects on unemployment than standard theories can possibly explain. We develop a theory that can explain such persistence, and that is based on the distinction between insiders and outsiders in wage bargaining. We argue that if wages are largely set by bargaining between insiders and firms, shocks which affect actual unemployment tend also to affect equilibrium unemployment. We then confront the theory with both the detailed facts of the European situation as well as those of earlier periods of high persistent unemployment, such as the Great Depression in the United States.

Do Equilibrium Real Business Cycle Theories Explain Postwar U.S. Business Cycles?

MARTIN EICHENBAUM AND KENNETH J. SINGLETON

This article presents and interprets some new evidence on the validity of the real business cycle (RBC) approach to business cycle analysis. The analysis is conducted in the context of a monetary business cycle model that makes explicit one potential link between monetary policy and real allocations. This model is used to interpret Granger causal relations between nominal and real aggregates. Perhaps the most striking empirical finding is that money growth does not Granger cause output growth in the context of several multivariate VARs and for various sample periods during the postwar period in the United States. Several possible reconciliations of this finding with both real and monetary business cycles models are discussed. We find that it is difficult to reconcile our empirical results with the view that exogenous monetary shocks were an important independent source of variation in output growth.

Why Is Japan's Saving Rate So Apparently High?

FUMIO HAYASHI

This article begins with a look at time-series data on aggregate saving for the United States and Japan. After showing that a resolution of conceptual differences substantially narrows the gap in the saving rates between the two countries, the article examines various explanations for Japan's high saving rate by confronting them with a wealth of tabulations from household surveys in Japan. The life-cycle explanation is found to be inadequate. The prevalence of the extended family and bequests are singled out as probably the most important factor contributing to higher saving. An attempt is made to estimate the flow of intergenerational transfers. It is argued at the end that Japan's recent large trade surplus is due more to her slumping investment than any increase in saving.

Efficiency Wage Theories: A Partial Evaluation

LAWRENCE F. KATZ

This paper surveys recent developments in the literature on efficiency wage theories of unemployment. Efficiency wage models have in common the property that in equilibrium firms may find it profitable to pay wages in excess of market clearing. High wages can help reduce turnover, elicit worker effort, prevent worker collective action, and attract higher-quality employees. Simple versions of efficiency wage models can explain normal involuntary unemployment, segmented labor markets, and wage differentials across firms and industries for workers with similar productive characteristics. However, deferred payment schemes can solve some efficiency wage problems without requiring job rationing. A wide variety of evidence on interindustry wage differences is analyzed. Efficiency wage models appear useful in explaining the observed pattern of wage differentials. The models also provide several mechanisms for cyclical fluctuations in response to aggregate demand shocks.

Macroeconomic Implications of Profit Sharing

MARTIN L. WEITZMAN

This article argues that substantial progress in the struggle for full employment without inflation will have to come largely from basic changes in pay-setting arrangements rather than from better manipulation of financial aggregates. My analysis suggests that widespread profit sharing, along the general lines practiced in Japan, represents a structural reform of the labor market that is likely to improve the unemployment-inflation trade-off. I attempt to place the problem of labor payment mechanisms in historical perspective; I then provide an analytic framework for comparing wage and profit-sharing systems. Major criticisms of profit sharing are discussed in a question and answer format. Profit sharing is then compared with three alternative and, I argue, less promising prototypes for structural reform of the labor market: incomes policy, two-tiered pay, and em-

ployee control. The Japanese experience is then examined with an eye to evaluating the possible macroeconomic impact of the bonus system and implications for profit or revenue sharing.

The Budget Deficit and the Dollar

MARTIN S. FELDSTEIN

This study examines the reasons for changes in the real exchange rate between the dollar and the German mark from the beginning of the floating rate regime in 1973 through 1984. The econometric analysis focuses on the effects of anticipated structural budget deficits and monetary policy in the United States and Germany and the changes in U.S. profitability induced by changes in tax rules. The possible impact of a number of other variables is also examined.

The evidence indicates that the rise in expected future deficits in the budget of the U.S. government has had a powerful effect on the exchange rate between the dollar and the German mark. Each one percentage point increase in the ratio of future budget deficits to GNP increased the exchange rate by about 30 percentage points. Changes in the growth of the money supply also affect the exchange rate. Changes in tax rules and in the inflation-tax interaction that altered the corporate demand for funds did not have any discernible effect on the exchange rate.

A separate analysis confirms that there is an equilibrium structural relation between the dollar-DM exchange rate and interest rates in the United States and Germany. An increase of one percentage point in the real interest rate differential has been associated with a rise in the DM-dollar rate of about 5 percent.