

Reviews

Minimum Wages and Poverty: An Evaluation of Policy Alternatives, by John P. Formby, John A. Bishop and Hoseong Kim (Elsevier, Oxford, 2005), p. 242.

One of the problems with the economic analysis of social policy is the tendency of researchers to consider policies in isolation from one another. Although *Econlit* contains over 2000 articles and books on minimum wages, and over 150 on Earned Income Tax Credits (EITCs), only 20 articles or books deal with the two topics together.

Although this ‘silo’ approach encourages in-depth analysis of individual policies, it often presents a problem to policy-makers, who need to know which is more cost-effective. Because politicians and bureaucrats must typically decide between alternative policies, studies that focus only on a single policy may not provide enough information to make a careful decision. Faced with two studies of different policies, each purporting to show that the benefit outweighs the cost, how is a decision-maker to go about choosing between them?

Minimum Wages and Poverty: An Evaluation of Policy Alternatives, by US economists Formby, Bishop and Kim, deals with this problem directly. The authors compare three popular policies, all with the same societal cost: a \$1 per hour increase in the minimum wage, an equiproportional increase in the EITC, and an equiproportional rebate of payroll taxes paid by low-income working families.

Each of these policies has been advocated as a means of curtailing the growth in inequality at the bottom of the distribution. Since the 1970s, the earnings of full-time US men in the bottom decile fell from 51 per cent of median earnings in 1976 to 45 per cent of median earnings today. Over the same period, earnings of Australian men in the bottom decile dropped from 73 per cent of median earnings to 60 per cent. Turning to household income inequality, the 10/50 ratio for household incomes has also fallen in both countries over the past 30 years, but the change has not been as substantial.

Assessing policies can often depend to a large extent on one’s assumptions, and Formby, Bishop and Kim are refreshingly open about theirs. The initial chapters of the book are devoted to discussing the main factors that affect how their proposed policies will affect the

poverty rate: the relationship between low-wage work and low-income households, the elasticity of labour demand with respect to the minimum wage and the elasticity of labour supply with respect to the after-tax wage.

The first issue – where low-wage workers fall in the household income distribution – was raised by Nobel laureate George Stigler in a 1946 paper that stated ‘The connection between hourly wages and the standard of living of the family is thus remote and fuzzy’. Formby, Bishop and Kim argue that the link is not as tenuous as Stigler asserted. They find that poor households are indeed more likely to earn near-minimum wages, but estimate that the earnings of low-wage workers accounted for only 10–15 per cent of the disposable income of low-income families. Similar results have been found in the Australian context (Richardson and Harding, 1999; Leigh, 2005).

The second factor is the elasticity of labour demand with respect to the minimum wage. Although noting research by Card and Krueger (1995) suggesting that raising the minimum wage has no disemployment effect, Formby, Bishop and Kim present additional evidence from state panel data suggesting that labour demand elasticities differ not only by age, but also by race and sex, ranging between -0.1 and -0.65 for workers aged between 16 and 24 (their largest elasticities are for black teenagers). In their preferred estimates, they simulate the effect of a minimum wage rise, allowing elasticities to differ by age, race and sex.

The third parameter affecting the choice of policies is the impact that a negative income tax (or lower payroll tax) will have on labour supply, taking into account both substitution and income effects. As the authors note, the natural experiment literature has tended to find that boosting the EITC has a large positive effect on labour supply among single women, and a small negative effect on labour supply of married women. It is therefore somewhat surprising that the trio choose to model the policy on the assumption that boosting the EITC has no effect on the labour supply of single women, but may reduce the labour supply of married women. Given the evidence, such an approach seems akin to handicapping the EITC horse from the start.

Yet this seems to make little difference to the eventual results. Across a suite of simulations, Formby, Bishop and Kim find that the EITC has the highest

social welfare gain, and is the most effective program at reducing poverty. Indeed, even if the Card and Krueger (1995) are taken to be correct in their finding that a higher minimum wage has no disemployment effect, it remains true that spending the same amount of money on boosting the EITC will deliver a greater benefit to the poor.

The authors argue that even with their preferred labour demand elasticities, a minimum wage rise will not hurt the poor. However, they find that a minimum wage rise is poorly targeted – with 45–49 per cent of the benefits accruing to those in the top three quintiles of the income distribution. By contrast, because the EITC is based on family incomes, spending the same amount on an EITC increase does a better job of improving the well-being of those at the very bottom of the income distribution.

In the case of a targeted payroll tax cut, the authors find that the benefits would accrue mostly to those clustered around 150–200 per cent of the poverty line. Although a targeted payroll tax cut does not benefit the rich, neither does it provide much assistance to the very poor. They conclude that whether one should prefer a payroll tax cut to a minimum wage rise depends on whether the target group is the moderately poor or the very poor.

I had only minor quibbles with this book. The three policies do not receive equal coverage: too much space is devoted to the minimum wage, and not enough to the other two policies. The authors assume that the incidence of a payroll tax cut or an EITC falls entirely on the worker, despite evidence to the contrary in both cases (see Gruber and Krueger, 1991 on the incidence of wage taxes; Leigh, 2004 on the incidence of the EITC). And the book feels as though it was last revised in 2002, citing working paper versions of now-published journal articles, and omitting some of the most recent literature.

But these are minor points. *Minimum Wages and Poverty: An Evaluation of Policy Alternatives* delivers on its promise – to critically compare three anti-poverty programs. For academics and policy-makers alike, this book should be a valuable guide to targeting scarce resources towards fighting poverty and reducing inequality.

ANDREW LEIGH
Australian National University

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- Discussing Economics: A Classroom Guide to Preparing Discussion Questions and Leading Discussion*, by Michael K. Salemi and W. Lee Hansen (Edward Elgar, Cheltenham, 2005), p. xvi and 318.
- A major – if not the major – attraction of economics is its use of logic in analysing how scarce resources are allocated in satisfying unlimited wants. A problem for all teachers is to develop in students an interest for understanding of appreciation, and ability to utilise core concepts and modes of analysis that characterise their respective disciplines. All disciplines, and university courses, require students to read and examine the works of leading thinkers.
- The distinctive contribution of *Discussing Economics*, by Salemi and Hansen, is how readings can be utilised in the classroom. Salemi and Hansen's message is simple. Students' understanding of economics can be improved by structured discussion of leading texts in class. By structured discussion the authors mean that teachers should have clear learning objectives and provide students with questions to guide their reading and subsequent discussion in class. Because their concern is with students acquiring a clearer understanding of ideas contained in readings, most of the questions they suggest are interpretative in orientation. Via discussion, students will develop a deeper appreciation of the ideas developed by leading writers, the distinctive contribution of economics as a discipline and an ability to apply economic analysis to new and different situations.
- Discussing Economics* is designed as a reference for teachers. Salemi and Hansen do not advocate discussion as the only way to teach students. They say

Discussion is not the be-all and end-all of 'hands on learning'. It is one of many strategies available to help students master course content. Students get more out of discussion when they understand how it fits with other course activities and how discussion readings fit together with other course resources (p. 49).

Salemi and Hansen organise their material into two basic sections. The first is four chapters that examine various aspects of discussion as a mode of teaching. In doing so, they illustrate their presentation by drawing on R.A. Radford's 'The Economic Organisation of a P. O. W. Camp', *Economica*, XII, November 1945, pp. 189–201, which is reproduced in an appendix. It is an article I remember reading as an undergraduate student. It has stood the test of time well. In these chapters, Salemi and Hansen consider such issues as the selection of readings, design of questions and the dynamics of classroom teaching. These chapters make explicit the implicit decision-making processes all of us make in devising and teaching courses. On page 39, they state, 'We tell our students that we expect regular attendance.' They leave it for their readers to decide what should be done when this expectation is not realised. Nor do they proffer any advice on how to act with students who find themselves 'unable' to read allocated texts.

The second, and major, part of *Discussing Economics* is where the authors demonstrate how their teaching method can be applied to various readings, 67 in all, which are grouped into four broad topic areas: economic principles, macro, micro and financial institutions. Two themes pervade the chosen texts. First, the relationship between markets and politics (or government intervention), and, second, scientific method.

The readings examined combine classic works with contemporary readings. The former include a number of chapters from Adam Smith's *The Wealth of Nations*, Irving Fisher, Milton Friedman, John Kenneth Galbraith, Friedrich von Hayek, Robert Heilbroner, John Maynard Keynes, Karl Marx (and Friedrich Engels), Arthur Okun, Joseph Schumpeter and Robert Solow. One of the authors' more interesting questions is 'What are your reactions to Heilbroner's writing style and his extensive use of metaphors?' (p. 183). The contemporary writings focus on the collapse of communism and the problems of Soviet bloc nations making the transition to market-based economies, and issues specific to the American economy.

Discussing Economics contains two major defects. The first is its provision of summaries of the vari-

ous texts. Any economist, worthy of the name, would not need these summaries. Students may require such help; not scholars who have devoted their intellectual life to economics. Or to state this another way, teachers/economists who need to be told what are the major ideas and issues in the texts should not be let loose on students. In short, it is doubtful, if anyone will actually make use of their summary material. Using Radford's classic prisoner of war study, as an example, is enough.

Second, the readings examined vary both in terms of their level (difficulty) of analysis and topics, or issues, covered. It is not as if this book could be used for one course. For both more advanced and specialist courses, teachers would have their own views on what readings should be included and how such material should be taught. Also, it might be reasonable to assume, in more advanced and specialist courses, that the emphasis on learning would not so much be in acquiring skills of interpretation and understanding (because if you have not acquired such skills by then you would not be allowed to enter such courses), but rather of being more analytical and critical. Their focus is on lower-rather than higher-level teaching.

All teachers need to think, continually, about how to improve their teaching; of how to convey to students the excitement of the ideas that they find interesting and the intrinsic characteristics and contribution of their discipline to knowledge and understanding. The strength of *Discussing Economics* is that it encourages its readers to do this. But it will be of little benefit to teachers who have mastered their craft.

BRAHAM DABSCHECK
University of New South Wales

Freakonomics: A Rogue Economist Explores the Hidden Side of Almost Everything, by Steven D. Levitt and Stephen J. Dubner (William Morrow, New York, 2005), p. 256.

Even if Steven D. Levitt's research interests are cheating, corruption and crime, it stretches credibility to label an MIT PhD, John Bates Clark Medal winner (and father of four) as a 'rogue'. But Levitt's innovative and dogged statistical investigations have certainly brought new insights into the most unlikely subjects, from real estate to sumo wrestling. By teaming up with journalist Stephen J. Dubner, he is now attempting to bring this knowledge to a wider audience.

Levitt is best known for his controversial argument that legalised abortion was largely responsible

for the unexpected drop in US crime rates during the 1990s. But the book covers many other topics. Match (or bout) fixing in sumo wrestling. Cheating on standardised tests, by teachers. Selling bagels with an honour system. The organization of crack gangs. There is no complicated theory or sophisticated mathematics, just ingenious use of unusual data. An enormous amount of work must have gone into these analyses, but the authors make it sound like simplicity itself. Suspicious patterns of right and wrong answers on multiple choice tests are used to catch cheating teachers. Consistent wins against the odds in crucial sumo bouts put the finger on colluding wrestlers. And a retired economist and college educated gang leader happen to keep unusually good records of their respective bagel and crack cocaine businesses.

If he is not a rogue, he is not recognizably an economist either. The book could just as easily have been written by a statistically minded sociologist. There is a constant focus on incentives, but these are classified as social and moral as well as economic. Economic incentives can backfire if they weaken social and moral incentives. As does imposing a small fine on tardy parents at a day-care centre or paying donors for blood. Which renders questionable the statement that 'Morality represents the way we would like the world to work, and economics represents the way it actually does work.' This line is so good that the authors cannot resist repeating it throughout the book, even after they have shown quite clearly that morality plays a big part in how the world works even when economics would suggest otherwise.

This is but one example of a much wider problem. Although the research is fascinating and well explained, it comes wrapped in such foolish platitudes that reading becomes an effort.

In the introduction, the authors make clear that the book does not have any neat unifying theme. Instead, they say they will employ a 'treasure-hunt approach', using the tools of economics to follow 'whatever freakish curiosities may occur to us'. Hence the title.

With a variety of topics illuminated by ingeniously simple statistical work, a collection of stand-alone chapters could have made an excellent read. But their claim to be themeless is somewhat undermined by the list of themes (conveniently highlighted in italics) just above it. Themes, moreover, stunning in their banality and vacuity. Incentives are the cornerstone of modern life. The conventional wisdom is often wrong. Dramatic effects often have distant, even subtle, causes. Experts use their informational advantages to serve their own agenda. Knowing what to measure and how to measure it makes a complicated world much less so.

You don't say! At least all the hot air has escaped from the balloon now. Right? Well, this is how they explain incentives:

If you toddle over to the hot stove and touch it, you burn a finger. But if you bring home straight A's from school, you get a new bike. If you are spotted picking your nose in class, you get ridiculed. But if you make the basketball team, you move up the social ladder. (There are three more pairs of totally unrelated opposites.)

And this is how they organise and summarise the first three chapters:

What do schoolteachers and sumo wrestlers have in common? They both cheat. How is the Ku Klux Klan like a group of real estate agents? Their power comes from hoarding information. What did crack cocaine have in common with nylon stockings? It brought class to the masses.

Like Peter Jackson's *Lord of the Rings* movies, *Freakonomics* is not a total waste of time and money. But given the basic material, it could and should have been a whole lot better. Anyone who does not need regression analysis explained to them and has access to the journals would be better off going straight to Levitt's articles. Even the non-statistically trained (formal economic theory is hardly a necessity) would probably be better informed in less time by skimming the abstracts.

DECLAN TROTT
Australian National University

International Migration and Economic Development: Lessons from Low-Income Countries, by Robert E. B. Lucas (Edward Elgar, Cheltenham, 2005), p. xvi + 360.

A book on this subject is especially timely in the light of recent high-level policy interest in migration and its consequences. At the initiative of Kofi Annan, the United Nations has established a Global Commission on International Migration, which recently published its first report. Like many other high-level consultations, the Commission reaches the conclusion that 'the international community has failed to realise the full potential of migration and has not risen to the many opportunities and challenges it presents'. Although there has been much research on the effects of immigration for the developed world, a common theme in the policy arena is how out-migration affects the world's poorest countries. Does emigration of the

best and the brightest further impoverish those who are left behind? Or does it leave them with higher living standards, more resources and greater opportunity? This fundamental question is at the heart of this book of Robert E. B. Lucas.

Over the last 30 years, Lucas has made a series of important contributions to our understanding of the causes and consequences of migration in and from less developed countries. In this book, he explores and surveys what is now a large literature on these themes. Lucas adroitly steers the reader through an impressive array of facts and findings, theories and hypotheses, setting out the issues and evaluating the empirical results. The treatment is almost entirely non-technical, and the book is clearly aimed at reaching an audience beyond that of economists and migration specialists.

To capture the variety of experience, Lucas takes as case studies four of the main streams of international migration. These are migration into the EU from North Africa and from the transition economies of Eastern Europe; the movement of contract workers to the Gulf States from South and Southeast Asia; the brain drain to North America and migration currents within East Asia.

The first substantive chapter of the book addresses the causes of migration. This is a fairly well-worked area and Lucas does a good job of summarising the literature. One particular issue is whether the characteristic time profile of migration from a poor country is 'hump' shaped. It has often been argued that potential migrants in low-income countries are constrained by their poverty. Consequently, emigration increases as domestic living standards improve and it only turns down as the poverty trap erodes and as domestic incomes converge on those in migrant destinations. Thus contrary to some views, fostering development in the poorest countries does not reduce the pressure for migration to rich countries that is manifested in a rising tide of asylum seekers and illegal immigrants. Lucas argues that no such consistent pattern can be established. Rather, migration pressure increases with the gap between incomes at home and in the destination. But these effects are sometimes obscured by other forces, particularly demographic booms and the cumulative effects of migrant networks, which sometimes lead to a migration hump.

Turning to the key chapters on the domestic impact of emigration, Lucas also finds that patterns vary between source countries and over time, leaving little scope for generalisation. Thus, he finds that migration of Pakistanis to the Gulf reduced domestic labour supply and raised real wages in Pakistan, particularly in the construction sector. In the Philippines, where

around 10 per cent of the population have emigrated, there was also some evidence of positive wage effects for the stayers. However, no such effects could be found for Sri Lanka, or for a number of other countries. Lucas argues that we should not be surprised that such wage effects are elusive: migrants are often only a small part of the source country's labour force and, in many cases, labour supply to the urban sector is fairly elastic.

One question that has recently attracted renewed interest is the brain drain. Although this is of limited importance for some migration streams such as to the Gulf, it looms large for others such as migration streams to North America. Lucas notes that half of the immigrant stock residing in the US have college degrees. And given the skill scarcity in some of the poorest countries 'it seems clear that the overall withdrawal of college graduates can be very large indeed' (p. 116). But it is far from clear that the 'loss' of educated workers actually reduces the skill base of source countries, and for two reasons. One is that the possibility of emigration may cause more people to get educated than actually end up emigrating. As Lucas notes, the jury is still out on whether (and if so where) the 'brain gain' dominates the brain drain. The second reason is that a large share of highly educated migrants observed in the US and other developed countries acquired some of their education in the host country. And in many cases it was paid for, or subsidised by, host country taxpayers. Thus there is no presumption that the migrants would have attained the same levels of education had they stayed at home.

Even if poor countries do suffer a loss of skills, they often benefit from a flow of remittances. These flows can be very large – 15 per cent of GDP for Moldova, 5–10 per cent for Morocco, around 7 per cent for Sri Lanka and 9 per cent for the Philippines. Even where they are a smaller share, such as in India, they loom large for certain regions, such as Kerala. Lucas surveys the extensive literature on what impact these remittances have on the source country. Are they used to finance investment in businesses, home ownership, or education? And is the effect to reduce poverty and inequality? The answer is that it depends on a variety of circumstances such as where in the hierarchy of class and income the migrants came from, whether they intend to return and what are the opportunities for investment at home. Given the right conditions, trans-national networks could also be a conduit for the transfer of technology, especially through return migration. But Lucas finds very little evidence for such effects. Thus the often-quoted example of the booming Indian software industry is 'principally the result of domestic entrepreneurs and domestic capabilities'

(p. 220) rather than of migrant networks or return migration.

What does all this add up to? If this book contains a central message it is that the effects of emigration on source country development vary widely from country to country, according to the type of migrants and the structure of the economy that they leave behind. Certainly, there is little systematic evidence that the very poorest countries either lose or gain on net. Hence, the most general finding is that sweeping generalisations are not possible on the basis of existing evidence. On one level that is frustrating because it is hard to know what the net benefits are until after the event when all the country-specific circumstances are revealed. On the other hand, it may be no bad thing as it serves as salutary caution against one-size-fits-all policy prescriptions. One thing is not in doubt: Robert Lucas has provided us with a thoughtful, balanced and objective account, which should be read by all those who are interested in the links between migration and development.

TIMOTHY J. HATTON
Australian National University

Classics and Moderns in Economics: Essays on Nineteenth- and Twentieth-Century Economic Thought, by Peter Groenewegen (Routledge, London, 2003), 2 vols., p. viii + 285, viii + 310.

This excellent two-volume collection of 32 essays, compiled by distinguished historian of economics, Peter Groenewegen, encompasses the breadth of nineteenth- and twentieth-century economic thought.¹ The volumes nicely complement an earlier compilation of essays devoted to seventeenth- and eighteenth-century economic thought. This selection of articles and reviews, originally published over a period of 35 years, further attests to the depth and breadth of Peter's intellectual curiosity in the whole of the history of economics. They also reflect, as the author himself notes in two very useful introductions to the volumes, 'a generalist approach to the subject, which may be considered as out of place in an age of ever-increasing specialisation'. This sentiment sheds further light on the author's own critical perspectives on the enduring worth of the history of economics. It should be

¹This review shall concentrate on the papers concerned with nineteenth-century economic thought. A review of the papers concerned with twentieth-century economic thought will be published in the June issue.

noted, however, that despite providing a representative overview of the author's work on the history of economic thought, this collection by no means covers all of Peter Groenewegen's published articles in this field.²

The bulk of the essays in the 'Classics and Moderns' collection saw publication (or completion) relatively late in Peter Groenewegen's academic career, largely dating from the 1980s through the 1990s. Essays devoted to the nineteenth-century classical economists represent a quarter of the total number included in the collection. Separate essays on major nineteenth-century classicists, such as Ricardo, Malthus and Marx, are included in this collection, with the puzzling exception of John Stuart Mill who, while nevertheless playing an important cameo role in several essays devoted to Marshall's early economic 'apprenticeship' and having his illuminating views on the making of 'a good economist' outlined in the Colin Clark Memorial Lecture, has not been dealt with exclusively in any particular essay. This omission seems all the more surprising in the light of the supporting quotation drawn from Jacob Viner that 'Mill's ideas still play a major role in the thinking of moral philosophers, of logicians, of political theorists, and of economists'. It is hardly surprising, however, that the essays concentrate for the greater part on certain aspects of Marshall's life and times. This systematic research programme culminated in the 1995 publication of *A Soaring Eagle: Alfred Marshall, 1842–1924*, which has been critically acclaimed and widely cited within academic circles.

The first essay, originally published in 1982, comprises Peter Groenewegen's inaugural lecture at the University of Sydney, an ideal introduction to the ensuing themes in the works of three great economists, Adam Smith, Karl Marx and Alfred Marshall, subsequently explored in other articles by Groenewegen. For one thing, the complex subject of 'history and equilibrium' in the works of such iconic economic figures (two of them major classical economists and the third a leading neoclassical economist) has been a recurring theme in Groenewegen's articles throughout a productive academic career spanning four decades. The opening article highlights also his intellectual indebtedness to the great Cambridge economist, Joan

²Notable omissions include several key papers covering various aspects of Alfred Marshall's life and times as well as studies of several (comparatively) lesser known nineteenth-century Continental economists such as Wilhelm Roscher and Hans von Mangoldt. The collection omits altogether Peter's published writings in the fields of public finance, post-Keynesian economics and radical political economy.

Robinson, an association he very deliberately acknowledges. This association provides hints of Peter's ongoing interest in heterodox economics, as delineated in publications (not included in this latest publishing venture) attempting to resuscitate John Maynard Keynes's work within what has become known as the post-Keynesian tradition. Another dominant theme in the opening essay which affords certain clues to Peter's distinctive approach to the study (and teaching) of the history of economics is the inclusion of relevant biographical details on the life and thought of his subjects. The biographical dimension relates not to everyday domestic ephemera; rather, the focus lies primarily upon intellectual history and biography as ways of clarifying and illuminating the scientific writings of a particular economist. The inclusion of relevant intellectual biography, as remains to be shown, colours many of the essays reprinted here.

An example of the pursuit of intellectual biography is the chapter on Clara Elizabeth Collet (1860–1948), one of Adam Smith's 'neglected daughters'. In addition, it highlights another interesting facet of Peter's recent work: the promotion of women in the history of economics. This subject, which has certainly been an area of growth in the field of the history of economics, attempts an evaluation of the role of women in the development and evolution of economic ideas. It also provides a discourse on the views on women in relation to economic progress. Peter's contribution to 'feminist economics', originally an outgrowth of a workshop on feminism and political economy in Victorian England organised by the Centre for the Study of the History of Economic Thought at the University of Sydney in 1992, has focused primarily on rehabilitating the role of neglected women political economists in the Victorian era. It is a research agenda closely associated with Peter's biography of Alfred Marshall covering Marshall's infamously misogynist views on 'Social Darwinism', eugenics, evolution and social progress. Peter's article entitled 'A Weird and Wonderful Partnership: Mary Paley and Alfred Marshall, 1877–1924' (sadly not included in this collection) is another outstanding example of this genre in its revealing of Mary Paley as the intellectual equal of her husband. During and after his lifetime, her presence added lustre to his intellectual reputation all the while securing for him an eternal legacy in his name.

In addition to being a prolific author of scholarly articles and books in the history of economics, Peter Groenewegen has always been an enthusiastic and adroit, albeit occasionally harsh, book reviewer as revealed in the sample contained in this collection. These include the appraisal of the Pickering edition of the *Collected Works of T.R. Malthus*, an appreciative

piece on Jacob Viner as historian of economics and the generous review of the three volumes of Marshall Correspondence superbly edited by John K. Whitaker. In his review of Viner's posthumously-published essays on intellectual history and the history of economics, Peter makes a perceptive comparison between Viner and Joseph Schumpeter as historians of economics, an exercise that betrays a great deal about Peter's own predilections as an historian. Although the review seemingly bestowed accolades on both writers, Viner emerges as the more complete example of an historian of economics precisely because his treatment of the subject has a greater 'sense of balance' and 'of the meaning of scholarship'. In fact Peter's honest evaluation of the merits and demerits of any book as a whole, often highlighting significant flaws in historical interpretation (usually by virtue of his own exhaustive research and voluminous reading of the literature) is one of the qualities that set him apart from others in his field. His criticisms are not reserved only for contemporaries; even great thinkers, Alfred Marshall and Joseph Schumpeter among others, have incurred his wrath for inaccuracies in historical interpretation. In this respect, his approach resembles closely that of Jacob Viner, who often deployed his encyclopaedic knowledge of the history of economics to carefully and methodically dissect misleading propositions and arguments.

In the light of the above, I approached with considerable curiosity the article, 'Alfred Marshall and Herbert Somerton Foxwell: a tale of two libraries', which carefully detailed the individual approaches underpinning the libraries accumulated by these two Cambridge economists; the former achieving fame for the books he wrote, the latter for the sheer audacity of his acquisitions. Peter Groenewegen's own libraries (one at his residence and the other at the university) house a vast number of books on diverse topics the underlying purpose of which has always been the pursuit of original research and teaching. In this respect his approach mirrors that of Marshall whose own personal library eventually formed the cornerstone of the Marshall Library of Economics at Cambridge. Historians of economics however will always be grateful for Foxwell's pecuniary sacrifice in assembling two magnificent collections of early rare tracts in the history of economics. Today these collections form the basis of the Goldsmiths's Library at the University of London and the Kress Library of Business and Economics at Harvard University. Sadly, Foxwell was forced to sell both collections after finding himself in dire financial straits brought on by impulsive and expensive book collecting sprees. Peter shares more in common with Marshall in his attitude towards

library-building, although Foxwell has surely earned Peter's gratitude for amassing such fine collections which have given him many pleasurable hours of scholarly contemplation.

The papers in these two volumes constitute a worthy tribute to Peter's intellectual craftsmanship, and serve as a fitting legacy for the next generation of historians of economics.

MARK DONOGHUE

National University of Singapore

The Chinese Stock Market, Efficiency, Predictability and Profitability, by Nicolaas Groenewold, Yanrui Wu, Sam Hak Kan Tang and Xiang Mei Fan (Edward Elgar, Cheltenham, 2004).

The Chinese stock market emerged with the establishments of Shanghai and Shenzhen stock exchanges in 1990 and 1991, respectively. During the past 15 years, it has grown exponentially, and has attracted global attention from academics and practitioners. There is a universal assumption that the Chinese stock market will become one of poles of the world's market. The attraction of the Chinese stock market lies not only in its speed of growth, but also from its unique features, such as market segmented with A-shares and B-shares, low floating ratio (with more than 50 per cent of shares non-tradable), government intervention and incomplete regulation.³ The future development of the Chinese stock market and its potential influence on the world market are serious concerns of economists and entrepreneurs. Empirical studies on the Chinese stock market are increasingly published within journals, monographs and books.

This book, however, is distinctive.

First, this book is well structured. A description of market evolution is followed by empirical tests;

³A-shares are restricted to Chinese residents. B-shares were initially designed for foreign investors and have been accessible to Chinese residents since April 2001. The transaction currency of A-shares is Chinese Renminbi and the transaction currency of B-shares is the \$US or Hong Kong yuan. Chinese firms have a complex ownership structure, and as of the end of 2004 only 41 per cent of issued shares are tradeable. The China Securities Regulatory Commission takes important roles in stock market operations that include the nomination of the directors of Shanghai and Shenzhen stock exchanges, and the timing of initial public offerings and listings. Although market regulation has improved recently, Chinese accounting standards are not internationally acceptable.

the investigation of local market of mainland China is linked to the markets of Hong Kong and Taiwan. The logical arrangement of the chapters allows the information in this book easily accessible.

Second, this book covers a number of substantial research topics; the random walk hypothesis, the presence of market seasonality, the spillover effect and the market predication. All of the chapters are well readable individually or collectively. This book looks like a handbook in which the readers may be able to look up what they want to know on the efficiency of the Chinese stock market.

Third, the empirical analyses are designed in a very progressive way, including the traditional autocorrelation test, unit root test and the recent generally applied VAR approach, GARCH modelling, impulse response function and forecast-error-variance decomposition method. In addition to knowing the insights of the Chinese stock market efficiency, the readers will be able to be familiar with the effective application of econometric modelling to the empirical analyses of market efficiency.

Following the introductory chapter, Chapter 2 discusses the emerging, development and prospect of the Chinese stock market by creating a four-stage chronological framework: the early stage of stock market emerging (1983–1991), the transition of the regular system (1992–1996), the Red Chips craze and deflation (1997–1999), WTO entry and state share reduction (2000 present). Although this chapter provides a legible outline of the market, it also displays the existence of major problems: illiquidity, a policy-based market, excessive speculation, incomplete law and regulation. Chapter 3 reviews the existing empirical literature on the efficiency and profitability of the Chinese stock market, possibly the first full retrospect on the relevant research. This chapter focuses on that dealing with the EMH, the classification of A-shares and B-shares and the relationship of Chinese stock prices to those of other markets.

Chapter 4 begins the empirical analysis on the market predicability via testing the market return autocorrelation and the presence of seasonality. The evidence shows the departures from weak form efficiency in the form of predictability of returns on the basis of their past values, as well as systematic day-of-the-week effect and holiday effect. Market efficiency is influenced by the financial deregulation. In particular, the involvement of banking sectors in the market improves the market liquidity and information transmission. Chapter 5 carries out the analysis on the profitability of trading rules. Empirical results represent that the portfolios based on trading rules substantially

outperform an equity buy-and-hold strategy. Less frequent trading rules generate better end-period returns than more frequent trading rules when taking the transaction cost into consideration.

Chapter 6 focuses on the dynamic causal relationship between returns and trading volume for Shanghai, Shenzhen and Hong Kong stock exchanges and the spillover effect among these markets. The significant positive contemporaneous relationship between the returns and the turnover are found on all of the three markets. A one-way spillover effect running from Hong Kong market to Chinese B-shares is detected. In line with previous chapter, Chapter 7 investigates the dynamic interrelationships among the Shanghai, Shenzhen, Hong Kong and Taiwan stock exchanges. The Chinese stock market is relatively isolated from the Hong Kong and Taiwan stock markets. However, in the specific period of 1990s, the interrelationships appear strength between the Chinese stock market and the Hong Kong market. In all cases, the two mainland markets, Shanghai and Shenzhen stock exchanges, response to outside shocks in a very similar manner. But they have little spillover to Taiwan or Hong Kong markets.

Chapter 8 moves the study on the impact of general and sector-specific regulatory exchanges on the whole market and on individual energy shares. Empirical results show that the general stock market regulatory changes affect both the intercepts and slopes of the relationship between trading volume and returns. The Red Chips craze prior to the Hong Kong handover significantly increased stock market activity, and the subsequent measures of cooling the market have intended effect. For the sector-specific regulatory changes, the deregulation of the supply prices depressed the activity in the stock market for the affected companies in electricity sector, but other policy changes, such as forced closure of small coal mines and deregulation of oil price, increase trading volume. Chapter 9 briefly indicates the possible implication of government policy in improving market efficiency.

Overall, this book succeeds in its mission of analysing the efficiency, predicability and profitability of the Chinese stock market. It is strongly recommended to scholars. It is additionally recommended to practitioners involved in the market, sharing its prosperity and avoiding the possible risk. This book is also recommended to the students who want to learn the systematic application of econometric modelling to market efficiency analysis.

SHIGUANG MA
Curtin University of Technology

The German Economy—Beyond the Social Market, by Horst Siebert (Princeton University Press, Princeton and Oxford, 2005), p. ix + 403.

In the words of the author, the book aims ‘to hold a mirror to the German public and German politics so that they may recognise and solve the issues at hand.’ (p. viii) Having served as a member of German government’s Council of Economic Advisors, the author has gained great insight into the institutional matters and the (mal) functioning of the German economy. Consequently, the book is written from the perspective of problems that need to be solved. As such, the book is a detailed reference for a large number of economic issues in Germany, for example, lack of growth, unemployment, social security system, human capital or fiscal policy.

Examples of well-written and very readable chapters are those on growth performance, on the labour market, on social security or on the system of governance. These chapters are impressive from the mere density of economic data that most of them use to support their arguments. They are an excellent reference for an international audience who wants to learn about the consequences of German Unification, about the peculiarities of the German social security system, about development of budget deficit or about the clumsiness of political decision-making. Among these highly informative chapters especially the one on the labour market sticks out and is a pleasure to read. Together with the subsequent chapter on social security, it lays out in great detail what causes high and persistent unemployment in Germany. In addition, the chapter on social security gives a perceptive summary about the complex system of one of the main structural policy issues in Germany. This chapter also stands out with respect to suggested strategies for reform.

The author is very detailed with his suggestions concerning the pension system, a constitutional rule to protect future generations, health insurance and competition in the health sector. Particularly this chapter meets the author’s aim to hold a mirror to the German public. Nevertheless, the strategies for reform presented can be assumed to appear drastic in the eyes of the German public. They are unlikely to be implemented in the near future.

In one of the last chapters, the author describes the system of governance in Germany’s social market economy. A large part of the chapter concentrates on a detailed description of the interplay between the two chambers *Bundesrat* and *Bundestag* in law-making. From this description, the reader must draw the conclusion that much of Germany’s economic malfunctioning is grounded in its federalism with ill-defined

competency and blurred responsibilities, its need for broad consensus between political parties and its awkward decision-making processes. In some way, the reform of political decision-making seems to be the key to solving many of the problems presented throughout the book. This might be the reason why this chapter is the last topic discussed. The author's conclusion at the end of this chapter is a rather pessimistic one when it comes to breaking the deadlock.

Other chapters add less than the mentioned chapters to understanding the German economy. The introductory chapter is very interesting concerning historical matters and general data, but the staccato of issues presented here make it hard to read. The author's comments on the regulation of product markets are shallow. It would have been interesting to read more about electricity and telecommunications in this chapter, for example, institutional change, deregulation, price development or competition among players. The rather brief chapter on ageing of society only sketches the effect of demographic change on social security, growth dynamics or foreign trade. Because demographic change in Germany is more dramatic than in other countries, as for example France, it would have been elucidating to analyse why this is the case and to hear the author's policy conclusion.

The great variety of topics spanning from the labour market to growth performance, from regulatory issues to human capital, from corporate finance to European integration is impressive but this variety may also be identified as the flaw of the book. In the trade-off between depth of argument and variety of topics, the author should have chosen to discuss a smaller number of topics to be more detailed on some topics that are only sketched.

The book's broad view necessarily requires compromises with respect to the depth of arguments in some chapters. Yet, without question, the book achieves its declared aim 'to provide a sober representation of the German economy'. Concisely, the book is an excellent reference for anyone being interested in first-hand information about the German economy. The author's rich experience in academics and economic consulting shines through in many excellent chapters of the book.

CHRISTIAN PFEIL
Bergische Universität Wuppertal

Public Goods, Redistribution and Rent Seeking,
 by Gordon Tullock (Edward Elgar, MA, 2005),
 p. vii + 163.

Tullock has followed an unorthodox academic career. His exposure to formal economics was limited to a single course as part of his training in law at the University of Chicago. Yet although without a degree in economics, he is one of the most respected and widely cited economists of the modern age. His influence on modern political economy is simply immense. Tullock and his 1965 co-author of *The Calculus of Consent*, Nobel laureate James Buchanan, are widely recognised as the cofounders of public choice, a field that systematically applies the rational choice approach of economics to the analysis of political markets.

The book under review is a quasi-history, partly autobiographical text supported with plenty of anecdotes. Tullock takes the reader on a whirlwind tour of his contributions to economics, political science, public choice, sociology, law and economics, and bioeconomics – but he somehow makes it all gel together reasonably well. The approach and structure that Tullock uses is unconventional and at times frustrating, but to be fair, the author does acknowledge this to a certain extent on the first page and asks for the reader's forbearance.

Despite being quite short, the book offers 12 quite separate and at times quite distinct chapters. Nevertheless, it has a central theme that resonates throughout. Broadly, the book deals with externalities and the role, if any, does (should) the government play in ameliorating these externalities. Tullock argues that economists frequently justify government as dealing with externalities, defined as benefits or costs that are generated as the result of an economic activity, but that do not accrue directly to those involved in the activity. In this original work, he posits that government can also create externalities. In doing so, he looks at governmental activity that internalises such externalities.

In explaining how government can introduce externalities through their own actions to correct other externalities, Tullock argues that what an 'externality' exactly constitutes is difficult to define and is a matter of subjective opinion that is usually influenced by – without any particular rationale – some kind of social or moral 'norm'.

As his general proposition, in democratic states, the majority may, and frequently does, inflict costs on the minorities. High taxes on the wealthy are an example that Tullock provides. But is this an externality? And in the event that an alternative solution is unavailable, then can government provide a solution? Tullock argues that in dealing with externalities, government in many cases does so by imposing a rule. The problem with this however is twofold; first, it is occasionally government who causes the externality. Second, even

if we accept the outcome of government eliminating disputes by imposing a rule that inconveniences one of the parties to benefit the other, this does not mean that the externality is cured *per se*. It merely says that one party can inflict an externality on the other.

Is there an alternative to government in handling externalities? Some economists suggest that Ronald Coase (1960) solved the problem of externalities. Tullock disagrees. He states that Coase simply clarified the problem for the economics profession rather than solve it, and that Coase's analysis was a gross oversimplification. But this insight is not new, the meaning and implications of Coase's seminal contribution are far from being settled more than four decades after its initial formulation. (e.g. an enquiry into the potential meanings of the so called 'Coase theorem' by Usher (1998).)

So, if the market and private property do not lead to optimal outcomes because of externalities, does that prove that governments will do better? To argue yes would be orthodox but Tullock suggests not. He asserts that the only reason we turn to government for dealing with externalities is that the government is the only authorised body for the use of force. But this does not explain why this force is necessary in the first place. Tullock concludes that the reason government exists is that on occasion (frequently), agreements between opposing parties are incomplete. Indeed, if there were general agreement on a particular issue, then no government would be necessary at all – the simple Coase solution assumes that there is no bargaining cost and no holdout problem. Moreover, in democratic societies, the majority's will is carried out. But majority is not unanimous, so even if most people agree, but some do not, then there must be some method of compelling everyone to take the required action – government.

This line of reasoning is carried through all the chapters. Of most interest to me were the chapters analysing the poor and the rich, which I will discuss briefly here. In Chapter 4, Tullock recounts a lecture that he attended delivered by Milton Friedman when he was just entering academia, where Friedman – to the dismay of the conservative audience – talked about the poor and the government's role in charitable distributions. His argument was that the poor generated an externality by making the non-poor unhappy. Tullock agrees with Friedman's assessment that poverty and suffering do create externalities, and hence call for at least some kind of government action, what this action should be exactly, Tullock admits he is unsure. In a similar fashion, Tullock argues that the rich also impose an externality on the non-wealthy by making them feel envious. He points out that government does take measures to eliminate the externalities

created by both the poor and the rich – the rich are taxed more and redistributions are made to the poor through the welfare system. The natural question that follows is: if these externalities can be addressed by moving towards a more egalitarian society, one must ask, equality among whom?

Tullock argues that if one were a true egalitarian, then one should advocate for worldwide equality but points out that this is not the stance taken by his leftist friends who have a preference for equality at a local or national but not international level. He criticises John Rawls for largely avoiding the issue in his famous book *Justice as Fairness* (2001). Here Tullock misses the point slightly. If equality is prized as a means to other values, it may be the case that only equality among individuals who interact in significant ways has a tendency to promote desired further goals. For example, if we prize equality of possessions to foster social solidarity, it may be that producing equality among people who live in distant parts of the globe and hardly interact will have no tendency to promote solidarity across the combined population. For the instrumental egalitarian, one should seek equality among those collections of people in which equality would produce the desired further results; for more on this, see Dworkin (2000) and Rawls (1999).

If equality is valued for its own sake, rather than as a means to further goals, then I agree with Tullock and it is less clear why the domain of persons among whom equality should obtain is limited in space or time or by political boundaries. But then, why not hold that it is desirable that equality should prevail to the degree this is feasible among all persons who shall ever live?

Tullock concludes his book with some recommendations for the possibly increasing the efficiency of government. Most of these insights are drawn from his earlier work *The Calculus of Consent* (1965) so are not new. He proposes a number of what he deems 'radical' adjustments to the American political system so that it is more representative, thus making more difficult rent-seeking activities in the form of logrolling or pork barrelling to occur. Currently each state has two senators regardless of population, which means that voters in less-populated states have more effective political power. So under this system, a majority in the senate does not necessarily represent a majority of the population. Tullock proposes restructuring the Senate such that the number of senators in a particular state is representative of the population. His other proposals include an abandoning simple majority voting in favour or a two-thirds or three-quarter majority, and having the President being directly elected by popular vote.

In sum, what Tullock has done is to explain some government activities that are not usually done so in the context of externalities. Most of the arguments are familiar, so Tullock has not contributed so much in the way of new ideas. What he has managed to do, however, is to succinctly synthesise the relationship between government and externalities in a way that is not obvious to most people. As Tullock admits in the preface, 'It is basically a revision and improvement of the public choice literature on why we have a state, and why it would be nice if it worked better.' The book offers a nice introduction into public choice but still has enough in it to keep more advanced scholars interested. Well worth reading for anyone with even a modicum of interest in economics and/or politics in the most non-partisan sense.

PHONG NGO

Australian National University

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- Keynes and his Critics. Treasury Responses to the Keynesian Revolution 1925–1946*, by Peden, G. C. (2004), Oxford University Press for the British Academy, Oxford, xv+372.

Was there a Keynesian revolution in economic thought and policy? Although *Keynes and his Critics* does not directly address this question, its contents may help to answer it. Its editor, Professor G. C. Peden, is the author of an acclaimed history of the British Treasury and has written with authority on Keynes. The book includes in full or part some 76 documents – memoranda and briefing notes – containing the Treasury's responses to Keynes's writing between 1925 and 1946. They are organised according to eleven topics, beginning with Keynes's criticism of Britain's decision to return to the gold standard at the prewar parity and concluding with his evidence to the National Debt Inquiry in the last year of his life. Extensive editorial comment is dispersed among the documents.

There is also a lengthy introduction, where the author sets the scene by providing a summary of Keynes's writing throughout the period, the policy issues of the time, information about the Treasury as an institution, its senior personnel, its sources of economic expertise and its reaction to Keynes's arguments.

The documents provide in detail an account of how the Treasury tried to blunt Keynes's influence upon economic policy. Keynes himself understood that the fate of his policy proposals depended in large measure upon his success in convincing the Treasury of their merit. Although the Treasury contained limited economic expertise before the Second World War, it possessed among its ranks Cambridge wranglers (holders of first class honours degrees in the mathematical tripos) and first class graduates in 'Greats' from Oxford and its equivalent at Cambridge. Clearly it was not short of brainpower. Indeed, during the 1920s, the Treasury officer in charge of economic and financial policy (Otto Niemeyer) had come first in the Civil Service examination of 1906; Keynes also sat the examination that year and came second.

There is no doubt that Keynes appreciated the intellectual brilliance of the Treasury's senior officers (with one or two notable exceptions), and that the Treasury in its turn respected Keynes's analytical ability and the remarkable fluency and cogency of his oral and written expression. After all, during the First World War, he had worked in the Treasury, becoming the head of its overseas division and was its representative at the treaty negotiations in Paris. Some of the Treasury officials who opposed him in the 1920s and 1930s were former colleagues and friends. Had he not resigned in 1919 it is possible that he would have succeeded in due course to the headship of the Treasury. As it was, he was appointed in 1940 to the Chancellor of the Exchequer's Consultative Council, with an office in the Treasury and a commission to advise the Chancellor on all aspects of the Treasury's operations. By then, he was the most famous economist in the world.

The documents highlight the fundamental change that occurred around 1930 in the tactics employed by the Treasury to deal with Keynes. At first, it attempted to counter his policy pronouncements on theoretical grounds. But, it soon learnt that it would not win the battle on this front. Put simply, it could never match the subtlety of Keynes's mind.

When the Treasury recommended to the Chancellor of the Exchequer, Winston Churchill, in 1925 that Britain should return immediately to the gold standard at the prewar parity with the US dollar, Keynes wrote his famous tract on *The Economic Consequences of Mr Churchill*. Given that Britain would be returning to gold at an overvalued rate, prices for British exports

and importing competing production had to be cut to preserve competitiveness and retain the fixed rate of exchange; in turn, to maintain profit rates, costs of production – particularly labour costs – had to be reduced. But as Keynes argued, wages had become increasingly inflexible and would only fall as unemployment rose. In the long run, something might be achieved in this way to restore equilibrium. But as he had written in a previous publication: the ‘*long run* is a misleading guide to current affairs. *In the long run* we are all dead.’

When Keynes turned out to be correct and unemployment continued to rise as monetary policy was tightened to preserve the exchange rate, he recommended that the government should promote employment by spending on public works. At first the Treasury tried to dismiss the proposal by invoking a theoretical argument formulated by its in-house economist, Ralph Hawtrey. The so-called Treasury view contended that increased government expenditure would be futile, because savings to fund the expenditure would have to be diverted from private expenditure: added employment on public activities would be offset by a decline in employment engaged on private activities. Keynes criticised this argument, contending that excess savings were available for the government to draw upon without entrenching on private activity. Furthermore, the unemployed would provide the human resources for public works without having to attract labour from private industry. The multiplier was then formulated to show that public expenditure, when unemployed resources existed, would lead to further expenditure and employment. Even more important, the multiplier would generate additional savings as incomes increased. Thanks to James Meade, Keynes was able to demonstrate that, with unemployed resources, an increase in government expenditure, by raising total income, would create the savings to match the initial increase in government outlays.

The Treasury, with all its brilliance, found it increasingly difficult to refute Keynes’s theoretical arguments. It fell back instead on arguments suggesting that increased public expenditure programs would give rise to administrative difficulties and would exert a negative effect upon confidence, leading to a decline in private investment. With these arguments, the Treasury was on firmer ground, drawing as it did upon its long experience with public expenditure programs and its understanding of market sentiment. What is surprising is the failure of the Treasury in the 1920s and 1930s to recruit professional economists. It was only after the outbreak of the war that it engaged Dennis

Robertson and Hubert Henderson on a short-term basis to advise it on economic policy; both left to take up chairs at Cambridge and Oxford before the end of the war. Rather than in the Treasury, the British government’s economic expertise was built up during and after the war mainly in the Economic Section of the Cabinet office; it was only when the Economic Section was transferred to the Treasury in 1953 that it acquired an adequate corps of economists. Before the war it had relied to some extent on Ralph Hawtrey, a Cambridge wrangler who had taught himself economics while a Treasury official.

The documents also reveal that, contrary to some recent accounts of Keynes’s influence on British economic policy, and on the Treasury in particular, the Treasury never accepted before the end date of these documents Keynes’s principal policy proposals arising from the *General Theory*. These included his insistence that interest rates should remain stable at low levels regardless of the state of aggregate demand; that fiscal policy, rather than monetary policy, should be the mechanism by which aggregate demand is managed; that current government expenditure should balance revenue and that government investment expenditure should vary according to the state of aggregate demand, even if that meant an overall budget deficit. Again, on all these matters, the Treasury’s criticism was inclined to focus either on administrative difficulties or on the adverse effect upon confidence of implementing the policies.

This is not to say that there was no Keynesian revolution. Keynes declared in 1937 that his main purpose for writing the *General Theory* was to provide a theoretical explanation of how the economy operated at the aggregate level. The theory had implications for policy, but whereas Keynes held his theoretical scheme to be immutable, the policy proposals were ‘not meant to be definitive; they are subject to all sorts of special assumptions and are necessarily related to the particular conditions of the time’. When the British budget of 1941 was formulated within the conceptual framework of the *General Theory*, Keynes’s theoretical revolution had perhaps arrived. It was confirmed when the British government’s 1944 white paper on *Employment Policy* based its explanation of general unemployment on Keynes’s theory. But in neither document had the government, influenced by the Treasury, accepted Keynes’s policies. Keynes himself applauded both documents because they had adopted his theoretical framework, though he was critical of aspects of the white paper’s policy discussion.

Peden’s judgment is that ‘Keynes was the most outspoken and original economist of his generation, and

he came to dominate the Treasury intellectually during the Second World War. However, Treasury officials never accepted his policy proposals uncritically, and their arguments provide an important commentary on the Keynesian revolution, as it affected Whitehall'

(p. 22). On the basis of these documents, this is both an important and a fair conclusion.

SELWYN CORNISH
The Australian National University