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
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-
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.  

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 Keynesian economics are various macroeconomic theories 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. Keynesian economics says government spending to boost demand is the best way to jumpstart growth. But too much deficit spending creates debt.  

Keynesian Economics Theory. How it works with examples.  

Takasuu / Getty Images. Table of Contents.  


7.7 Uneven economic development within the same economy.  

8 Economic role of the State.  

9 The recent global financial crisis.  

9.1 Excessive loan growth scenario and its aftermath.  

9.2 International dimensions of the recent global financial crisis.  

Kazem Falahati is currently teaching International Financial Management at Glasgow Caledonian University, UK. He is an accountant-cum-economist by professional training. His experience includes senior managerial positions in both the financial and non-financial industries. He has advised major multinationals and financial institutions on their strategic investments and divestments as well as their financial structure, reporting and control with huge beneficial impact to their stakeholders.  

Book Series.  

6. Economists try to find out how to satisfy society’s wants in the best possible way.  

Whether the people in a given economy will be prosperous or poverty-stricken depends in large part on how well their resources are allocated. Rich resources often exist in very poor countries, simply because the country lacks the economic mechanisms, as well as specific skills, for efficiently turning those resources into abundant output. Conversely, countries with relatively few natural resources—Japan or Switzerland, for example—can have very high standards of living, if their people and their economy are well adapted for allocating and using whatever resources they have or can purchase.