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Editorial

This new journal aims to encourage and disseminate research on real macroeconomic problems. It will appear once a year, and will include two kinds of articles, the first directed to answering specific questions, the second showing the empirical relevance of potentially important new ideas in macroeconomics.

Three articles in this volume fall into the first category: Blanchard and Summers analyze the causes of high European unemployment; Hayashi examines the causes of high Japanese saving rates; and Feldstein seeks to establish, empirically, links between the budget deficit and the exchange rate. The articles by Martin Eichenbaum and Kenneth Singleton on real business cycles, Lawrence Katz on efficiency wage theory, and Martin Weitzman on profit sharing, are of the second kind.

The articles were invited for this volume, and were initially presented at a conference held in Cambridge, Massachusetts, in early March 1986. They have been revised in light of the incisive comments made by the formal discussants and the discussion at the conference. The discussants' comments and a brief summary of the discussion at the conference follow each article. To maintain the currency of the papers and the comments, the journal appears very rapidly after the conference.

Although each article sets its own scene well, I will briefly describe the motivation and the approach taken by the authors, starting with the paper by Olivier Blanchard and Lawrence Summers. European unemployment has been rising more or less steadily since 1970. European unemployment had been well below U.S. levels in the 1950s and 1960s, reached U.S. levels in the 1970s, and by now is well above U.S. rates in most countries—and almost double the U.S. rate in the United Kingdom.

Blanchard and Summers describe the problem and find that in the past there have been similar periods in which unemployment in both Europe and the United States has risen and stayed high. Indeed, they argue that the unemployment rate is so persistent that the standard textbook view that the economy, left alone, tends to revert to a stable "natural" rate of

unemployment has to be questioned. They explain this persistence by the contrast between insiders (those with a job) and outsiders (the unemployed). Wage bargaining between the firm and its insider-workers results in a contract that takes into account the interests of the insiders but not the outsiders. Workers cease to influence wage bargains once they have lost their jobs, and therefore cannot take actions that will increase their chances of being employed. Thus the unemployment rate tends to stay at its current level, except for shocks such as unexpected changes in aggregate supply (increases or decreases in oil prices, for example) or demand. They explain rising European unemployment as the result of a sequence of adverse supply shocks in the 70's, and demand shocks in the 80's, particularly increasingly tight European fiscal policy.

The Blanchard-Summers article departs, by implication, from the previously standard view that European unemployment is in large measure the result of excessively high real wages. They do not focus on the behavior of real wages, emphasizing that both real wages and unemployment are endogenous and that it makes very little sense to blame unemployment on real wages. In their model, a union that is willing to incur a greater risk of unemployment in exchange for higher real wages will produce the unemployment but not higher real wages. Real wages in their model are determined by production conditions. They leave for future research an explanation of the joint movement of real wages and unemployment.

Martin Eichenbaum and Kenneth Singleton describe real business cycle theory. The theory is that business cycle phenomena can be understood as reflecting the effects of a variety of *real* disturbances on an economy in which markets are continuously *in equilibrium*. The theory is identified by both its italicized characteristics. The view is that monetary disturbances, changes in the money stock—or monetary policy more generally—do not affect real economic variables, such as the level of output, the real interest rate, or the real exchange rate. Second, the theory sees no need to assume that markets are in disequilibrium, since many of the phenomena that are usually viewed as reflecting disequilibrium, such as cyclical fluctuations, are potentially consistent with equilibrium. Eichenbaum and Singleton take a pragmatic approach to the nonmonetary aspect of the approach, arguing not that monetary disturbances inherently cannot affect real variables, but that they have not in practice done so in the postwar U.S. economy.

After constructing an equilibrium business cycle model that includes a potential role for monetary disturbances to affect output, Eichenbaum and Singleton concentrate on empirical work that examines the role of money in postwar U.S. cycles. Using vector autoregressions, they fail to

find signs of monetary influences. These surprising results receive considerable attention both from the formal discussants and in the informal discussion. The discussants also noted that a failure to find monetary effects on real output bore on the first characteristic of real business cycle theory—that the cycle is not caused by monetary factors—but left open the second issue, whether the cycle is an equilibrium phenomenon driven mainly by shocks to productivity.

Extraordinarily high Japanese saving rates contrast remarkably with U.S. savings behavior. Observers who worry about lagging U.S. productivity growth and the need for modernizing investment hope that saving incentives will increase the supply of investment funds in this country. Fumio Hayashi's careful and informative paper seeking to explain the high Japanese saving rate first puts U.S. and Japanese savings data on a common statistical basis, thereby reducing some of the discrepancy. Even so, there is a large difference to explain.

Hayashi then turns to detailed cross-sectional Japanese data. The standard life-cycle model in which individual saving is driven by the need to finance retirement spending is shown not to account for the high Japanese saving rate, even when account is taken of the difficulty of borrowing to buy houses in Japan. Two striking features of the Japanese life-cycle pattern are that elderly parents tend to move in with their children and that housing (particularly the value of land) accounts for a large share of wealth. Hayashi attributes some of the high Japanese saving rate to these characteristics, arguing that parents appear to accumulate wealth in large part to make bequests, largely in the form of housing, to children.

The national saving rate in Japan declined substantially in the 1970s as the government started running large deficits, and the Japanese saving rate began to fall towards (but is still far from) the U.S. rate. Hayashi believes that this trend will continue, with part of Japanese saving behavior during the 1960s and 1970s reflecting an effort by individuals to raise their standard of living rapidly. His discussants raise the question of whether the high Japanese growth rate might not be responsible for the high saving rate, rather than vice versa, though the channels for that line of causation remain unclear.

Many theories attribute business cycle fluctuations largely to wage and price stickiness. If there is excess unemployment, firms would, according to these views, be willing to hire more workers if only wages could be cut. Although this argument is not watertight, it does focus attention on the behavior of wages. Efficiency wage theory is the view that firms do not cut wages because the efficiency with which labor works depends on the real or relative wage it receives.

Lawrence Katz describes several versions of efficiency wage theory. He starts from the strongest form of the theory relevant in poor countries where the physical health and efficiency of the worker depends on his or her earning enough to pay for food. He also discusses versions in which workers whose effort on the job is only imperfectly observable are paid above market wages so that there is a real penalty in the loss of a job if they are caught shirking. In addition to describing the theories, Katz draws out their empirical implications, many of which relate to differences in wages across different job categories. The alternative, standard theory ascribes wage differentials to differences in workers' abilities, rather than to, for example, the difficulty of monitoring effort on different jobs.

The macroeconomic implications of efficiency wage theory receive attention in both Katz's paper and the following discussion. The real wage rigidity implied by the theory may allow supply shocks to affect employment. It is more difficult to show that real wage rigidity can account for effects of nominal shocks, such as changes in monetary policy, on output. A recent development outlined by Katz is the "small menu cost" approach that shows that under certain circumstances, small costs of changing prices will lead to price rigidity that may have large impacts on the level of output. The merits of this approach too receive considerable attention in the discussion.

Martin Weitzman's work on the macroeconomic implications of alternative labor compensation arrangements has led him to the view that profit sharing would produce more stable employment with less inflation than the current wage system. His article develops the analytical basis for this conclusion. The analysis suggests that although the equilibrium level of unemployment might be similar under wage and profit sharing systems, responses of output and employment to shocks would be very different. In particular, with profit sharing, the incentive of firms to lay off workers in response to reductions in product demand is much reduced. In a useful question-and-answer section of the paper, Weitzman answers many of the questions typically raised about profit sharing. He then examines the Japanese bonus system, concluding that it can be viewed as a profit sharing system. He cautiously suggests it may have some responsibility for the superior employment performance of the Japanese economy.

Weitzman's work has received considerable public attention, and even recognition in the 1986 British budget. Discussants of course raised their doubts about the approach, many along the lines of "How come if this is a good idea it hasn't already been implemented?" In reply Weitzman emphasizes the possible divergence between private and social benefit: em-

ployment might be more stable in the economy as a whole with the implementation of profit sharing, even though no single firm might find it worthwhile to introduce if all other firms are on the wage system.

The extraordinary appreciation of the dollar between 1980 and the beginning of 1985 is the focus of Martin Feldstein's "The Budget Deficit and the Dollar." Conventional macroeconomic models predict that expansionary fiscal policy will produce higher real interest rates, an appreciation, and a current account deficit. Feldstein explores the exchange rate–budget deficit link in a series of regressions of the real exchange rate of the dollar against current and expected budget deficits, and a variety of other variables that might be expected to affect the exchange rate. These include the investment-incentive tax changes of 1981 that have been held partly responsible for the increase in demand for funds in the United States, and the growth rate of the monetary base, representing monetary policy.

Feldstein's results appear remarkably robust, with the budget variable almost inevitably significant in affecting the exchange rate. According to his regressions most of the appreciation of the dollar is accounted for by the change in U.S. fiscal policy. Some of the discussants accepted Feldstein's basic approach but probed the sensitivity of his conclusions. Others believed that to a first approximation, changes in taxes have no effects on interest rates or the exchange rate, but that changes in government spending do. This is the so-called Ricardian equivalence theory that holds that deficits merely represent future taxes, which have precisely the same effect on current actions as current taxes. Several discussants pointed out that changes in the mix of national spending—for instance, toward foreign goods—associated with fiscal changes could affect the real exchange rate even if Ricardian equivalence held. Whatever the doubts, Feldstein's regressions point to significant fiscal policy effects on exchange rates.

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