surge of interest in financial markets regulation recognises this fact but a theme of the papers in this volume is that analysis of the issue is not helped by the beliefs that money is neutral and that financial markets are always efficient.

Turning to the practitioners, Goodhart is supportive of the IT policy framework on the grounds that it has provided a nominal anchor via a more transparent and effective policy framework. There is some merit to this view but doubts linger about how effective the framework will be in dealing with future shocks. The point here is that the low inflation outcome during the 'great moderation' of the 1990s was a global phenomenon unrelated to IT per se. Goodhart points out that the movements in the Bank of England's interest rate during this period could account for only a fraction of the improved inflation performance. Nevertheless, he attributes some of the additional improvement in inflation performance to superior monetary policy as a result of the increased effectiveness in 'anchoring' expectations by announcing a credible inflation target.

Freedman is largely in agreement with Goodhart's vision but from the perspective of the Bank of Canada's search for an effective operational approach to IT. Of particular importance here is his explanation of the Bank of Canada's use of the IT framework to deal with supply-price shocks. As this is an issue that central banks around the world are now facing, it is worth stressing a key element of the Bank of Canada's approach to dealing with supply shocks without raising interest rates. In Freedman's (p. 183) words:

> Indeed, there may be circumstances in which the central bank can cope with an unfavourable price shock without having to raise interest rates. If the [inflation] target is credible, with expected inflation well anchored by the target, and if the central bank has gained widespread understanding and acceptance by the public of its position that it is willing to accommodate the first-round price-level effects of a price shock but not the second-round or ongoing effects of inflation, there would be a possibility of absorbing the price shock without having to move below capacity, and therefore, without interest rates having to rise.

This is important advice regarding the operational challenges currently facing the global IT framework.

To sum up, this book provides a useful overview of the challenges facing the IT policy framework, both by pointing to the limitations of the underlying theory and, more importantly, by outlining the importance of a transparent policy framework for anchoring expectations. The importance of this point cannot be overstated because it highlights the operational need for clear communication by the central bank of its analysis of specific price shocks if it is to retain credibility. Simply announcing and enforcing an inflation target will not be sufficient to anchor expectations. For this reason alone, the book should be of interest to all central bankers and students of monetary policy.

Colin Rogers
University of Adelaide

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Marvin Goodfriend, 2007. 'How the World Achieved Consensus on Monetary Policy, *Journal of Economic Perspectives*, **21**, 47–68, pp. 424.

Water Resource Economics: The Analysis of Scarcity Policies and Projects, by Ronald C. Griffin (MIT Press, Cambridge, MA, 2006), 424 pp.

Water Resource Economics is a must read. In fact, I would go as far as to say, it is a must buy for every Australian involved in the analysis, development and critique of water policies. The book is also a must read for those interested in understanding the way water policies in the USA have evolved and where opportunities for their improvement lie.

Ronald Griffin's *Water Resource Economics* is written with two purposes in mind. The first purpose is to provide an insightful microeconomics text book using water as the medium to demonstrate well rehearsed concepts. The second purpose is to show people how to think about and analyse water supply, water management and other related natural resource management issues.

As a microeconomics textbook, this is the style of book that I like. All the examples and case studies derive from real world experience. From the first chapter, the reader is forced to deal with complexity. Unlike many of the standard texts that I have come across, problems and difficulties are not assumed away. The approach is refreshing. The book has a sense of realism and relevance that is missing from many of the textbooks I have read.

As each chapter in the book ends with a set of exercises, the book could be used as the basis for teaching a course in water economics. In fact, I can think of many reasons why this book should be used to teach water economics to engineers, hydrologists etc.

In addition to the usual resource economic chapters on optimisation, dynamic efficiency, cost–benefit analysis and policy analysis, there are excellent chapters on water marketing, water pricing, demand analysis, supply analysis and water resource modeling.

The book's second purpose is to show people how to analyse water policies. The great news is that it does this brilliantly. Every CEO of every water corporation should be urged to read and understand this book. The chapters on the economics of institutions and water law are excellent.

Another reason for reading this book is that it offers a rich summary of American water policy literature. In particular, the chapter on water marketing – called water trading in Australia – should be read by all.

My only real criticism of this book is that it is too American and, as a result, misses some important concepts. Glaring omissions include the Australian experience in unbundling water rights. Similarly, strategies for dealing with and managing supply risk and climate change are not well covered. All this can, however, be fixed in the second edition.

Mike Young
The University of Adelaide