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Book Review

[Book Review of] Frenkel, Jacob ... : Fiscal policy and the world economy : an intertemporal approach, Cambridge, Mass., MIT Press, 1987

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Frenkel, Jacob A., Assaf Razin, Fiscal Policy and the World Economy. An Intertemporal Approach. Cambridge, Mass., London 1987. MIT Press. XIX, 484 pp.

The theory of fiscal policies in an interdependent world economy is the theme of this book. The authors develop a unified framework which – in contrast to traditional approaches – permits a rigorous analysis of both the international and the intertemporal effects of government spending and taxation.

The authors start by presenting a few stylized facts on fiscal policies and international interdependence. A review and synthesis of traditional approaches to open-economy macroeconomics is then given. The attraction of this section lies in the development of a coherent income-expenditure model (using elements of the Mundell-Fleming and the McKinnon-Oates approaches) which can be applied to the analysis of fiscal policies in various settings: a small-open economy with rigid prices (Ch. 2), a small-open economy with fully flexible prices (Ch. 3) and a two-country world with perfect capital mobility (Ch. 4).

As the authors show, the traditional approach has a number of important shortcomings: it lacks a solid microeconomic foundation, it pays not attention to intertemporal budget constraints and it excludes forward-looking behaviour.

Chapters 5 to 15 give an innovative intertemporal approach to the analysis of fiscal policies in open economies. This approach is based on explicit maximizing behaviour of individuals and permits a distinction between transitory and permanent fiscal policies, between current and expected government actions and between various specifications of tax policies.

Chapters 5 and 6 introduce major intertemporal elements starting with a one-commodity world and then extending it to a multi-commodity world with interaction of temporal prices (terms of trade) and intertemporal prices (interest rates). This section contains a very useful presentation of basic concepts of intertemporal economics (e.g. the determinants of borrowing and lending, consumption-based real wealth and consumption-based real interest rates). It also includes an analysis of terms-of-trade shocks and output disturbances.

In the following chapter the authors consider the effects of government spending under Ricardian-equivalence conditions, extending closed-economy analysis of the Barro-type to the open economy. They demonstrate, inter alia, that the effects of government spending on the interest rate and the current account crucially depend on whether the change in spending is permanent or transitory and whether the country is a net lender or a net borrower.

One reason for deviations from Ricardian-equivalence is the existence of distortionary taxes. In Chapter 8 the authors analyse the effects of changes in consumption taxes and income taxes on the interest rate and the current account. They find that a transitory cut in income taxes causes a decline in world interest rates and a surplus in the domestic trade account. A transitory increase in consumption taxes has the opposite effects: the world interest rate falls and the domestic trade account moves into deficit. As the authors show, this result also holds in a multi-commodity world with both tradables and non-tradables. A second reason for deviations from Ricardian-equivalence is the existence of finite time horizons of individuals together with the appearance of a new generation – as demonstrated by the Yaari-Blanchard approach to the analysis of fiscal policy in closed economies.

In Chapters 10 to 13 Frenkel and Razin extend this approach to the open economy. They discuss the main features of overlapping generations models and then analyse the effects of various fiscal policies in the context of a two-country overlapping-generations model. They demonstrate that the effects of fiscal measures crucially depend on the relative marginal savings propensities of the private and public sectors, on the relative marginal savings propensities of current and future generations and on relative marginal savings propensities of both domestic and foreign residents. A brief analysis of the welfare implications of budget deficits is also provided. They arrive at the result that – in the context of the model – a budget deficit raises the welfare of the existing domestic population. The welfare of the foreign populations also rises if foreigners are net savers, but it falls if foreigners are net borrowers. In Chapters 12 and 13 the authors consider the effects of fiscal policies on the term structure of interest rates and on the relative price of tradable and non-tradable goods.

While the intertemporal approach to open-economy macroeconomics, as presented by Frenkel and Razin in this book, brings a number of considerable improvements when compared with the traditional approach, these improvements are not costless. Two major shortcomings are that the new approach does not yet allow for price rigidities or for changes in the velocity of money – the role of money being largely that of a veil (as shown in Chapters 14 and 15). These shortcomings also make it very difficult to use the theoretical model for empirical analysis, i.e. for forecasting macroeconomic variables. In Chapter 16 the authors present some quantitative predictions of their model based on exogenous assumptions about parameter values, and show that predicted and actual growth rates of consumption are positively correlated. Inspection of the results, however, also exhibits substantial prediction errors which suggest that the new approach does not as yet yield better predictions than traditional forecasting methods.

The book closes with some interesting suggestions for future research, a number of very useful bibliographical notes and a comprehensive list of references. To sum up, the study by Frenkel and Razin is a pathbreaking book which may well become a standard reference in international open-economy macroeconomics.

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Heijmans, Risto, Heinz Neudecker, The Practice of Econometrics. Studies on Demand, Forecasting, Money and Income. Dordrecht, Boston, Lancaster 1987. Kluwer Academic Publishers. XII, 273 S.

Das vorliegende Buch ist eine Festschrift zum 25jährigen Dienstjubiläum von Professor Jan Salomon Cramer auf dem Lehrstuhl für Ökonometrie an der Universität Amsterdam. Es enthält sechzehn Beiträge von seinen Schülern aus den Gebieten: Nachfrage nach Konsumgütern (5), Nachfrage nach Geld (4), Einkommensverteilung (2) und ökonometrische Methoden (5).

R. Blundell und *C. Meghir* („Engel curve estimation with individual data") berichten über die Schätzung einer Engel-Kurve für Bekleidung aus den Daten der britischen Haushaltsausgabenerhebung von 1981. Das Problem einer solchen Schätzung besteht darin, daß manche Haushalte im Erhebungszeitraum keine Ausgaben für Bekleidung haben, aber bei ihnen natürlich eine Nutzung vorhandener Kleidungsbestände zu Konsumzwecken geschieht, daß generell Haushaltsausgaben und Haushaltskonsum, der den Nutzen bringt, auseinanderklaffen und daß nur die Ausgaben beobachtbar sind, der Verbrauch aber nicht.

S. Georgantelis, G.D.A. Phillips und *W. Zhang* („Estimating and testing an almost ideal demand system") schätzen auf der Basis jährlicher Nahrungsmittelausgaben (nominal und real) in Großbritannien für die Zeit von 1950 bis 1983 aufgeteilt nach zehn