

Book Reviews

Edited by Stan Herren

***Money: A Market-Oriented Approach.*** By WILLIAM D. GERDES.  
Groothusen Press. Pp. 269. \$40.00.

When we speak or write of money, we are telling a story that is very old and very new and a story that is both simple and complex. The story centers on money as a medium of exchange. When money is used as a medium of exchange, ratios of exchange or prices result. When prices have been established for commodities, we develop the concept of relative prices, a key concept in resource and product allocation.

Professor William Gerdes has written a book on money, which begins with this basic function of money and quickly builds into a wide river running through the history and theory of money. The book covers many topics including: financial markets, the foreign exchange markets, and monetary policy.

The opening chapter discusses the types of money, beginning with commodity money. Gerdes examines in some detail the characteristics of fiduciary money. He then introduces and studies money in use today, fiat money.

Chapter two discusses financial markets. The flow of money or funds from savings surplus individuals to savings deficit individuals is brought together and directed by institutions within the financial markets. Financial markets, as Gerdes points out, have critical importance in capital formation. They are important in economic development and characteristic of economically developed nations.

The author devotes a chapter to consideration of foreign exchange markets and foreign exchange rates. A foreign exchange rate is the price of one currency in terms of another currency. Foreign exchange rates are determined by the trading of currencies by large banks and other traders in the international currency markets or foreign exchange markets. The author discusses several exchange rate systems including the former fixed exchange rate adjustable peg system and the current flexible exchange rate system. The encouragement of speculation under the adjustable peg gives insight into profit opportunities under this system. The adoption of flexible exchange rates by developed nations in the 1970s solved problems associated with the earlier system of fixed exchange rates.

Gerdes moves from a discussion of exchange rates to a study of the national money supply. This section includes a discussion of the monetary base and the quantity of money. There is a detailed explanation of the M1 money supply multiplier, along with an example. This chapter also contains a review and evaluation of the tools of monetary policy: open market operations, discount rate policy, and reserve ratio requirements. Of particular interest in this section is an examination of the impact of sweeps on reserve ratio requirements and the level of reserves actually held by commercial banks.

The author follows with a detailed study of the equation of exchange. He presents the equation of exchange developed by Irving Fisher, followed by the more recent modified version of Fisher's equation of exchange. This more recent version is operational. All values in the equation can be found in government national income accounting data, or they can be calculated using values of the other variables. Gerdes uses the equation of exchange to analyze three scenarios, the relationships between: (1) the money supply and velocity, (2) the money supply and real Gross Domestic Product (GDP), and (3) the money supply and the price level.

A key topic in the following chapter is monetary policy and the transmission mechanism of monetary policy. He first discusses the Keynesian transmission mechanism, so called because it is based on Keynesian theory. In this mechanism, an increase in reserves lowers the nominal federal funds rate which results in a drop in the long term real interest rate. This increases both investment and nominal GDP. This transmission mechanism is consistent with a central bank targeting interest rates.

The author also presents the classical or monetarist transmission mechanism. This sequence is based on the equation of exchange and the quantity theory of money. In the classical mechanism, an increase in reserves causes the monetary base to rise which raises the money supply. This causes an upward movement in both total spending (aggregate demand) and nominal GDP.

This exposition of the two transmission mechanisms is very clear and precise, as presented by Gerdes in an exhibit. He carefully labels the policy instrument, the operating target, the intermediate target, and the policy objective. This is the clearest presentation of this material that I have observed.

The final chapter contains an interesting discussion of Milton Friedman's arguments against discretionary monetary policy. On one

hand, Friedman argues that politics often interferes with the implementation of appropriate monetary policy. He also contends that time lags make it difficult to carry out monetary policy in a timely manner. The result is monetary policy that increases business cycle fluctuations rather than moderating the cycle.

A favorite aspect of the book is that the author provides throughout the book sketches of the economic thought of famous economists. Although some of these ideas have been examined earlier in this review, here is one last retrospective. We look back on the price-specie flow mechanism of David Hume. We see the Fisher Equation, where Irving Fisher ties together the nominal interest rate, the real interest rate, and the expected rate of inflation. Fisher also provided us with an early version of the equation of exchange. As a result of the Keynesian revolution, economists developed the Keynesian monetary transmission mechanism. The monetarists contributed the classical (monetarist) monetary transmission mechanism. A noted monetarist, Milton Friedman, presented a monetary theory of the business cycle, a critique of Keynesian monetary policy, and the monetary rule. Economists of the Austrian school argued that the value of money should be determined in the market place like any other commodity, and they favored a return to the gold standard. These contributions give us a broad view of the diverse nature of monetary economics.

William Gerdes has written an interesting book on the economics of money. His treatment of the subject is thorough and comprehensive. The book provides an enjoyable and educational reading experience. It would be suitable as a text in Money and Banking or Monetary Theory. It would also serve as valuable reference for those who teach monetary economics.

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***The German Economy: Beyond the Social Market.*** By HORST SIEBERT.  
Princeton, NJ: Princeton University Press, 2005. Page ix, 403.  
\$60.00.

Horst Siebert's book is an informative, if somewhat pessimistic analysis of the German economy. Much of the book's focus is on the post-1990 reunified nation, but stops before the recent implementation of the "Hartz