

Salinas, Zedillo, and Fox.

In chapter seven, Santiso documents that this movement to more orthodox economic policies can retreat as Argentina and more so Venezuela have shown. Yet, the pragmatic policies of Chile, Brazil, and Mexico may inspire other countries. For instance, in Colombia similar economic policies seem to have taken hold, in Uruguay a leftist coalition has introduced fiscal and monetary orthodoxy.

While Santiso is skeptical of the Marxist-inspired Revolution and of pure neo-classical models, he concludes that institutional anchoring of prudent fiscal and monetary policy, protection of property rights, general commitment to the market, openness to trade, and government control when needed are both engines of growth and inhibitors of populists drifts.

Because his project is ambitious, Santiso had to paint with broad strokes where much significant detail is left out. This, however, would be true of any book on a region as large and diverse as Latin America. I recommend this book for anyone curious and concerned about current events in Latin America. Santiso's conclusions (and wishes) are reassuring. May the institutional anchoring of prudent fiscal and monetary policy, protection of property rights, general commitment to the market, openness to trade, and government control when needed he sees happening in most of Latin America (with acknowledged exceptions) continue to deepen and expand. Amen.

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Competition and Growth: Reconciling Theory and Evidence. PHILIPPE AGHION AND RACHEL GRIFFITH. Cambridge, MA: The MIT Press, 2005. Pp. x, 104, \$28.00.

In this book, Philippe Aghion and Rachel Griffith examine the causal relationship between changes in product market competition and economic growth. They analyze two conflicting views: (1) the prediction of theoretical (growth and industrial organization) models that increased competition dampens economic growth by reducing the rents from innovative activity; (2) the common wisdom and supporting evidence from empirical studies that competition encourages growth by forcing firms to innovate and to be more efficient. Aghion and Griffith attempt to

reconcile these alternative views by developing an integrated version of the endogenous growth theory. In particular, they incorporate two novel elements—post versus pre-innovation rents and distance to the technological frontier—to their base model. Finally, they also evaluate the policy effects of patent protection and market entry on innovation and economic growth.

Aghion and Griffith's book consists of four chapters, with each section explaining the theoretical models first followed by a discussion of current empirical studies and findings. The authors' review of the competition-growth nexus is very focused and selective (models are from the early 1990s). They do an excellent, thorough job of explaining the relevant theoretical models and related empirical tests of these models. Aghion and Griffith then present the shortcomings and deficiencies of these studies, thus providing a backdrop for their proposed theoretical modifications and eventual synthesis or reconciliation of the two opposing views.

In the first chapter, Aghion and Griffith present theoretical economic models from the early 1990s which predict that increased product market competition reduces post-entry rents, thereby discouraging innovation and growth. Much earlier studies testing the link between competition and growth find no statistical evidence supporting the theory. However, Aghion and Griffith point out that there are some significant problems associated with the empirical literature, including: (1) the past studies' emphasis on the relation between firm size or market concentration and innovation; (2) failure to adjust for firm and industry fixed effects; (3) simultaneity or endogeneity problem. The contradictory finding that higher degree of competition retards innovation and growth prevails in the 1990s despite the advent of better datasets and econometric methods. In this initial chapter, the authors discuss their base model following the endogenous growth theory.

In chapter 2, Aghion and Griffith modify their base theoretical model by integrating several assumptions from Hart's (1983) agency model: (1) competition acts as an incentive for even non-profit-maximizing firms to be more efficient; (2) competition and hard budget constraints are complementary. However, the authors find mixed or no evidence to validate their theoretical expectations.

In the next chapter, Aghion and Griffith extend their model by assuming that incumbent firms can innovate (contrary to earlier theory) and that a firm's decision to innovate depends on the difference between

pre-innovation and post-innovation rents. As a result, the authors predict: (1) the relationship between competition and innovation is an inverted-U shape, that is, increased competition will have a positive impact on innovation at low initial levels of competition while it will negatively affect innovation at higher levels; (2) the technological gap between leading firms and lagging firms widens with increased product market competition; (3) firms which share the same or similar technology (“neck-and-neck”) will engage in more innovation and R&D investment in order to escape competition. To test these predictions, the authors offer a 2003 study by Aghion, Bloom, Blundell, Griffith, and Howitt that use firm-level data from the London Stock Exchange and the United States Patent Office. The results show an inverted-U relationship, especially for the top innovating sectors (motor vehicles, chemicals, electrical and electronic, food, beverages and tobacco). Aghion and Griffith argue that patent policy and competition policy are complementary, and they present a final extended form of their theory in the last chapter.

In chapter 4, the authors include the impact of foreign entry and labor market reforms (pro-employer versus pro-worker) into their base growth model. They expect that the potential entry or penetration of foreign firms into the market will force leading firms initially close to the technological frontier to innovate more than lagging firms. They also predict that pro-worker regulations will have an adverse effect on innovation and growth. Empirical evidence using data from the United Kingdom, India, and an OECD cross-country panel confirm these predictions.

The book is essentially a compilation of papers by Aghion and colleagues. Aghion and Griffith do a fine job of presenting the development and evolution of Aghion’s ideas building on earlier work by Joseph Schumpeter (“creative destruction”). They select a good mix of articles explaining the conflict between theoretical predictions and empirical findings, and effectively synthesize and reconcile the differences. An important contribution is the authors’ insights on the differential impact of patent protection and antitrust policy on innovation and productivity. Despite this book’s conclusions, there remains healthy controversy over empirical issues such as the proper definition or measure of competition (Lerner index vs. concentration ratio), the impact of domestic competition versus foreign competition, and the bi-causality between competition and growth.

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The Macroeconomics of Fiscal Policy. RICHARD W. KOPCKE, GEOFFREY M. B. TOOTELL and RICHARD K. TRIEST (Editors). Cambridge, MA: The MIT Press, 2006, Pp. 1X, 383. \$40.00.

During the three decades following the publication of John Maynard Keynes, "General Theory of Employment, Interest, and Money" in 1936, countercyclical fiscal policy became preferred stabilization policy among academics and practitioners. Conversely, the past four decades have witnessed the decline of fiscal policy in favor of monetary policy. However, large sustained budget deficits especially in United States made fiscal policy superior again in the eye of some economists and the macroeconomic policy option started to swing back towards a renewed consideration of fiscal policy. Thus, discussions of fiscal policy have renewed attention to the effects of fiscal deficits on macroeconomic variables.

By bringing together elite researchers and policy makers to review the efficiency and consequences of fiscal policy, this excellent book includes a great collection of papers and offers a state-of-the-art consideration of where fiscal policy stands today. Instead of examining what the theory should say about the data, this book explores what the data say about the theory. Contributors deal with the effectiveness of United States fiscal policy as a stabilization tool and the impact of fiscal decisions on macro economy in both the short run and long run.

After discussing the practical arguments against the implementation of discretionary fiscal policy, Alan S. Blinder concludes that fiscal policy's inability to accomplish countercyclical stabilization in usual circumstances means that monetary policy should be relied upon as the primary policy tool for macroeconomic stabilization: "Today's conventional wisdom holds that discretionary changes in fiscal policy are unlikely to do much good, and might even do harm" (page 52). On the other hand, Blinder indicates that the appropriate times to supplement