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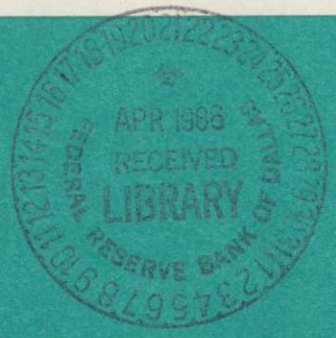

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In This Issue

Making Policy With VAR Models

In "Are Forecasting Models Usable for Policy Analysis?" (p. 2), Christopher A. Sims argues the answer to his title is yes. Sims explains that any decisionmaking model must incorporate some identifying assumptions to enable it to forecast the effects of alternative decisions. He argues that although all identifying assumptions in econometric policymaking models are of uncertain validity, those incorporated in vector autoregression (VAR) forecasting models have the advantage of allowing their uncertainty to be measured. Sims concludes by demonstrating a method for identifying a small macroeconomic VAR model so that it can be used to analyze monetary policy.

Evading Gresham's Law

In "Gresham's Law or Gresham's Fallacy?" (p. 17), Arthur J. Rolnick and Warren E. Weber argue the answer to their title depends on whether a qualifier is added to the standard version of the law that "bad money drives out good." By examining several historical episodes, they find instances where bad money (valued more at the mint than in the market) failed to drive out good money (valued less at the mint than in the market). Rolnick and Weber next explain why the common qualifier to this law, which requires the mint to fix the rate of exchange at face value, does not reinstate the law. The common qualifier fails to give plausible reasons for how the mint price of money can coexist with a different market price. They then propose a new qualifier to Gresham's Law and argue its validity: bad money drives out good only when there are significant costs to using the good money at a premium.