

Book Reviews

Kazem Falahati

New Paradigms in Financial Economics: How would Keynes reconstruct economics?

New York: Routledge, 2013

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The book aims to uncover with mathematical rigour the internal contradictions of Neoclassical financial economics (or the ‘standard paradigm’), and to put forward a new, empirically-grounded paradigm based on the *realeconomik* of financial actors and markets.

The approximately 200 pages that comprise the book’s 10 chapters can really be separated into two parts, each with two subparts. The first half of the book is micro-based and is undoubtedly the book’s strength. It criticises the standard paradigm through revealing various inconsistencies of canonical models in finance. This includes enlightening discussions on the impossibility of the existence of utility functions, contradictions in the Modigliani-Miller propositions and CAPM, accounting identities, and on the shortcomings of Markowitz portfolio theory. One shortcoming is that it is not always precisely teased out how a model’s contradictions relate to its empirical breakdown.

After devoting a mere page to contradictions in the Marxian paradigm in Chapter 3, Chapter 4 develops the new paradigm. A component of this is that firms have a maximum amount of debt which they can tolerate. The core of the new paradigm, though, is a rejection of both the law of one price and the impossibility of arbitrage. This is because transactions require liquidity, which is not costless. More precisely, there is a positive, albeit tiny quantity of time between when, for instance, a trader pays for an asset and when the ownership claim on that asset becomes valid. The opportunity cost of the so-called ‘capital in circulation’ represents the cost of liquidity. Thus, arbitrage requires resources and multiple prices for one good can persist.

This is an interesting elaboration on the cost of arbitrage. Again, linking theory with some institutional description would have clarified the argument and enhanced the book. For instance, while multiple prices of securities among dealers are not uncommon in decentralized fixed-income markets, how does the notion of capital in circulation square with the modern world of high-frequency traders? Capital in circulation is partially elaborated but not

fleshed-out in the appendix when it is remarked that the massive interbank recycling of funds that passes through central banks daily leads to the generation of 'an almost permanent huge deposit base representing the capital of non-banks tied up in transit within the banking system' (p177).

The second half of the book is macro-oriented and puts forward a model of endogenous imbalances. These arise because in a non-equilibrating economy the value of payments and receipts between households and firms need not match, thus creating excesses and shortages of liquidity. These are intermediated in the banking system from which emerge booms and busts. The remainder of the book discusses the European crisis followed by a lengthy discussion of some policy implications.

While the notion that credit cycles can be traced to the real economy is sound (e.g. income distribution), Falahati fails to convincingly connect it with real world examples. He tenuously juxtaposes the model with European current account imbalances. His argument is also undermined by his adroit rejection of post-Keynesian endogenous money without any justification.

Overall, the book makes some valuable theoretical contributions in undermining the logical coherence of the standard paradigm. It puts forward a number of interesting alternative propositions which could form the basis of a new financial paradigm, if they can be sufficiently linked to real processes in financial markets. However, as an original and substantiated contribution to knowledge, the second half of the book is weak. The book is also marred by a too occasional lack of clarity and the sometimes disjointed arrangement of key arguments.

Filippo di Mauro and M Hashem Pesaran (Eds)

The GVAR Handbook: Structure and applications of a macro model of the global economy for policy analysis

Oxford: Oxford U P, 2013

978-0-19-967008-6

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In the wake of an increasingly interconnected global economy, The Global Vector Autoregressive (GVAR) approach has become an invaluable tool in the analysis of complex interactions and closed system scenarios. The GVAR handbook summarises this increasingly relevant econometric method of estimating complex multi-dimensional systems while retaining statistically consistent outcomes. In this resource, Filippo di Mauro and M Hashem Pesaran edit the work of 27 contributors to provide a collection of literature that strikes a balance between technically rich in detail, yet accessible to the non-special-

Keynesian economics are various macroeconomic scenarios about how economic output is strongly influenced by aggregate demand (total spending in the economy). In the Keynesian view, aggregate demand does not necessarily equal the productive capacity of the economy. Instead, it is influenced by a host of factors. According to Keynes, the productive capacity of the economy sometimes behaves erratically, affecting production, employment, and inflation. A simplified explanation of Keynesian economics - role of fiscal policy/government borrowing in overcoming recessions. Quotes diagrams and examples of Keynesian economics in action.Â Theory behind Keynesian economics. 1. If saving exceeds investment, we get a recession. Classical theory suggested any fall in investment would lead to lower interest rates; this fall in interest rates would reduce saving, increase investment and cause the economy to return to a new equilibrium of full employment. However, Keynes's analysis suggests this is unlikely to occur, due to a number of factors, such as a liquidity trap and the general glut of savings. Financial Economics is designed for enrollees with ample background in Mathematics and Fundamental Economics who wish to master present-day economic models and econometric methods. Giving students skills they need to succeed on the finance job markets in Russia and globally, the programme receives academic support from The London School of Economics and Political Science, meeting the British standards in education and fostering industry connection between students and employers abroad.Â 8% become consultants (McKinsey, BCG, Oliver Wyman) or start their own businesses. The rest of the participants choose to pursue academic careers by enrolling in the PhD programmes in Economics or Finance being offered by schools in London (Routledge International Studies in Money and Banking) Kazem Falahati. The recent global financial crisis has made the inadequacies of the scientific state of economics and finance glaringly obvious, as these disciplines gave the false reassurance that such a self-destructive phenomenon could not happen. A similar phenomenon arose in the 1930s, when the pitfalls of the dominant economic theories were sharply exposed. Since then, the same analytical framework, in its new versions, has revealed a huge number of other empirical and experimental failures.Â Download and Read Free Online New Paradigms in Financial Economics: How Would Keynes Reconstruct Economics? (Routledge International Studies in Money and Banking) Kazem Falahati. From reader reviews