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Book review

Lavoie, M. (2014): *Post-Keynesian Economics: New Foundations*, Cheltenham, UK and Northampton, MA, USA (680 pages, hardcover, Edward Elgar, ISBN 978-1-84720-483-7)

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I am delighted to have been invited to present a discussion of Marc Lavoie's *Post-Keynesian Economics: New Foundations*. I was contemplating whether to give my short review, 'it's a brilliant book, you must buy it', or my longer and more considered review, 'it's a brilliant book, you must buy it and I wish I had written it'!

However, I fear I must justify these conclusions a little more, and I hope you will excuse me if I use this opportunity to range a little more widely than is usual in a book review to reflect on the state and future of post-Keynesian economics.

Economists, certainly neoclassical economists, never pay much if any attention to economic methodologists except to the extent that they may have read, in passing, Milton Friedman's (1953) classic, but very misleading, 'The methodology of positive economics'. This reassures them that no matter how absurd or unrealistic are the assumptions of their models, they represent an advance in the subject so long as the models are not refuted by empirical testing. Of course, the qualification that they need to pass empirical testing is often implicitly interpreted as 'sometime in the unspecified future', or is simply overlooked altogether.

But perhaps we should not be surprised that economic methodologists, in effect, write solely for each other, because this is certainly true of those of the physical sciences. There are no courses in the philosophy of science given by the core natural science departments at, say, the University of Cambridge. They are given by a separate department, namely the History and Philosophy of Science, and I expect this is true in most, if not all, universities. This is not surprising because, as Thomas Kuhn (1970) argued convincingly many years ago in *The Structure of Scientific Revolutions*, students of an academic discipline learn the correct way of analysing a problem, and indeed what constitutes a legitimate research topic, by ostentation or tacit knowledge. In other words, methodology is acquired by learning-by-doing. This is based on the prevailing paradigm (or disciplinary matrix, I should perhaps say).

Kuhn's approach, now widened into what may be broadly called the sociology of knowledge, stresses the great importance of the textbook as the key to the perpetuation of a paradigm. The student, and future researcher, acquires an understanding of his subject through the acquisition of knowledge in the textbooks and the undertaking and answering, or solving, of the questions usually at the ends of the chapters. He (or she)

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is confident that these Kuhnian puzzles are based on the consensus on the subject. The latter cannot be wrong or challenged, even if the student is of an enquiring mind.

As Kuhn (1970: 47) emphasizes:

That process of learning by finger exercise or by doing continues throughout the process of professional initiation. As the student proceeds from his freshman course to and through his doctoral dissertation, the problems assigned to him become more complex and less completely predated. But they continue to be closely modeled on previous achievements as are the problems that normally occupy him during his subsequent independent scientific career.

He continues:

Though many scientists talk easily and well about the particular individual hypotheses that underlie a concrete piece of current research, they are little better than laymen at characterizing the established bases of their field, its legitimate problems and methods.

The challenges thrown up by the sub-prime crisis to the macroeconomics profession certainly confirms this last statement. Let me give you an example of the first statement. In chapter 7 of Mankiw's (2010) popular, and ubiquitous, macroeconomics textbook, we find a simplified version of the Solow model, in all its glory. At the end of the chapter are questions starting with the aggregate production function and asking the student to work out what happens to, say, the steady-state solution as the variables change value. There is no discussion in the chapter as to the shortcomings of the aggregate production function or a question as to how empirically relevant it is. This absence, *per se*, is damaging to the development of the subject as the omission implies that the critique of the aggregate production function, should the economist stumble across it, cannot be important: after all, if it was, it would be mentioned in the textbooks.

Hence, at last, I come to Marc Lavoie's excellent and comprehensive textbook on post-Keynesian economics, the importance of which cannot be overstated. It is an important update and extension of his previous book written in 1992. Consequently, much of what I say refers in a way to both books, although I shall naturally focus on the 2014 volume. This book of 680 pages is extremely important in many respects. It is at the moment the definitive advanced synthesis of the many strands of post-Keynesian economics. This is not to say that there are not many other excellent, more introductory, post-Keynesian economics textbooks.

But to my mind, the greatest significance of this work is that it clearly demonstrates that there is a coherent and interrelated body of economic theory that stands in marked contrast to the neoclassical framework. Indeed, with the deficiencies of the prevailing orthodoxy exposed by the sub-prime crisis, the publication of this book could not have come at a more propitious time. Some post-Keynesians have concentrated on attacking the foundations of the neoclassical paradigm (the problems of the measurement of capital, the deficiencies of the aggregate production function, the problems of methodological individualism, the distinction between uncertainty and risk) to such an extent that they could (and have been) unfairly accused of nihilism.

But as Kuhn has pointed out, a paradigm can only be overthrown by the development of a new paradigm, and Marc Lavoie's book shows that there is a substantial corpus of post-Keynesian economics that meets this criterion. Criticisms of a paradigm, by themselves, are not enough.

Of course, this is not the first non-orthodox economics textbook. In 1973, Joan Robinson and John Eatwell published their *Introduction to Macroeconomics*, which was to be a major alternative to the prevailing neoclassical textbooks at that time. Why was the volume not a success? The timing could not have been better. The 1970s was a

time when the orthodox neoclassical approach was being so heavily criticized from all quarters that it seemed as if it was not likely to survive. (Does this ring any bells?) See, for example, Leontief (1971), Robinson (1972), Ward (1972) and Worwick (1972). The phrase 'paradigmatic crisis' was often heard at this time. The main thrust of these critiques was the familiar criticism that economics was becoming too formalized and divorced from real-world problems.

King/Millmow (2003: 123) fairly summarize the reasons for the failure as follows:

A common thread running through all the reviews was that the book was too difficult for beginners in economics. Apart from bemoaning the polemical bent of the text, both Terence Hutchison (1976) and Jonathan Baldry (1974) assailed the book's pedagogic worth by drawing attention to the divorce between theory and real-world applications. Hutchison argued that the analytical core of the book generated few empirically testable theories. Baldry (1974, 396), for his part, took issue with the misrepresentation of neoclassical theory and its replacement with a grand Ricardian model, which left it the 'least worldly of textbooks' he had ever seen. He had a point. Nearly one-third of the economic analysis section of the book, for instance, was conducted in terms of a two-sector economy producing steel and corn with the *numéraire* in corn prices. This was likely to test the powers of abstraction, indeed patience, of even the brightest student.

Then there was Wynne Godley and Francis Cripps's (1983) book *Macroeconomics*, which unfortunately made hardly a ripple on the subject. Why? It was original, challenged the orthodoxy and presented a Keynesian view of the subject. However, it had few, if any, links to orthodox macroeconomics whether it be the IS/LM model or the AD/AS model, notwithstanding their faults. It was this, I think, that severely limited its pedagogical impact.

This rather long preamble about the importance of textbooks brings me at last to my review of *Post-Keynesian Economics: New Foundations*. What does it set out to do and does it succeed?

The book is addressed primarily to those with a good training in economics, namely Masters students and PhD students working in heterodox economics (and dare I say post-Keynesian scholars in general) who want a concise and well-written overview of all aspects of post-Keynesian economics. It has the virtue of distilling often very complex arguments into a clear discussion of the essentials. There are many examples I could give from the book, but I will content myself with mentioning three from the beginning of the book: the Cambridge capital theory controversies, the Sonnenschein–Mantel–Debreu theorem, and problems of the aggregate production function. If you want a quick, yet thorough, understanding of these complex issues, this book is for you. But it is not merely an explicit critique of neoclassical economics, as it focuses much more on the more constructive contributions of post-Keynesian economics. The links of the analysis to mainstream arguments are there in order to set the post-Keynesian contributions in context, but the book's importance firmly relates to the latter.

It is traditional in book reviews to say something about the content, but given space constraints I shall be eclectic. The book starts with a discussion of what post-Keynesian economics is and why it deserves to be treated as a separate paradigm. I think if post-Keynesians have a fault, it is that too much time is wasted over discussing what is and what is not post-Keynesian economics. Can we now simply read chapter 1, 'Essentials of heterodox and post-Keynesian economics', and be done with it? The book then shows that post-Keynesian economics is not simply post-Keynesian *macroeconomics* by discussing choice theory (and this is far from a repetition of neoclassical consumer theory, discussing *inter alia* bounded rationality, uncertainty and behavioural economics) and the theory of the firm, again grounded in the reality of the objectives of the firm and mark-up pricing. One of the major areas in which the sub-prime crisis has exposed the

shortcomings of what has come to be known as the New Neoclassical Synthesis is its treatment (or perhaps non-treatment) of the banking system. This is also where post-Keynesians have made a notable contribution, and there can be no better exposition of these issues than in chapter 4, 'Credit, money and central banks'. The other chapters cover, as you would expect, short-term macroeconomics (effective demand, etc.), growth and the open economy. Inflation theory, now not so pressing as a couple of decades ago, is also covered.

Chapter 5 turns to the short-run determination of the level of demand and the level of employment drawing on post-Keynesian and Kaleckian versions of the labour market. It starts with the contention that for post-Keynesians labour markets do not exist. That should grab the student's attention! There is no well-behaved demand for labour as in the simplistic marginal productivity theory of factor pricing. There are questions of norms and fairness as well. When one reads this chapter, it becomes clear how simplistic the conventional IS/LM and the related AS/AD models from the standard textbooks are.

The chapter on accumulation and capital provides a coherent alternative to the Solow augmented growth model and the endogenous growth models. Again the richness of the alternative approach is readily seen. The chapter on the open-economy model has some overlap with the traditional Mundell–Fleming model, but again the diversity of the post-Keynesian approach is apparent.

It is worth re-emphasizing that one of the great successes of this book is that it takes many important contributions of the post-Keynesians which may otherwise have been lost, buried in the journals and as chapters in books, and integrates them into a coherent story; in a very real sense the sum of this work is greater than the parts.

Let me now turn to some other issues, lest I be accused of hagiography. An implication of Kuhn for heterodox economics is that it is important that the next generation of economics students is exposed to the ideas of post-Keynesians, especially at the undergraduate level. (As Francis Xavier, the co-founder of the Jesuits, is reputed to have said, 'give me a child before the age of seven and I'll show you the man'.) The problem is that the vast majority of economics courses are dominated by the traditional textbooks and the examinations are based on solving puzzles based on these textbooks.

The difficulty is that while I could see myself using parts of Marc Lavoie's book, it is too detailed and requires too much background knowledge to be used comprehensively at the undergraduate level. But of course, this was never Marc Lavoie's intention. So what is the answer? I think the next step for Marc Lavoie would be to update his *Introduction to Post Keynesian Economics* (2009) to make the *New Foundations* accessible to third-year undergraduates and short enough to give a quick overview and to appear on undergraduate reading lists.

The second point is the need to bring together or synthesize the major *applied* contributions of the post-Keynesians to the policy debates. This is more a textbook about *theory*. I was heavily influenced by Kaldor's essentially inductive approach towards economics (as epitomized by his stylized facts). Thus, I think there is a case for an applied undergraduate textbook interpreting current (macro)economic problems from a post-Keynesian viewpoint.

Whatever one may think of the intellectual arguments of the modern undergraduate economics textbooks, they have been improved by incorporating case studies (often in inset boxes). *New Foundations* does of course refer to the empirical literature where appropriate, but it is at an advanced level.

In the concluding section, Marc Lavoie has a brief discussion of the future of post-Keynesian economics. Let me conclude by posing the unattractive question: is *New Foundations* the 'swan song' of post-Keynesian economics? Marc Lavoie is optimistic; I am not. All UK university departments are subject to a 5- or 6-year grading by an external panel (the Research Assessment Framework) that is largely determined by their research outputs. While the assessment panels are instructed to rate the research on its intrinsic merits, of

course, given the vast volume of material, they go by the ‘rankings’ of journals. In economics, the putative top, or ‘A-rated’, journals are all, perhaps not surprisingly, mainstream neoclassical journals. Books and book chapters are given zero weighting. The only non-mainstream journal that enters into this list is the *Cambridge Journal of Economics*. I say the current list is ‘arbitrary’ because another methodology of ranking, by Fred Lee et al. (2010), gives much greater weight to the heterodox journals, several of which are now ranked as ‘A’ quality.

But the situation is such that any young economist wishing to publish in heterodox economics does so at considerable risk to his, or her, own career in terms of tenure and promotion. The pernicious influence of the ‘A list’ has spread to the European continent. Maybe I am too pessimistic. (I think I tend to be a ‘glass half-empty’ rather than a ‘glass half-full’ person on this issue). There are a few, but too few, departments where heterodox (and I deliberately use the broader term) are flourishing, with the support of their universities. There are some excellent conferences that keep the flame alive. The recent manifesto by the students at the University of Manchester (Post-Crash Economics Society 2014) has shown the substantial dissatisfaction of many students with much of orthodox economics. It also makes an important contribution to the debate as to what a new, more relevant economics curriculum should contain. As Haldane, Chief Economist at the Bank of England, notes in his foreword to this document:

Employers of economists, like the Bank of England, stand to benefit from such an evolution in the economics curriculum. Answering effectively public policy questions of the future requires an understanding of the past. It also requires eclecticism in the choice of methodology, a knowledge of political economy, an appreciation of institutions, an understanding of money and banking. A revamped economics curriculum could serve these needs, and hence those of public policy, well.

Indeed, what any new curriculum requires is a substantial input from post-Keynesian economics, particularly as set out in *New Foundations*. Mention should also be made of Harcourt/Kriesler’s (2013) excellent complementary two-volume *Oxford Handbook of Post-Keynesian Economics*, which is accessible to students.

But whether all this will have a major impact on the economics profession, beyond lip service, remains to be seen. It also remains to be seen whether Soros’s Institute for New Economic Thinking will stimulate radical change in economics teaching and research or merely lead to the tweaking of the usual neoclassical models and assumptions and to ‘paradigmatic capture’ by the neoclassical orthodoxy.

Anyway, I have departed too far from my remit, which is to review *New Foundations*. Let me conclude by saying it is a book every economist should have on his (or her) shelf, placed within easy reach. The only thing that worries me comes from that basic economic concept, the price elasticity of demand. The book costs £125. Fortunately, a paperback at £45 is also now available.

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