Review of the book From micro to macro in disequilibrium economics

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ical model. The model developed is a rather large disequilibrium model with four sectors (households, firms, banks and the government). This model incorporates an interesting attempt to elaborate the kinked demand curve approach in a dynamic general equilibrium setting. Unfortunately the model is so complex that much effort was spent on the technical exposition of the model, and little attention is given to the analytical features of this central economic element. Why did the author not work out the dynamics of the kinked demand curve in a more comprehensible analytical setting like the foregoing chapters?

The rest of the model is more conventional, although it has some peculiarities. Firstly, it is not clear why Van Ees now drops the efficiency wage approach, which was one of the basic elements of his theoretical model in chapter 5, in favour of a traditional Phillips curve mechanism. Secondly, the model neglects the intertemporal problem of savings and consumption. Households are assumed to maximise current period utility only; savings affect utility directly through inclusion of end-of-period stocks of assets in the utility function. Finally, for expectations Van Ees considers the case of adaptive expectations only; no attention is paid to the alternative of rational expectations. The simulations of the model corroborate that budgetary policy may be effective in a disequilibrium framework. The trajectories, which show remarkably chaotic patterns, prove to be very sensitive to the specification of expectations formation. A point of criticism is that no attempt is made to obtain a more analytical insight into the dynamics of the model. The simulation is to the trajectories for the first 100 periods starting from an arbitrary starting point. No answer is given to the questions: Does the seemingly chaotic pattern tend towards a stable pattern? Does the model converge to a steady state? And if it converges, what are the steady-state effects of the policy measures considered?

This is a book with two sides: on the one hand it offers a valuable discussion of recent macroeconomic literature and an interesting extension of new Keynesian theory, and on the other hand it presents a simulation study of an intricate numerical model. The connection between those parts is not always clear.

Casper van Ewijk

K.A. Springer, *From Micro to Macro in Disequilibrium Economics. A New Keynesian Analysis of the Dutch Unemployment Problem*, VU University Press, Amsterdam, 1991. Pp. 232.

The title of this book is rather promising. It suggests that, starting from a microeconomic foundation, a macroeconomic disequilibrium model is built which is subsequently used to analyse the Dutch unemployment problem. This would be a great achievement because, as noted by the author, such a venture is threatened by two pitfalls: there is the risk of being swallowed by technical microeconomics or of falling back to simple macroeconomics. Let us see if the author stands up to this promise.

Although not explicitly organized this way, Springer's thesis consists of two parts. The first, more theoretical, part is mainly concerned with microeconomics. It starts, however, in chapter 2 with a discussion of the core macroeconomic disequilibrium model as developed by Barro and Grossman, and Malinvaud.[1] The author criticizes this model on several points, all relating to the dynamics of the model: the lack of a theory on wage and price formation, the assumption of a fixed capital stock and the way expectations and rationality are dealt with. Subsequently, he describes some lines of research found in the literature that try to cope with those shortcomings by using microeconomic behaviour to endogenize relevant dynamic variables. In the next two chapters a selection of these lines is studied in more detail. Chapter 3 deals with price-setting and investment in a dynamic perfect-foresight model of monopolistic competition with costs of price adjustment. Chapter 4 elaborates on wage rigidity and the persistence of unemployment. It discusses efficiency wages and hysteresis theories such as the insider-outsider theory. The consequences of incorporating a wage equation based on these mechanisms in a macroeconomic model with quantity rationing are illustrated by some numerical simulation experiments using a monopolistic-competition model as presented in the previous chapter. Although it does not contain much original work (except for the simulations at the end of chapter 4), this part of the book provides a clearly written survey of disequilibrium and labour market theories. As a microeconomic basis for a macromodel it is somewhat narrow however, as it *e.g.* neglects rational consumer behaviour.

In the second part of the book the discussion moves in a more empirical direction. In order to make it more realistic, the basic model is extended in chapter 5 to a disequilibrium model for an open economy. In such a model unemployment may be the consequence of an oil price shock or a resource boom. The problems of translating microeconomic behaviour towards a macroeconomic level is the subject of chapter 6. As the assumption of representative agents is used, the discussion is restricted to a problem that is specific to disequilibrium economics, namely the problem of regime switches. It does not seem very realistic that the economy completely switches over from one regime to another at some point. Therefore, it is assumed that segments of markets can be in an excess-demand regime while there is excess supply in others. This explains why on the labour market, in the aggregate, unemployment and vacancies can coexist. The aggregation over these micro market regimes is performed by the smoothing approach which allows the proportions of markets in different regimes to change in a continuous way.

The actual empirical disequilibrium model of the Dutch economy is presented in chapter 7. Unfortunately, we can only recognize the microeconomics of the first part of the book in this macro-model to a very limited extent: monopolistic price-setting is reduced to mark-up pricing, with respect to wage formation it is assumed that insider-outsider theory is the most relevant, and efficiency-wage considerations are not taken into account, the influence of expectations is cut down by reducing intertemporal optimization by firms to maximization of present profits and for the output-capital ratio even a simple adjustment mechanism had to be adopted.

The analysis of the Dutch unemployment problem by means of the model in chapter 7 leads to the conclusion that, although the Keynesian regime was dominant during the

1 R.J. Barro and H.I. Grossman, 'A General Disequilibrium Model of Income and Unemployment,' *American Economic Review*, 61 (1971), pp. 82–93; E. Malinvaud, *The Theory of Unemployment Reconsidered*, Oxford, 1977.

period 1978–1988, the classical regime became increasingly important during the later 1980s. However, this result hinges on the figures used for the rate of capital utilization used in the estimation procedure.[2] The author's conclusion that Keynesian as well as classical elements play a role in unemployment implies that a policy directed at lowering unemployment demands a two-sided approach where both demand and supply receive due attention. Simulation experiments suggest that outsider ineffectiveness is more important than insider power in explaining the slow adjustment in the labour market. Therefore, a policy of social renewal, that is a set of measures by which long-term unemployed get retraining and working experience so that they will be able to compete on the labour market again, is the most promising, especially when it is accompanied by a demand impulse. One should note, however, that taxes are exogenous in the model so that the costs of such a policy are not taken into account.

Does the book verify its title? I think it does only partly. Surely, it is a good book. Springer does not run into the pitfalls he noted. He is neither swallowed by technical microeconomics nor does he fall back to simple macroeconomics. He tries to find his way between the devil and the blue sea by modestly exploring microeconomic foundations but keeping track of basic macroeconomic phenomena like unemployment. But in my opinion his path from micro to macro is too disconnected for the book to be the great achievement promised by its title.

Lex Meijdam

Thomas Blank, *Finanzinnovationen und Geldpolitik (Financial Innovations and Monetary Policy)*, Duncker and Humblot, Berlin, 1991. Pp. 203. DM 98,–

In the Anglo-Saxon literature the consequences of financial innovations for monetary policy has been an important issue on the research agenda. In the German literature, however, financial innovations have received much less attention. This is, no doubt, due to the fact that – in contrast to the U.S. – financial innovations were not abundant in the Federal Republic of Germany (FRG). One important reason is that the Deutsche Bundesbank was very reluctant to permit the issuance of many new financial instruments. Certificates of Deposits (CDs) were, for instance, not allowed until the first of May 1986 (Figure 1).

In the book under review financial innovations are broadly defined as all financial instruments that could potentially change the structure of the monetary sector in such a way that it becomes relevant for monetary policy. In the first part of the book financial innovations and their causes are discussed. The most important innovations on U.S.

2 These figures are composed rather arbitrarily as an unweighted average of the figures used by the Dutch Central Planning Bureau and a time series for the rate of capital utilization constructed by the author on the basis of Dutch business surveys. The problem with these surveys is that there always is a large number of firms that reports not to be constrained at all, which is not possible within a disequilibrium model as used by Springer. Therefore, he constructed his figures for the rate of capital utilization by assuming that a part of these firms is, in fact, capacity-constrained. This leads to a bias of the results towards the classical regime, however.