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Book review

Dimand, Robert W. (2014): *James Tobin*, Basingstoke, UK (197 pages, hardcover, Palgrave Macmillan, ISBN 978-14039-8555-2)

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James Tobin was a leading – perhaps the leading – American neo-Keynesian macroeconomist in the era of Keynesian dominance after World War II that extended through to the early 1970s. Along with growth theorist Robert Solow and micro and trade theorist Paul Samuelson, the three substantially shaped what became known as the neoclassical synthesis which fused neoclassical microeconomic theory, Keynesian macro theory, and neoclassical growth theory. The macroeconomic component of the neoclassical synthesis is also termed neo-Keynesianism. All three received the Royal Bank of Sweden Prize in Economic Science in Memory of Alfred Nobel, with Tobin winning his prize in 1981. Tobin died in 2002, aged 84.

Robert Dimand has written a short book, which is part of *The Great Thinkers in Economics* series edited by Tony Thirlwall, on Tobin's economics. For purposes of truth in advertising, it should be noted that Dimand was a student of Tobin's at Yale University and wrote his dissertation under Tobin's supervision. Like so many students who studied under Tobin, Dimand clearly has an abiding deep respect and admiration for Tobin, as does this reviewer.

Dimand's assessment of Tobin's contribution is elegantly framed in terms of Hicks's (1937) IS–LM model which dominated neo-Keynesian economics, and which Tobin subscribed to and sought to improve. Thus, there are chapters on Tobin's contributions to the economics of consumption and saving (*S*), investment theory (*I*), the theory of money demand and portfolio balance (*L*), and the theory of the money supply and financial market equilibrium (*M*). Additionally, there is a chapter on Tobin's view of Keynesian economics, a chapter on money and growth theory, and two policy chapters on inequality and financial market speculation. This list reveals the extraordinary range of Tobin's contribution to economics.

Chapter 1, titled 'An American Keynesian,' describes Tobin's views about the macro economy. Dimand argues Tobin's work constituted a coherent research program based on Keynes's explanation of the Great Depression. Monetary economies are prone to demand shortages and nominal wage and price flexibility cannot be relied on to eliminate unemployment.

Chapter 2, titled 'Transforming the IS–LM model sector by sector,' essentially provides an overview of the book. Tobin took the IS–LM model and both provided its component elements with microeconomic foundations rooted in neoclassical optimizing behavior and extended the model to include a broader menu of financial assets. The latter feature defined what became known as the Yale School of macroeconomics. The modeling approach was to use market demand functions with plausible restrictions on partial

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derivatives and subject to adding-up constraints and stock-flow consistency. This demand function approach contrasts with the representative agent utility maximization approach of today's new classical and new Keynesian macroeconomics.

Macroeconomists now take the interest elasticity of money demand for granted. Dimand shows this was a controversial issue in the 1940s and Tobin (1947/1948) was instrumental in winning the day on this proposition, paving the way for the triumph of the standard IS–LM model and the belief that expansionary fiscal policy is at least partially effective.

Chapter 3 covers Tobin's contribution to the theory of consumption and saving, which also included developing the Tobit estimator. Tobin was a pioneer in introducing wealth into the aggregate consumption function, which was the neo-Keynesians' way of explaining why the average propensity to consume did not fall over time as predicted by Keynes's consumption theory.

Chapter 4 covers Tobin's contribution to money demand, portfolio balance, and money creation. Whereas much of Tobin's macroeconomic research program has been abandoned by contemporary mainstream economics, his contributions on money demand and portfolio balance endure.

Chapter 5 covers Tobin's q and his theory of investment, which has been another element of Tobin's work that has been embraced by contemporary mainstream economics. Dimand's approach to discussing q theory is via the history of thought, and he compares Tobin's q with Keynes's Q and Myrdal's Q . There is also a brief discussion of Crotty's (1990) post-Keynesian critique of q .

Chapter 6 examines Tobin's contribution to neoclassical growth theory via the addition of money holdings. Money competes with capital for a place in portfolios. Inflation causes a shift in portfolio demands away from money to capital, which increases the long-run capital–labor ratio but not growth. Steady-state inflation is determined by the rate of money-supply growth, so that money exerts real effects contrary to classical monetary theory. Unfortunately, this result does not hold up well when modeled in a neoclassical optimizing framework, an approach which Tobin applied to the IS–LM model.

Chapter 7 deals with Tobin's concern with inequality, while chapter 8 deals with his concerns with speculation that prompted his Tobin tax proposal for foreign-exchange markets.

Chapter 9 concludes the book and is titled 'Tobin's legacy and modern macroeconomics.' The key takeaway is that the market mechanism, operating through price and nominal wage adjustment, may not be able to restore full employment. Indeed, greater flexibility and faster adjustment of prices and nominal wages may make things worse (Palley 2008). This is the enduring big picture message from Tobin's macroeconomic vision, but it was developed late in the game (Tobin 1975; 1980; 1993). By then, early neo-Keynesianism had stained Keynesianism as macroeconomics with downward nominal wage rigidity, and new classical macroeconomics had captured the mainstream profession with claims about the market-clearing role of price and nominal wage flexibility.

The great strength of Dimand's book is its organization in terms of the IS–LM model which provides a framework for placing Tobin's enormous and varied contributions in an orderly and understandable way.

Strangely, Dimand does not discuss Tobin's (1972) theory of the Phillips curve which responded to Friedman's vertical Phillips curve based on the non-accelerating inflation rate of unemployment (NAIRU) hypothesis. The NAIRU hypothesis was instrumental in overthrowing neo-Keynesianism. Tobin's 'inflation greases the wheels of labor market adjustment' theory of the Phillips curve provides a compelling counter. Unfortunately, Tobin only sketched his theory and it was not formally modeled until much later (Palley

1994; Akerlof et al. 1996), by which time the NAIRU had become hegemonic within mainstream economics.

One tantalizing area is the relation between Tobin and his heterodox critics. There is a brief mention of the post-Keynesian theory of endogenous money in chapter 4 (p. 71) and there is a discussion of Tobin's response to his post-Keynesian critics of q theory in chapter 5 (p. 87–88). As Dimand reports, Tobin viewed heterodox criticism (Crotty 1990) as misrepresenting his construction of q theory by claiming he believed in 'stable' and 'efficient' financial markets.

The big question is why Tobin's macroeconomics faded away so quickly and comprehensively. Tobin and the neo-Keynesians dominated the mainstream in 1970. By 1980 they were substantially on the way out. Why?

Dimand makes mention of the 'resurgence of inflation as a policy problem' (p. 146) and the Lucas critique that traditional Keynesian 'structural models could not be used to evaluate the effects of policy regime changes' (p. 147). However, the bulk of Dimand's explanation is that Tobin's disaggregated multi-asset IS–LM-styled model 'did not have closed-form solutions, and using simulations to solve the model numerically was a challenge to the computing capacity of 1980' (p. 148); 'there simply was not enough available data for a Tobin-style disaggregate portfolio choice model' (p. 148); the data was 'plagued by severe multicollinearity problems' (p. 149); and the money and long-run growth results 'turned out to be sensitive to model specifications' (p. 150) and significantly affected by 'seemingly small and innocuous changes in exactly how a model is specified' (p. 150).

All of the above is true, but I think it is insufficient. In my view, Tobin's macroeconomics has faded because of political reasons and because of theoretical limitations, but explaining that requires a paper of its own. The good news is that Tobin's macroeconomics remains profoundly relevant and can be revived theoretically, as suggested by the work of Godley/Lavoie (2007). Robert Dimand's book further motivates the case for that revival.

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