BOOK REVIEWS


The purpose of this book, as described in the preface, is to provide a "comprehensive, balanced, and integrated survey" of the field of international monetary economics after a decade of floating exchange rates. The audience for the book is advanced undergraduates and first-year graduate students. Stylistically, the book is deliberately austere: it is wholly devoted to theory, with virtually no discussion of either empirical work or experience. While the mathematics is not difficult, it is abundant, so that the book is a substantially more technical read than, for example, Rudiger Dornbusch's *Open Economy Macroeconomics*.

Writing a survey of international monetary theory at the present time is no easy task. The 1970s were marked by a proliferation of new theoretical models in the field; the 1980s have seen not so much a convergence on a unified approach as a general disillusionment with all of the existing models. For practical discussion of economic policy it often seems that economists end up relying on simple models from the pre-1973 period rather than more complex later models. Niehans, in fact, implicitly recognizes this point in the way his book is structured. The book is organized in three parts. The first covers the theory of an open economy without capital mobility; the second covers the microeconomics of international finance; the third the dynamics of monetary policy under floating rates. Only in the third part do the models developed in an effort to understand the post-73 experience really come into play. The rest of the book is devoted to issues and models that have not changed too much in the past decade.

It is the middle part of the book that constitutes its greatest strength. Chapter 6 provides a valuable treatment of the long-run determinants of capital movement, which is especially useful in the way it draws parallels between the gains from trade and the gains from financial integration. Chapter 7 provides an interesting and generally illuminating discussion of the role of financial diversification in producing two-way foreign investment flows. Chapter 9 presents an admirably clear-headed discussion of what the Eurodollar market does and why.

The first part of the book is not as strong. It is organized in the traditional way around elasticity, absorption, and monetary approaches. Even though the author states that there is no contradiction between these views, presenting things this way conveys the impression of a continuing analytical problem where there is really no dispute. In general, one wonders what students would make of this part of the book, some of which reads like a debate with inaudible opponents.

The third part is where the book is most disappointing. First of all, there is no exposition of the basic Mundell-Fleming model. The weaknesses of that model are well known, but it remains the workhorse of international macro and a necessary part of a student's repertoire. Related to this lack is a failure to build any bridge from closed-economy macro to international finance. Beyond this, the discussion does not
give any clear sense of the key issues that have driven theoretical controversy in the field, such as the substitutability of assets denominated in different currencies or the flexibility of prices.

At a more petty level, there are problems with the way the book handles specific issues, some of which border on error. One issue in particular bothered this reviewer. In much of the book the algebraic analysis relies on partial adjustment of money demand as a source of dynamics. There seems to be a confusion here between gradual adjustment of the composition of investors’ portfolios, and gradual adjustment toward target levels of wealth—which have very different implications. Worse still, in several places the book appears to be asserting that gradual adjustment of money demand gives rise to sluggish adjustment of prices, something which is not true. The point is that in a book intended to serve as a text, one should not blur important distinctions between portfolio decisions and saving decisions, or between goods markets and asset markets.

In sum, Niehans has produced a book with many excellent features, but with some serious problems. The central section of the book should be widely read by professionals, for it contains both useful synthesis of familiar ideas and valuable innovations. The weaknesses elsewhere, however, would make me hesitate to recommend it as a text.

PAUL KRUGMAN

Massachusetts Institute of Technology


This volume consists of a collection of thirteen papers that are intended to deal with various aspects of exchange rate and trade instability. As with most edited collections, there is substantial diversity in both the quality and interest of the papers contained in the book. In the absence of any statement by the editors it is impossible to ascertain the criteria by which the editors selected the papers or to determine what (if any) effort had been made to improve the quality of the papers via a review process. Nevertheless, there are some contributions of moderate interest in this volume.

Part I consists of three chapters written respectively by Frenkel, Bigman and Lee, and Dooley and Shafer. These papers are intended to present evidence with respect to instabilities associated with generally floating exchange rates. Frenkel's paper interprets the empirical record with floating exchange rates in the context of three "key" sets of "facts." First, exchange rates, being asset prices, are strongly influenced by expectational phenomena and are therefore bound to display seemingly erratic behavior. Second, in contrast to exchange rate, price levels are much less sensitive to changes in expectations and this, along with the massive "real" shocks experienced in the seventies, could account for the observed substantial deviations from purchasing power parities. Finally, and most interestingly, exchange rate policies targeted towards interest rates are either irrelevant or unreliable. Frenkel also