

Nicholas Kaldor, *Economics without Equilibrium* (M.E. Sharpe, Armonk, New York, 1985) 79 pp., \$12.50.

This book contains three lectures delivered at Yale University in October, 1983, as the first program in a continuing series of lectures in memory of Arthur M. Okun. There is also a brief preface by James Tobin, summarizing the event.

The first lecture, 'Stylized Facts as a Basis for Theory Building', is composed largely of an attack upon the price-taking assumption of general equilibrium theory. Kaldor argues that market clearing takes place through inventory adjustment and changes in production levels rather than through price. He maintains that producers' control over prices has increased over the last century, as the effects of advertising and brand loyalty have insulated them from competitive forces. Firms do not change prices frequently in response to fluctuations in demand because they wish to preserve the goodwill of their customers; instead 'prices are set by the producers on normal costs of production ... including a customary percentage added for profit ...'. He concludes from all this that competitive equilibrium theory, which rests on an assumption that it is price adjustments that clear markets, is even less relevant now than it was at the time of Walras. He takes a number of other positions that are at variance with conventional micro-economic theory. For example, he observes that many markets require the services of intermediary dealers, who must be compensated, but whereas most economists would regard the incidence of this cost between final buyer and producer to be an interesting question, he concludes that 'buying or selling necessarily involves transaction costs that cannot be said to fall on the seller any more than on the buyer; they are divided between them, but it is not meaningful to ask how much falls on one side rather than the other'.

The second lecture, 'Supply and Demand', expands on the premises of the first. Kaldor believes that 'production in general is demand constrained rather than resource constrained', with inventories absorbing fluctuations in the economy. This view extends even to labor markets in which he envisages a queue of potential employees (segregated, however, by skill level), who then have their careers chosen for them by the nature of the job openings that happen to come up when they are at the head of their queues. 'Full Employment' is not a consideration here because Kaldor does not believe that it exists. In his view, high levels of economic activity reduce levels of 'disguised unemployment' and create 'bottlenecks' that make the further reduction of unemployment impossible. He also puts forward a possible explanation for a 'Phillips Curve', which goes something like this: Firms produce under conditions of declining costs (because of fixed capital and overhead labor), so that when demand expands, and unemployment falls, profits rise; these higher profits enable the firms to pay higher wages -

something they wish to do because it improves their labor relations, makes it easier to fill vacancies, and increases their profits further. This last effect arises because the method of mark-up pricing ensures that 'every increase in wages will raise profits, since for each unit of output, much of the same percentage is added to value-added as is added to wages'. More explanation is given of Kaldor's theory of mark-up pricing. The mark-up itself is not to be understood to be a common rate determined throughout an industry, but is determined by each firm on the basis of (a) competition with other firms, and (b) a desire to maximize the rate of growth of the firm (this translates into a price that enables the firm to accumulate the greatest amount of capital internally).

The third chapter, 'Interregional Trade and Causation', begins with a charge that mathematics is no longer being used as a convenient shorthand for describing empirical regularities, but has become the fabric for a 'logically watertight' equilibrium system that bears no relation to reality, and is too inflexible to accommodate such obvious economic phenomena as increasing returns or imperfect competition. Kaldor suggests that the appropriate model of industrial production would be one with a fixed capital-output ratio, but a labor-output ratio that declines with increases in scale. In such a model, labor productivity increases with the size of the firm. Kaldor then argues that similar firms tend to cluster in geographic 'centers' (because of the presence of specialized manpower) so that production tends to become concentrated in certain regions. It is in the nature of such a model that the region in which an industry develops need only be the one that started growing first – thus the eventual and future course of industrial development depends on historical circumstances, and even historical accident, rather than on any equilibrium process. Kaldor goes on to consider the implications of his model for international trade, and observes that if one country becomes a major exporter, then the consequently large market size will enhance the productivity of its labor force, while productivity in importing countries will fall. He does not confine this condition to particular sectors, however, but implies that this disparity may arise across the board. Thus instead of leading to a system of comparative advantages, he maintains that the economic system is likely to be composed of nations with chronic trade surpluses and others with chronic deficits.

Overall, the lectures are entirely non-technical, but they are not quite as readable as that fact might imply. First, they presume a good deal of familiarity with the issues on the part of the reader. Second, the logical structure of the argument is not always as clear as it could be, and it takes some effort to extract the main points from it. Many proposed explanations are – to me, at least – opaque. (In a discussion of the properties of a declining-cost firm, for example, he states that 'Marginal productivity is not relevant in this case, since as long as average productivity is rising, marginal

productivity can have no role in the firm's decision making'.) At a number of places, the challenges to technical economic theory seem overstated and even glib.

One is unlikely to *learn* much from this book. Most of the arguments in their verbal form have been stated many times before, and none of them are supported here by either carefully developed theory or by any data. Many of Kaldor's propositions might be developed into useful and interesting models, while others might well prove to be extremely difficult to formulate into a logically consistent theory, but at this level it is difficult to know which is which. Obviously the questions are controversial, and those who already agree with Kaldor's conclusions are as likely to be pleased with this book as are those who do not agree likely to be hostile. Unfortunately, there is very little material here that will serve to change anyone's mind.

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Reuven Brenner, *Betting on Ideas: Wars, Invention, Inflation* (The University of Chicago Press, Chicago and London, 1985) pp. xxii + 247, \$32.00.

In *Betting on Ideas* Reuven Brenner extends the insights into human behavior under uncertainty he first put forth in *History – The Human Gamble* (1983) by applying his theory to war, inflation, creativity and the history of French inheritance laws (the latter two topics in collaboration with Gabrielle Brenner). Having found the first book to be ingenious and fascinating, yet terribly frustrating, I can now report that the second work is equally ingenious and fascinating, and at least as frustrating.

In both works the core of Brenner's analysis derives from his answer to the question: 'Why do people gamble?' or more accurately, 'Why do people participate in lotteries whose expected return is lower than the ticket cost?' He dismisses the standard economic explanations of risk-loving behavior stemming from an oddly-shaped utility function of money as being both silly and inconsistent with the fact that people who gamble often also hold insurance. Jettisoning the assumption of selfish individuals, Brenner (rather like Duesenberry) argues that people care about their absolute and relative levels of wealth. He models the latter feature by directly entering the proportion of the population that is richer than oneself as an argument in the utility function.

It is then easy to see why there are conditions under which a small sum of money which makes no appreciable change (to a first-order approximation) in one's status is worth risking for a large sum that significantly changes both one's absolute and relative wealth. This insight is simple, neat and generally overlooked by most economists, who distrust what they view as ad