Book reviews

Money, Distribution Conflict and Capital Accumulation
E Hein
Palgrave Macmillan: Hampshire, 2008
0230521576, hardback, £58

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Marx and Keynes are making something of a comeback in the wake of the financial crisis that has swept the world since 2007. With the economic orthodoxy falling painfully short of a correct analysis of how capitalism works, previously heterodox traditions of economic thought are being brought back into the mainstream. The most glaringly obvious failure has been the targeting of 'real' inflation by central banks throughout the world. Underpinning this policy has been the separation between real and monetary forces. So long as the price level for real goods is kept under control, money will act as a mere facilitating device to ensure that the market economy works efficiently — or so it was thought. Far from being neutral, monetary forces have unleashed a spectacular bubble which has sucked the world economy into a deep recession. While regulators carefully targeted real price indices, the world's financiers gambled trillions of dollars on shares, property and instruments of debt.

Drawing on the traditions of both Marx and Keynes, Eckhard Hein's book makes a strong case for interpreting capitalism as a monetary production economy: a system in which money matters. As the world has recently discovered, capitalism requires credit money as its elixir of life. Without a functioning banking system there can be no capitalist system. This book suggests how an alternative to orthodox economic theory can be constructed in which money and banks are accorded special status.

In the first part of the book, Hein makes this case by drawing together some key strands of Marxian and Keynesian monetary analysis. The Marx that Hein draws on is somewhat different from the version that is often touted on the left. Instead of seeing the ultimate collapse of capitalism as dependent on the 'real' secular fall of the rate of profit, Marx is interpreted as a monetary theorist. Right at the start of Capital, Marx recognised that agents hoard money, which breaks the link between demand and supply (as witnessed by the recent credit crunch). From a Post Keynesian perspective, Keynes is also distinguished from the neutral money approach of the neoclassical synthesis, and its New Keynesian counterpart. These bastard Keynesian approaches are lumped together under the umbrella of 'real' analysis, and surveyed alongside the Monetarist, New Classical and New Consensus theories. This useful and accessible survey points towards some of the implications for monetary policy and the development of economic theory.

Part two develops a monetary theory that draws on Post-Keynesian and Marxian monetary analysis, together with the Neo-Ricardian monetary theory of distribution. The core model, inspired by Joan Robinson, Nicholas Kaldor and Michal Kalecki, rests on a key interpretation of credit money as an endogenous variable, created by the interaction of banks, central banks, firms and households. Based on a money circuit approach, the model moves beyond Keynes's short run focus to a consideration of long run capital accumulation and distribution. A series of accessible equations carefully develop variables such as mark up prices, profit rates and capacity utilisation. The outcome is a long run model of growth which is dependent on the role of money, interest rates and banks.

Part three looks at the role of conflict and inflation. The natural rate of unemployment, as for example represented by the NAIRU, is modelled in the context of debt and interest rate policy. By applying his theoretical framework, Hein develops a strong critique of the targeting of inflation using interest rates. Interest rate hikes are not a price worth paying (as the British Chancellor Norman Lamont once claimed): via their impact on investment they generate unnecessary high unemployment. Moreover, during periods of recession interest rate cuts are ineffective in the context of disinflation and deflation. In a monetary production economy, the natural rate of unemployment is itself an endogenous variable, dependent upon monetary forces.

Hein is clear that this integration of different strands of heterodox theories is foundational. He notes the absence, for example, of any consideration of technical change, stock markets, or international trade. One key issue that might also be raised is the severe assumption in the book of a one-commodity world. From a theoretical perspective, it is difficult to conceive how money can play a core role without the exchange of heterogeneous commodities. This should not, however, detract from the overall contribution of the book, which offers coherence and depth to the somewhat neglected and highly relevant field of heterodox monetary economics. It may also provide a starting point for economics students looking for alternative explanations of the current economic crisis.

The Cult of Statistical Significance: How the Standard Error Costs Us Jobs, Justice, and Lives
S T Ziliak and D N McCloskey
University of Michigan Press: Ann Arbor, 2008
9780472050079, paperback, £23.95

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Persuading professionals that their procedures are wrong is a long and lonely task. McCloskey, joined later by Ziliak, has been conducting such a crusade against the misuse of significance testing for over 25 years. This book presents their argument, gives lots of examples of the adverse consequences of misuse, and provides some history of the controversy, which dates from the origins of mathematical statistics. By 'the standard error' they mean 'the usual mistake' and they believe that most teaching and research is wrong.

They are not anti-statistics and they are not explicit Bayesians. My interpretation is that their argument contains four points. Firstly that statistical significance is commonly confused with substantive significance: the economic or clinical importance of the effect. Obsessed by the precision of the estimate, researchers ignore, or often do not even report, the size of the coefficient but just give t statistics or p values. But large important effects can be insignificant, for example if the sample is small, and tiny unimportant effects can be highly significant if the sample is large; size matters. Secondly, standard errors are only informative about sampling error, and other sorts of error are usually more important. In econometrics, specification uncertainty (the sensitivity of the coefficient to other variables included) usually dwarfs sampling uncertainty. Standard errors are uninformative about this since they are estimated conditional on the chosen specification. Thirdly, using a 5 per cent significance level (the probability of rejecting the null hypothesis when true) is an arbitrary convention which is rarely justified in terms of the consequences of the decision (the loss function) or the power of the test (the probability of rejecting a false null). Fourthly, there is a widespread logical fallacy that proposition A: the data is unlikely given the hypothesis (indicated by rejection on a significance test) implies proposition B: the hypothesis is unlikely given the data.

Many have agreed with this logic, but maintained that the mistakes are not important in practice. In response, the authors have carried out detailed reviews of papers published in the *American Economic Review*. They found that the mistakes were prevalent (one of my papers scored poorly) and that the frequency of the mistakes had not declined with time. They are not alone in this crusade, supported by many eminent statisticians and economists, and there are like-minded campaigners in areas like drug testing and medicine. Some sciences, for example physics, chemistry and biology, seem immune to the infection, but where misuse of significance has taken hold it seems almost impossible to eradicate. There are various explanations. The authors emphasise path-dependent history, in particular the influence of R A Fisher. Despite the objections of many of the founders of statistics (including Gosset, who developed the *t* test), Fisher established an evangelical network of disciples of significance. Academic bureaucracy with its scientistic desire for standard operating procedures and seemingly objective rules also promotes mechanical significance testing. Incentives matter: significance tests make publication and teaching easier. Authors find it easier to get significant results than important results; editors find it easier to discriminate on the basis of significance than importance. It may be hard to teach significance testing, but it is even harder to teach, let alone examine, the ability of students to think for themselves and judge statistical importance on the basis of all the evidence.

While they have a long fight ahead, there are some signs of hope. Kennedy (2003) includes in his ten commandments of applied econometrics 'Thou shalt not confuse significance with substance'. Elliot and Timmerman (2008) emphasise the role of loss functions in forecast evaluation. Practice in finance is switching from evaluating models by the significance of their coefficients to evaluating them by the profitability of the strategies they imply. Gosset, a brewer with Guinness, would have approved.

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Bank Performance: A Theoretical and Empirical Framework for the Analysis of Profitability, Competition and Efficiency
J A Bikker and J W B Bos
Routledge: London and New York, 2008
9780415397667, hardback, £65

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This book presents a comparative study of nine different approaches to analyzing competition and efficiency in the banking sector, all derived from a single theoretical profit maximizing framework. A central theme of the book is its argument that alternative approaches can be complementary. This is because different analytical approaches yield very different, often conflicting, estimates of the performance of banking institutions. The authors seek to show that there is no single 'true' measure of bank performance. For example, some approaches are particularly useful for assessing the impact of disintermediation, while others are more suitable for analyzing the consequences of internationalization. They conclude, therefore, by recommending the use of a balanced score-card approach to the analysis of issues such as the degree of competition amongst banks, the extent of market concentration and levels of efficiency, productivity and profitability.

The book is made up of eighteen chapters which are organised into five more or less self-contained parts. The authors suggest that each part of the book, like the individual chapters within it, may either be read sequentially or studied separately. An important feature of this book is its use of a standardized data set of 13,000 private and public banks, in 46 countries, to generate empirical tests of the various analytical approaches considered. The data set, obtained from Fitch IBCA's Bankscope, covers the period 1996 to 2005.

Part 1 of the book addresses some background issues, explains some core concepts and reviews alternative explanations of bank performance. Part 2 develops the book's theoretical framework. It sets out the basic model of a profit maximizing bank and shows how this can be used to derive a range of competitive models and measures of cost and profit, x-efficiency and economies of scope and scale. Part 3 contains a review of some recent trends in banking and considers their causes and consequences for the different analytical models discussed. Among the trends covered here are: developments in information and communication technology, liberalization and harmonization of banking rules, disintermediation, internationalization, increasing contestability of national banking markets and increasing concentration. In Part 4 the authors present the empirical results of the various tests of the different analytical models made against their data set. Models tested include: the structure conduct performance model, Cournot's model and the Panzar-Rosse and Bresnahan models. There is also a detailed description of the data set itself and the authors set out their case for the use of a balanced score-card approach. Part 5 draws some conclusions and presents an agenda for further research.

Bikker and Bos have written a text which could be very usefully incorporated into a range of postgraduate and professional courses in banking and finance and financial regulation. Indeed, it contains a guide on how to use the book in a university masters course on banking. It also blends a synthesis of analytical approaches common to the literature on bank performance with an application to real world data -in a way that gives the book some relevance to more general courses in managerial economics and microeconomic modelling and estimation. A real weakness of this book - one which diminishes its applicability to third year undergraduate courses - is its inconsistent and rather arbitrary treatment of some key issues. For example, whereas the Basel Accords receive a fairly thorough analysis, other important issues for bank performance, such as bank runs and off balance sheet activities, are given rather short shrift.

Social Policies, Labour Markets & Motherhood: A Comparative Analysis of European Counties
D Del Boca and C Wetzels (editors)
Cambridge University Press, Cambridge, 2007
9780521877411, hardback, £55.00

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Rising female labour market participation, and the impact this is having on fertility rates, is of interest to economists, social policy analysts, sociologists and demographers. In this edited collection, Del Boca and Wetzels address two related questions: why are women's fertility and participation rates so different between European nations; and why are fertility rates declining in Southern Europe (where women's participation rates are low) but growing in the Nordic nations (where participation rates are relatively high)?

The book is divided into three parts. The first begins with a survey of the social policy literature on welfare state typologies (Meulders and O'Dorchai) and is followed by three chapters (De Henau, Meulders and O'Dorchai) that construct quantitative indicators of cross-national policy support for combining motherhood and work in three key areas: public and private childcare provision, parental leave entitlements and cash and tax benefits. Part two surveys the recent empirical literature on cross-national variations in the relationships between motherhood and employment (Del Boca and Locatelli), the timing of childbirth (Gustaffson and Kenjoh) and motherhood and wages (Wetzels). Finally, part three presents an empirical analysis (Del Boca, Pasqua, Pronzato and Wetzels) using recent data drawn from the European Community Household Panel; two of the indicators derived in part one are also used to model the effects of social policies on fertility, employment and the hourly earnings of European women.

The main strengths of the book are that it integrates microeconomic analysis with the comparative approach to women's employment favoured by many social policy analysts and political scientists (see Sainsbury, 1999). Thus it helps bridge the gap between the economic approaches to explaining maternal employment and those which stress institutional factors. Hence the book will appeal mainly to economists who are interested in social policies and labour market issues, especially those who wish to understand some of the more technical issues in conducting econometric analysis in these areas; and to social policy analysts who are open to economic approaches to these issues (sadly not all are). Likewise the chapters which construct empirical estimates of public support for women's work, though overly technical, usefully update earlier work in relation to more recent policy developments. Finally, part two's survey of the recent economic literature on the relationships between women's family and labour market outcomes will be useful to academics, students and policy-makers. Of these, the chapter by Del Boca and Locatelli is the most important as it both answers the main research questions while providing some useful qualifications to the analysis.

Of these, the main weakness of the book is its emphasis on institutional factors in determining cross-national variations in women's employment, and its relative neglect of deeper social factors which may give rise to such policy configurations in the first place. Thus the work of Pfau-Effinger (2004), who explains cross-country variations in public policies toward motherhood largely in terms of differing cultural norms, is introduced in chapter one but barely developed (with the exception of the chapter on motherhood and participation by Del Boca and Locatelli). This omission is more than academic: the extent to which certain national policy configurations reflect such norms may reduce the scope for transferring apparently successful policies from one national context to another; while empirical attempts to estimate the impact of individual social policies on maternal employment rates that do not incorporate indicators of cultural norms may bias up their impact (see Fortin, 2005). This is not to say that social policies are unimportant, as the empirical evidence presented in the book clearly shows that they are, but only to suggest that an analysis of the wider social context in which they arise is also essential to understanding their likely impact.

In terms of its main research questions, Meulders and O'Dorchai (p.10) suggest that cross-national variations in employment and fertility arise because women 'face the dichotomous choice either to have children or to pursue a career'. Subsequent chapters develop this theme. Nations that provide high levels of child care support tend to promote higher levels of women's employment and fertility. Nations which provide less support rely on extended families to provide care face falling fertility. More generally (not made quite clear as the book lacks a concluding chapter) where women increasingly expect to enter, and remain, in paid employment, failing to provide adequate employment opportunities and support leads them to postpone or avoid motherhood. Thus, and as argued by Castles (2003), in modern societies promoting women's work and fertility are not mutually exclusive but now highly complementary.

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Sainsbury D (ed) (1999) *Gender and Welfare State Regimes*, Oxford: Oxford University Press.

A Short History of Economic Thought (2e)
B Sandelin, H-M Trautwein and R Widmark
Routledge: London and New York, 2008
9780415438858, hardback, £80.00

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This seven chapter, 118 page book (also available in paperback), is intended to offer 'an elementary introduction to the history of economic thought'. It is intended for courses in which the history of economics comprises only a small part of the required course material. For the most part, it succeeds exceedingly well in its objective, not withstanding differences about the classification and dating of some contributions.

One difference relates to the classification of the Physiocrats, who are described as 'pre-classical'. This is at odds with some recent contributions to the history of economic thought that emphasizes Physiocratic anticipation of such modern analytical constructs as aggregate effective demand (see Pressman 1994). Unlike the writings of pre-18th century thinkers who considered economic questions only in the context of other issues (like Aristotle's Politics) or religious teaching (like St. Thomas), the Physiocrats were concerned with explaining why, in spite of a beneficent natural order, an economy (e.g., France) could become economically sick.

It is also unusual to identify the beginning of the neoclassical tradition as dating from the 1870s rather than from Alfred Marshall's *Principles of Economics*, published in 1890. Marshall is identified only as one of several 'second generation' contributors to marginalism. It is relevant to recall Jevons' observation twenty years before Marshall's *Principles*:

> Repeated reflection and inquiry have led me to the somewhat novel opinion that value depends entirely on utility. Prevailing opinions make labour rather than utility the origin of value . . . The degree of utility is, in mathematical language, the differential coefficient of *u* considered as a function of *x*, and will itself by another function of *x*. (Jevons 1957)

Much of *A Short History* is concerned with explaining the neoclassical synthesis that J R Hicks generated with his IS/LM concept in his 'Mr. Keynes and the Classics'. The joint paper by Kenneth Arrow and Gerald Debreu integrated the Phillips curve to show that it is possible to represent all markets (especially labour) as able to clear. This 'new' synthesis (so-called by Samuelson) has become the dominant academic and political perspective. It is being challenged by Keynes's modern Cambridge followers to complete Keynes's revolution via the development of capital, distribution, and growth theories. But, despite the brilliance of their individual contributions, Cambridge theorizing remains as simply one heterodox group of thinkers whose contributions are noted briefly in a concluding Chapter 7, 'Orthodoxy and Change'.

It poses the question 'What is the source of changes in the way economists have developed their understanding of the functioning of free markets?' Some historians of economic thought have pursued the sub-field of methodology to answer this question. They have studied the work of the physicist Thomas Kuhn, the philosopher Imre Lakatos, and Deidre McCloskey, whose most recent interest is economic ethics. The questions they ask are important, but it is less clear that the recent focus by historians of economic thought on methodological issues best defines the content of a concluding chapter of a book on the history of economics, regardless of its length. Given the historical role of dissent in shaping the progression of economic thought, an alternative option might have been to examine the resurgence of various heterodox schools. This focus would have been a forward looking final chapter for a book on the history of economic thought. This does not, of course, detract from the positive contribution that Bo Sandelin and his colleagues have made to explain how, from the late-18th century to the present time, economic thinking has been dominated by a theoretical core of thought that preponderantly supports a free market policy.

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Integrity and Agreement: Economics when Principles Also Matter
L Minkler
University of Michigan Press, Ann Arbor, 2008
9780472116430, hardback, £47.95

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The neoclassical model — at least in its unalloyed form — depicts economic agents as always and everywhere maximising, at least by intention if not by outcome. Even if, as some theoretical perspectives allow, they are constrained from doing so, they would still, given the chance, aim for this optimum 'holy grail'.

To some this may seem like a self-evident truism: why would they do anything else other than maximise what they hold most dear? But others (and now Minkler) have raised doubts as to the veracity and legitimacy of instrumental rationality, the mainstay of economic naturalism. Instead, they would portray economic agents as being 'other' — or even not agents at all. These 'alternative' economists seek to replace the concept of rational maximisation as a primary explanation for economic behaviour. In this analysis, Minkler seeks to introduce a new motive of 'commitment integrity' as the primary explanation and rationale for economic (and human) behaviour, shifting the focus away from a naturalistic and scientific methodology to an approach that incorporates a more subjective and 'internalist' view of human decision making. An explicit departure from a scientific deductive methodology to one that might trace its roots back to Locke, Hume and Mill, Minkler's approach thus incorporates lessons from literature, psychology and ethics in order to restore equity, cooperation and mutual dependence to the heart of economic analysis.

Minkler starts with the assertion that lying is acceptable in economic theory so long as it is rational. Economic man is depicted as an opportunist who might be principled, but only so far as it conforms with his preference map. This he characterises as preference integrity. The alternative, far superior both in terms of its empirical validity and explanatory value, is commitment integrity. He draws on an eclectic range of sources to illustrate his point — from Conrad's *Lucky Jim* to behaviouralism in economics — and shows that instrumental rationality can play only a very limited role in explaining the choices people make. The concept of commitment rationality is the result of his search for a methodological realism where the assumptions and outcomes of economic analysis can be judged upon their veracity.

Chapters 1-3 establish the superiority of commitment integrity over preference integrity, to show how the former can constitute a proper place to begin economic analysis. Chapters 4-7 consider contexts in which integrity provides insight into economic behaviour and its outcomes. These include game theory, the employment relation, and also human action and interaction in a wider socio-political context: social contracts, political behaviour, religious belief and human rights. For game theory, commitment integrity broadens the focus from the mechanics of the game itself to the wider context in which an agreement is formulated — the underlying principle being that agents may abide by agreements because they want to, rather than to achieve some additional or future advantage. In the chapter on employment relationships, it is argued that the premise that workers and managers are persons of integrity can be used to empirically supplant transaction costs/agency based theoretical frameworks. This would produce a much more informed, and informative, picture of the modern firm, which has important implications for resource management, productivity and worker motivation and reward more generally.

Does this constitute an alternative perspective or a potential revolution in paradigm — a fundamental reformulation of the framework of economic analysis?

Disappointingly, it is probably the former. Whilst his reconstruction of the theory from new first principles is ingenious, it is in essence a hybrid derived from a range of disciplines, some of which do not share any epistemological common ground with economics; and thus the final product is rather muddled and lacking in either coherence or predictive capacity. It is on these very grounds that neoclassical economics so often appears to see off its opponents. I found this book both entertaining and absorbing. It is written in an accessible and engaging prose that can prove very convincing, and the examples it draws on imply that these were just some of the many areas where commitment integrity offered so much more than instrumental rationality. Most of them revolve around some form of contracting, however, and it may be that, as many economists have already recognised, trust plays a very special role in contractual relations. And then I was struck by a final thought: if, as I was always taught, the neoclassical model assumes perfect information amongst its agents, then lying is not simply ruled out by a preference function, but assumed out of the picture altogether.