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Abstracts

Ten Years of Mrs. T.

CHARLES BEAN AND JAMES SYMONS

We argue that the 1970s were characterized by attempts to maintain a cooperative, low-unemployment equilibrium in the face of considerable union power, through the use of incomes policies and neo-corporatist machinery. The 1980s saw a shift away from this, toward direct measures to limit union power. This, together with the adoption of tight macroeconomic policies, explains the initial rise in unemployment. Empirical evidence suggests that its persistence throughout the decade is due to the effect of prolonged unemployment on the search behaviour of the outsiders, rather than the insider mechanism emphasized by Blanchard and Summers, and others.

The reduction in union power also helps to explain the acceleration in productivity growth. The craft nature of much of the British union movement has led to a multiplication of bargaining units within firms. Bargaining in isolation a union can perceive overmanning and other restrictive practices as being in its interests, resulting in low wages and productivity. A fall in union power results in a reduction in these inefficiencies and leads not only to a rise in productivity but also in wages. Cross-section empirical evidence supports the thesis that the productivity acceleration has been greatest where multi-unionism is present. We also show how this explains the widening in pre-tax as well as post-tax earnings.

Recent Trends in U.S. Earnings and Family Incomes

FRANK LEVY

Since 1973, U.S. wage rates have shown slow growth bordering on stagnation. During this period, the real *annual* earnings distribution of prime age men has shown both little average growth and increased inequality. The distribution of real annual family incomes has similarly shown little average growth and increased inequality. By contrast, the distribution of real annual women's earnings has shown modest growth and a slight trend toward equality. When wage trends are disaggregated by group, the data show a sharp deterioration in the real wages of young, less educated men and a sharp increase in the wage rates of younger, better educated women. Disaggregation of the family income distribution shows that growing family income inequality is driven, in part, by the growing number of families who are are either headed by a single woman or are husband-wife families with two earners.

Does Monetary Policy Matter? A New Test in the Spirit of Friedman and Schwartz

CHRISTINA D. ROMER AND DAVID H. ROMER

This paper uses the historical record to isolate episodes in which there were large monetary disturbances not caused by output fluctuations. It then tests whether these monetary changes have important real effects. The central part of the paper is a study of postwar U.S. monetary history. We identify six episodes in which the Federal Reserve in effect decided to attempt to create a recession to reduce inflation. We find that a shift to anti-inflationary policy led, on average, to a rise in the unemployment rate of two percentage points, and that this effect is highly statistically significant and robust to a variety of changes in specification.

We reach three other major conclusions. First, the real effects of these monetary disturbances are highly persistent. Second, the six shocks that we identify account for a considerable fraction of postwar economic fluctuations. And third, evidence from the interwar era also suggests that monetary disturbances have large real effects.

Consumption, Income, and Interest Rates: Reinterpreting the Time Series Evidence

JOHN Y. CAMPBELL AND N. GREGORY MANKIW

This paper proposes that the time-series data on consumption, income, and interest rates are best viewed as generated not by a single representative consumer but by two groups of consumers. Half the consumers are forward-looking and consume their permanent income, but are extremely reluctant to substitute consumption intertemporally. Half the consumers follow the "rule of thumb" of consuming their current income. The paper documents three empirical regularities that, it argues, are best explained by this model. First, expected changes in income are associated with expected changes in consumption. Second, expected real interest rates are not associated with expected changes in consumption. Third, periods in which consumption is high relative to income are typically followed by high growth in income. The paper concludes by briefly discussing the implications of these findings for economic policy and economic research.

Building Blocks of Market Clearing Business Cycle Models

KEVIN M. MURPHY, ANDREI SHLEIFER, AND ROBERT W. VISHNY

We compare "real business cycle" and increasing returns models of economic fluctuations. In these models, business cycles are driven by productivity changes resulting either from technology shocks or from movements along the increasing returns production function. We stress four crucial building blocks that give both types of models hope of fitting the data. These building blocks include durability of goods, specialized labor, imperfect credit and elastic labor supply. We also present new evidence on co-movement of both outputs and labor inputs across sectors and on the behavior of relative prices over the business cycle. We conclude that the increasing returns model is easier to reconcile with the data than the real business cycle model.

Restrictions on Financial Intermediaries and Implications for Aggregate Fluctuations: Canada and the United States 1870–1913

STEPHEN D. WILLIAMSON

During the period 1870–1913, Canada had a well-diversified branch banking system while banks in the U.S. unit banking system were less diversified. Canadian banks could issue large-denomination notes with no restrictions on their backing, while all U.S. currency was essentially an obligation of the U.S. government. Also, experience in the two countries with regard to bank failures and banking panics was quite different. A general equilibrium business cycle model with endogenous financial intermediation is constructed that captures these historical Canadian and American monetary and banking arrangements as special cases. The predictions of the model contradict conventional wisdom with regard to the cyclical effects of banking panics. Support for these predictions is found in aggregate annual time series data for Canada and the United States.

New Indexes of Coincident and Leading Economic Indicators

JAMES H. STOCK AND MARK W. WATSON

The system of Leading and Coincident Economic Indicators, currently maintained by the U.S. Department of Commerce (DOC), was developed as part of the NBER research program on business cycles over fifty years ago. This paper uses recent developments in econometric methodology and computing technology to take a fresh look at this system. The result is three experimental indexes. The first, constructed using a dynamic factor model, is numerically similar to the current index of coincident indicators maintained by the DOC. The second, an alternative index of leading indicators, is designed to forecast the growth in the DOC index over a six month horizon. The third—a "Recession Index"—estimates the probability that the economy will be in a recession six months

hence. Only two of the seven series in the proposed leading index are used by the DOC to construct their index. Of these new series, interest rates (a public-private risk premium and the slope of the yield curve) are found to be particularly useful predictors of future economic activity.