

Rejoinder

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I find Gordon's reduced form approach very unsatisfying for reasons that are stated in my paper. One doesn't know whether the variables that Gordon adds to his equation belong in the structural price equation, in the structural wage equation, or in both, and so the results are hard to evaluate. Among other things, the structural approach allows one to examine the implied behavior of the real wage, and this is an important check on the individual price and wage equations. In Model 2 in my paper, the long-run behavior of the real wage with respect to changes in both the unemployment rate and the price of imports is suspect, and in Model 1 the long-run behavior with respect to changes in the price of imports is suspect. There is room for further work here. The reduced form approach does not, however, get around this problem. The problem is simply ignored.

There is always a danger of data-mining in macroeconomic work, i.e., running enough regressions to find the result that one wants when in fact the result is spurious. A model may fit the data well and give the desired result when it is in fact a poor approximation of the true structure. The method that I use to compare the different models accounts for this possible problem since it accounts for the possible misspecification of the models. Before one can have any confidence in Gordon's results, his model needs to be put through further tests.

Is the sum of the nominal RHS coefficients in Gordon's equation really one, or has Gordon in his diligence merely found a specification that gives a value of one? The main change that seems to give a value of one is the addition of the 9th through 12th lag of the dependent variable. This is equivalent in Model 2 to adding the price change lagged five quarters to the wage equation. The results discussed in my paper show that this change is not significant. There is no evidence in my work that price

changes lagged more than four quarters belong in the wage equation. The new lagged price variable is also not significant in Gordon's equation until Gordon's other variables are added to the equation (compare columns 4 and 5 in Gordon's Table 1). The important question is thus whether these other variables belong in the equation. My feeling is that until a more structural approach is taken and until Gordon's model is subject to misspecification tests, these results are not to be trusted.

Finally, Gordon makes no mention of Model 1 except to say that inside it "is a rate-of-change equation struggling to get out, since in both the price and wage equations the coefficient on the lagged dependent variable is greater than 0.9." The coefficient estimates are, however, significantly less than one by a large margin, and the equations are really not struggling in this way. From my tests, Model 1 seems to be the best of the three, and it should not be put out of the running in the never-ending search for the best model of price and wage behavior.