drawbacks on the balance of payments. Or even worse, some governments borrow abroad for consumption expenditures (e.g. military equipment); the resulting interest payments may be harmful for economic growth. A large foreign debt may make a country more vulnerable for foreign monetary policy, as is clearly illustrated by the international debt crisis of the 1980s. In that decade Brazil, Argentina and Mexico experienced a disruption of society.

Therefore, even if the net foreign asset position of a country is the result of a consolidation of the balance sheets of all its citizens, who have deliberately decided on their transactions with non-residents, a large foreign debt may have, under certain circumstances, macroeconomic consequences that are undesirable for the country as a whole. A large current account deficit may, for instance, indicate that savings are taxed too heavily. Alternatively, a large current account surplus can be a sign of lack of investment opportunities due to severe (labour) market imperfections. We can therefore conclude that in general the assessment of balance of payments positions and net external asset positions depends on the overall picture of the economy. Sinn is right in stressing the fact that these 'imbalances' can be a healthy outcome of saving and investment decisions, but it goes without saying that they are quite as often a signal of economic disfunctioning.

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T. Mayer, ed., The Political Economy of American Monetary Policy (Cambridge University Press, Cambridge, 1990), ISBN 0-521-36316-0, £30.00.

Economists disagree. This is once again illustrated by the book 'The political economy of American monetary policy', edited by Thomas Mayer. Apart from the introduction, this book contains 18 chapters, most of them dealing with questions such as how does the Fed behave? and what are the motives behind Fed's behaviour? The contributors to this book (25!) seem to agree that central banks' behaviour should be seen against the background of central banks' formal and informal relationships with other actors in the economy, like the executive, Congress, financial institutions, etc. In spite of this general point of agreement, the answers to the questions formulated above widely diverge. Some contributors argue, for example, that monetary policy is strongly influenced by Congress or by the executive branch. Other contributors deny such influences or even argue that it is in the interest of the executive branch to carry over monetary policy to an independent central bank, as this enables the executive branch to blame the central bank for high inflation or high interest rates.

Chapters 2 to 5, referred to as the first part of this volume, have in common that they utilize reaction functions to infer aspects of the behaviour of central banks. In Chapter 2, Willett and Keen present estimated reaction functions, suggesting that Congressional elections affect monetary policy. Unfortunately, their evidence is far from convincing. The reaction functions only include one dummy variable which is found significant one out of seven cases. Furthermore, in Chapter 8 Beck points out that electoral cycles in monetary instruments may result from electoral cycles in real variables, due to fiscal policy.

The empirical research discussed by Epstein and Schor in Chapter 3 is more sophisticated. They investigate whether or not the Federal Reserve is responsive to corporate and rentier interests. First, they show that financial and non-financial corporate profits are affected by macroeconomic variables, such as unanticipated inflation and the rate of growth of real GNP. Next, they present estimated reaction functions, revealing that the same variables affect monetary policy. On the basis of these results Epstein and Schor conclude that monetary policy could be motivated by the Fed's concern for corporate profitability.

In Chapter 5, Melton and Roley make use of reaction functions to identify monetary operating procedures. They distinguish three types of operating procedures, namely a federal funds rate procedure, the non-borrowed reserve procedure, and the borrowed reserve procedure. The procedure adopted by the Fed affects several aspects of interest rate behaviour. Melton and Roley argue, for example, that interest rate volatility is relatively low under a federal funds rate procedure, higher under a borrowed reserve procedure and the highest under a non-borrowed reserve procedure. Time series of interest rates support their claim. Furthermore, they point out that under rational expectations, interest rates react differently to money and economic announcements under different procedures. Unanticipated announced changes in money and other economic variables affect interest rates under a non-borrowed reserve procedure only. Estimated reaction functions show that interest rate behaviour in the period January 1980–October 1982 was consistent with a non-borrowed reserve procedure.

Against the background of the empirical work discussed above, the chapter by Khoury is somewhat distressing. First, Khoury exhibits that estimated reaction functions published in the literature differ in the independent variables included, and that the effects of the independent variables on the instrument variable, often the federal funds rate, vary widely. Next, he tests reaction functions for their robustness with a specification search. The results of this test are disappointing. Only GNP appears to pass the robustness test for the entire sample period.

The second part of the volume, consisting of Chapters 6 to 11, deals with the Fed's sensitivity to pressures exerted by bureaucrats and politicians. Most contributors take as uncontroversial that the Fed plays an important role in the economic policy process and that political actors have incentives, induced by electoral and/or partisan motives, to exert pressures over the Fed. The question about the existence of links between political actors and the Fed becomes even more intriguing if one considers that the Fed owes its autonomy, if it has autonomy at all, to the political actors. Furthermore, Congress has the possibility to take Fed's autonomy back. From this institutional setting, two conclusions can be drawn. First, the Fed cannot continuously harm the interests of Congress and second, if the Fed is autonomous, political actors must benefit from it.

The evidence in the economic literature on political influences on Fed's behaviour is far from conclusive. The chapters included in this volume seem to be a good reflection of economists' positions on this point. The majority of the contributors conclude that the direct links between political actors and the Fed are rather weak. Instead, Congress uses the Fed as a whipping boy: Congress blames the Fed when things do not go right (see also Kane in Chapter 19 of this book).

In Chapter 8, Beck discusses the work of Grier on the Fed's autonomy. Grier (1984) perhaps presented the strongest evidence for the existence of electoral monetary cycles with a monetary expansion just before elections. However, according to Beck, the cycles found by Grier cannot be optimal for the executive, since the effects of a monetary expansion on real variables take some time. Beck, furthermore, argues that monetary expansion can be the result of expansionary fiscal policy through the demand for money. In my opinion, Beck has missed a step in his explanation. He ascribes the monetary cycle to an electoral cycle in GNP, but the existence of a cycle in GNP is hard to determine empirically.

One of the most interesting chapters in this volume is written by Hetzel, who discusses a simple model describing the links between the Fed and Congress. Congress is regarded as the dominant actor. Elections induce Congress to redistribute income through inflation. The actual demand for inflation may fluctuate over time, depending on institutional arrangements. Inflation, however, is not hidden for the public, and the electorate may blame

Congress for inflationary policy. For this reason, Congress may benefit from giving the Fed autonomy, without guaranteeing this autonomy. As a consequence, the Fed is locked by its own dependency. To some extent, it can pursue its own goals, whatever they are, but it has to bend regularly to pressure from the Congress. In such a situation, Congress still has the possibility to affect monetary policy, but it can blame the 'autonomous' Fed for high inflation.

In Chapter 11, Cargill and Hutchison also emphasize the importance of institutional arrangements for the demand for inflation. They compare monetary policy in Japan with monetary policy in the United States, and attribute the differences mainly to institutional factors causing a higher demand for inflation in the United States than in Japan.

Considering the second part of the book, it is striking that none of the authors consider the Fed to be the servant of the executive or Congress. On the other hand, the Fed is not regarded as a political enemy either. It is worth mentioning that the analysis of the links between the Fed and the political actors is hampered by insufficient knowledge about the objectives and constraints of political actors. Or to put it in Beck's words: 'We cannot know if the Fed is doing what the president wants, without knowing what the president wants'.

The first and second part of the volume mainly deal with the (political) motives behind monetary policy. In the third part, attention is devoted to the information on which Fed's decisions are based and to the question how Fed's decisions come about. In Chapter 12, Lombra and Karamouris evaluate Fed's forecasts for GNP and inflation. They show that there have been substantial errors in Fed's forecasts. Against this background, it is not surprising that monetary policy is found to be poorly timed (see also Poole in Chapter 17).

In economic literature, the Fed is often viewed as an homogeneous entity, whose behaviour can be described by the optimisation of an objective function, subject to constraints imposed by the economic and political environment in which the Fed operates. Obviously, this simplification facilitates the analysis enormously, but it bypasses several aspects of monetary policy. Some of those aspects are highlighted in Chapters 13 to 16. Chapter 13 by Havrilesky and Schweitzer and Chapter 14 by Gildea try to explain FOMC members' votes. Havrilesky and Schweitzer show that members whose careers are linked to the central government are more inclined to support inflationary policy than members whose careers are not linked. Gildea's analysis suggests that members' votes depend on members' personal characteristics, like their social background, past career and education. Both chapters illustrate that political actors can influence Fed's behaviour by appointing 'proper' candidates. In line with these chapters, Mayer points out (Chapter 16) that because FOMC members attach costs to dissenting from the general accepted doctrine, the FOMC may stick to suboptimal monetary policy.

Let me conclude this review with some general remarks. Little is known about the behaviour of monetary authorities. Strong empirical evidence on the motives behind monetary policy and on the links between central banks and political actors is lacking. This volume is a good representation of the existing literature on central bank behaviour, but, of course, it does not fill the lacuna in our knowledge. Nevertheless, the volume offers a good starting point for economists intending to study central bank behaviour.

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Wallace C. Peterson, Transfer Spending, Taxes, and the American Welfare State (Kluwer Academic Publishers, Boston–Dordrecht–London, 1991), pp. xv + 176, ISBN 0-7923-9077-6.

United States tax and transfer policy has taken many twists and turns in the past three decades, as presidents as diverse as Lyndon Johnson, Richard Nixon and Ronald Reagan have left their individual marks on it. In this synthesis of American policy, aimed at the general reader, economist Wallace C. Peterson shows 'who gets what' and importantly 'who pays what' in America.

The book is divided into five chapters. Chapter one reviews the history of government spending in the United States and shows that while traditional purchases of goods and services – military, roads, government works – dominated in the 1950s, by the 1970s transfer payments did. Today two-thirds of all spending goes to people in direct money or in-kind benefits, or indirectly through grants to local governments, foreign aid or in interest payments on the public debt.

Chapter two looks at 'who gets what' with respect to these transfers. Transfers doubled as a percentage of national income between 1960 and 1975 but this ratio has remained relatively constant since. Surprisingly the greatest growth was during the presidency of Richard Nixon. But the great bulk of these transfers are paid through broad-based social insurance programs – retirement, disability, medicare, and unemployment – predominantly to the middle class. Means tested programs targeted on the poor make up only a small fraction of such transfers. This in large part explains why despite the significant increase in overall transfers, poverty still exists in the United States.

Chapter three introduces the concept of a 'tax expenditure', which is