Book Review

Sergio Cesaratto, *Heterodox Challenges in Economics. Theoretical Issues and the Crisis of the Eurozone*, Springer 2020, ISBN 978-3-030-54447-8, 277 pp.[*]

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The teaching of economics has recently again been the subject of intense debate. In two articles published on the website of INET, German economist Peter Bofinger attacked the bestselling economics textbooks by N. Gregory Mankiw.[1] His posts then prompted a panel discussion about the shortcomings of mainstream economics textbooks.[2] The criticisms levelled against Mankiw's textbooks are manifold and range from its use of loanable funds theory as opposed to monetary analysis to the neglect of heterodox approaches to economics.

The dissatisfaction with mainstream textbooks raises the question of what alternatives are available. With *Heterodox Challenges in Economics. Theoretical Issues and the Crisis of the Eurozone*, the Italian economist Sergio Cesaratto provides such an alternative. Cesaratto is someone who knows his heterodox economics. A professor of economics at the University of Siena, he has taught classes on heterodox growth theory as well as European monetary and fiscal policy for years. He has authored numerous articles on post-Keynesian and Sraffian growth theory, as well as monetary aspects of the Eurozone crisis that appeared in major heterodox journals such as the *Cambridge Journal of Economics*, *International Journal of Political Economy*, the *Review of Keynesian Economics*, and the *Review of Political Economy.*

Heterodox Challenges is broadly divided into two parts: theory and application. The first part (chaps. 1 to 5) covers major economic theories, both mainstream and, more extensively, heterodox. The second part (chaps. 6 and 7) applies some of those theories to Italian post-war economic history and the Eurozone crisis. Each chapter is introduced by an abstract and ends with an annotated reading list. The book concludes with an epilogue that reflects on the future of capitalism.

Chap. 1 starts out with a general reflection on what economics should be about. Cesaratto considers it a discipline that involves both politics and mathematics "Political Economy" as it was called by the classics. Politics enters through what Cesaratto deems a key aspect of Political Economy: distributional conflict. Unlike marginalist theory that was developed in the 1870s and later became mainstream, the classics did not start from the optimization of insulated agents but from social classes (workers, capitalists, rentiers) and their conflicting interests. Insofar Political Economy deals with quantitative magnitudes such as total output, profits, and prices, mathematics presents itself as a useful tool that helps keep track of the flows of income across different classes and sectors. But Cesaratto cautions against

[1] See here and here.

[2] See here.

the “Ricardian vice” of making heroic assumptions just to be able to formalize an economic problem. Instead, he demands attention to ‘the deep bond between economics, history and politics’ (p.4-5) behind any abstract formal models.

Having outlined the methodological approach, chaps. 2 to 4 introduce major economic theories, mostly from a historical perspective. Chap. 2 lays out what Cesaratto considers to be the foundation of heterodox economics: the classical surplus approach. Once societies were able to produce a surplus (rather than just reproducing themselves), the question of how to distribute it enters the picture. In this context, Cesaratto points to some interesting parallels between Classical Political Economy and anthropology. Anthropologists such as Vere Gordon Childe and Jared Diamond studied the importance of the “Neolithic revolution”, the switch from hunting and gathering towards agriculture, for the emergence of economic growth and social stratification. According to Cesaratto, those anthropologists independently addressed the same issues as Classical Political Economy. The chapter then reviews Classical Political Economists, covering Smith’s, Ricardo’s, Marx’s, and Sraffa’s approaches to distribution and growth. What all these have in common is the political nature of income distribution.

Chap. 3 covers the orthodox marginalist approach. Unlike in the classical surplus approach, income distribution in the marginalist perspective is determined by the marginal productivity of the factors of production. In other words: technology, not politics, matters. More generally, marginalism shifts the attention from distribution to the determination of relative prices in free markets which, if led undisturbed, leads to full employment. Cesaratto swiftly proceeds to review the Sraffian criticism of the marginalist approach. Labour demand and supply curves may not be down- and upward-sloping (or not even be well defined) if the factors of production are not fully utilized and there is reswitching among different techniques. Another weakness of marginalism highlighted by Cesaratto is its commitment to Say’s law, i.e. the view that there can never be a shortfall of aggregate demand.

The criticism of marginalism directly feeds into chaps. 4 and 5 which cover the Keynesian revolution, as well as an introduction to Keynesian monetary theory. In the Keynesian perspective, investment and saving are not brought into a full-employment equilibrium by the rate of interest, but by aggregate income. But what drives aggregate income? Here, Cesaratto draws on the increasingly prominent “Sraffian supermultiplier” approach to Keynesian macroeconomics that emphasizes autonomous expenditures such as consumption, government expenditures, and exports as sources of demand-driven growth. Unlike the

Keynesian animal spirits, these autonomous sources of demand are likely to shape the growth rate expected by firms, thereby rending investment fully endogenous. This underlines the importance of government consumption as an exogenous source of demand, and Cesaratto carefully explains why government debt is not problematic per se.

Chap. 5 then deepens the Keynesian approach by introducing endogenous money theory and what Cesaratto calls the "external constraint". The ability of banks to create purchasing power that finances autonomous expenditures independently of prior saving is considered an important pillar of the Keynesian approach. But it is the external constraint, along with the notion of surplus, that is regarded as the key concept of the book. Cesaratto defines the external constraint as a rule by which ' a "normal" country cannot have a persistently negative trade balance, because it will end up in the debt trap' (p.137). He differentiates between countries that suffer from "original sin", meaning they can borrow from abroad only in foreign currency, and exceptional countries like the USA that can borrow in home currency. The former are not able to endogenously create the currency they need to service their debts. However, Cesaratto eventually argues that even countries that can borrow abroad in their own currency are not free from the external constraint (p. 152) – a point to which we will return below.

Chaps. 6 and 7 put those heterodox theories to work by applying them to the Eurozone. Chap. 6 presents a fascinating political history of Italy's post-war economic development. Through the lens of the surplus approach, distributional conflict is identified as the key source of Italy's high inflation rates in the 1960s and 1970s. Cesaratto considers devaluation of the lira as a vital adjustment mechanism through which Italy was repeatedly able to restore its price competitiveness after bouts of inflation. Italy's entry into the 1979-1999 European Monetary System (EMS) somewhat constrained this mechanism's scope, resulting in rising current account deficits and government bond yields, which eventually culminated in the 1992 speculative attack on the lira. In Cesaratto's view, the lessons of the EMS crisis were not learned when the euro was founded in 1999. On the contrary, the common currency deprived member states of any mechanism for external adjustment. Consequently, the 2010-12 divergence in government bond yields of peripheral Eurozone members is interpreted as the outcome of unresolved balance-of-payments problems that had gradually built up during the boom of the 2000s. Unable to rebalance their current accounts through devaluation, peripheral countries had to wait for Mario Draghi's 2012 "whatever-it-takes" speech that put speculation against their government bonds to an end. Chap. 7 analyses the ECB's monetary policy strategy. Cesaratto sharply criticizes the ECB for swiftly acting

as a lender of last resort for banks in 2008, but not for governments. When the ECB finally adopted that role in 2012, it came with strings attached: financial assistance was made conditional on fiscal austerity, whose purpose was to rebalance current accounts. The chapter ends with a plea for the return to national currencies, which would restore countries' ability to adjust their external competitiveness.

Overall, Cesaratto's book provides an accessible and entertaining introduction to major approaches in heterodox economics. Especially the entertaining side of the book deserves emphasis. Cesaratto put much work into making this book a fun read, despite its coverage of sometimes abstract theory. One of the ways in which this is accomplished are the patient answers to thoughtful questions by a fictitious economics student, giving the book a touch of a Platonic dialogue. For example, in chap. 5, where the ability of commercial banks to endogenously create deposit money is explained, the fictitious student promptly asks '*But Prof, why do banks need deposits when they can create them*' and '[...] *if banks can create money, how can they go bankrupt*' (p. 129). It is precisely such straightforward questions that often bug students of economics the most but are rarely directly addressed in conventional texts. The annotated reading list at the end of each chapter further provides readers with guidance on where to dig deeper. Another engaging dimension comes in through Cesaratto's sense of humour. At times, the book is outright funny. For example, in chap. 7, some of the peculiarities of the ECB's approach to the Eurozone crisis are discussed: '*Prof, there is another rise in interest rates in mid-2011. Could it be that Berlin* Yes. Ig-Metal, the powerful German metalworkers union, asked for excessive wage increases, and in the middle of the spread crisis Berlin had the ECB raise interest rates to threaten the unions. It was not until Draghi became president of the ECB on 1st November 2011, that the bank ceased to speak exclusively German' (pp. 205-206).

While the book's pedagogical value is high, it could be increased further. In its present form, the format and target audience of the book are not fully clear. Is it a textbook or a monograph? Is it mostly directed to undergraduate students of economics or economic policy debates on the Eurozone? This ambiguity begins with the title: '*Heterodox Challenges in Economics. Theoretical Issues and the Crisis of the Eurozone*'. I am not sure how much it would have appealed to me as an undergraduate student (It was challenging enough to follow the standard material, do I need a book with even more challenges? And why exactly the Eurozone crisis, isn't that a fairly narrow topic?). At the same time, social scientists and policymakers interested in the Eurozone crisis may not be drawn to the heterodox theory promised in the title. Given the book's current composition with more than two-thirds

dedicated to theory, it seems closer to a textbook than a monograph. But despite its efforts to be accessible and entertaining, it also tends to make allusions and side-comment about specific theoretical debates or advanced issues that can potentially be confusing to students.[3] Similarly, the often flat-out normative tone might scare off modern-day students who have been drilled to be wary of supposedly ideological influences. For a fully-fledged textbook, more discipline with respect to the systematic introduction of concepts and debates would be required. Another shortcoming is the lack of concluding sections at the end of each chapter (and the book as a whole). Finally, the book's main structure with its division into theory and application could be made clearer to the reader; for example, by more cross-referencing and explicit statements how certain theoretical insights inform the analysis of the Eurozone.

A final remark relates to the external constraint. Given its centrality, the discussion could have been clearer and more precise. As documented above, Cesaratto defends a strong version whereby countries cannot run sustained current account deficits even if they can borrow abroad in their own currency. He decisively disagrees with Australian economist Bill Mitchell's claim that no such constraint limits countries like Australia that can borrow in their own countries. The fact that Australia has consistently run current account deficits since the mid-1970s and only went into surplus in 2019 is not directly addressed by Cesaratto. However, on p.149, he admits that what really matters is external debt sustainability. Here he mentions the critical relationship between the interest rate on external debt and the domestic growth rate. Still, he fails to state that this relationship is a much weaker version of the external constraint. The chapter would have benefitted from a more qualified analysis of factors that may allow the external constraint to be satisfied despite current account deficits. While the chapter mentions Kaldor and Thirlwall in passing (but they don't appear in the reference list), the highly related balance-of-payments constraint growth literature is not discussed in any detail. This is a shortcoming as this literature has made efforts to integrate net capital flows (and thus current account deficits) into models with external constraints (see Thirlwall 2011, pp. 332-337). For example, Barbosa-Filho (2001)'s contribution shifts the attention from balanced current accounts to external debt sustainability and provides a stability condition similar to the one casually mentioned by Cesaratto (p.149). Kohler (2017) further analyses external debt sustainability in a Kaleckian macromodel in which external borrowing cost may be a function of the external debt ratio. This mechanism is also mentioned by Cesaratto (p.149) and appears

[3]For example, on pp.2 and 7, there are hints a towards Modern Money Theory (MMT) or on p.126 there is a brief mentioning of TARGET2, which is, however, only explained in detail almost a hundred pages later.

to be one of the reasons for his strong version of the external constraint. The stability condition in Kohler (2017) is indeed stricter as the one in Barbosa-Filho (2001), but also boils down to a relationship between domestic growth and external borrowing cost. From this perspective, it is not clear why a country with monetary policy control over its external borrowing cost would not be able to run deficits over sustained periods of time. The discussion may seem pedantic, but it has implications for Cesaratto's insistence that despite the presence of TARGET2, the Eurozone was a balance-of-payment crisis (e.g. on pp.260-261). As pointed out by several authors (e.g. Grauwe & Ji 2012, Febrero et al. 2018, Lavoie 2015*a*,*b*) the Eurozone crisis was not so much about unsustainable current account deficits but more about the unwillingness of the ECB to unequivocally guarantee the solvency of all EMU member states. Cesaratto appears to agree with this point but insists that a rebalancing of current accounts was still necessary. In his view, this was accomplished by austerity, which was 'meant to enable the spendthrift states to repay their foreign debt by virtue of current account surpluses' (p.261). While there is no doubt that austerity did contribute to a rebalancing of current accounts, I am not convinced that this can be taken as an instance of an external constraint biting. There is a difference between the "silent compulsion of economic relations" (Marx) represented by an external constraint and the troika's concerted political intervention. Glancing back to chap. 1 of *Heterodox Challenges*, understanding this aspect of the Eurozone crisis may require more history and politics than iron economic laws.

In sum, *Heterodox Challenges in Economics* constitutes a welcome alternative textbook on economics that demonstrates the realism and relevance of heterodox approaches to aspiring economists. It deserves a wide readership.

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