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Book Reviews

Editor's Note: Guidelines for Selecting Books to Review

Occasionally, we receive questions regarding the selection of books reviewed in the *Journal of Economic Literature*. A statement of our guidelines for book selection might therefore be useful.

The general purpose of our book reviews is to help keep members of the American Economic Association informed of significant English-language publications in economics research. We also review significant books in related social sciences that might be of special interest to economists. On occasion, we review books that are written for the public at large if these books speak to issues that are of interest to economists. Finally, we review some reports or publications that have significant policy impact. Annotations are published for all books received. However, we receive many more books than we are able to review so choices must be made in selecting books for review.

We try to identify for review scholarly, well-researched books that embody serious and original research on a particular topic. We do not review textbooks. Other things being equal, we avoid volumes of collected papers such as festschriften and conference volumes. Often such volumes pose difficult problems for the reviewer who may find herself having to describe and evaluate many different contributions. Among such volumes, we prefer those on a single, well-defined theme that a typical reviewer may develop in his review.

We avoid volumes that collect previously published papers unless there is some material value added from bringing the papers together. Also, we refrain from reviewing second or revised editions unless the revisions of the original edition are really substantial.

Our policy is not to accept offers to review (and unsolicited reviews of) particular books. Coauthorship of reviews is not forbidden but it is unusual and we ask our invited reviewers to discuss with us first any changes in the authorship or assigned length of a review.

A General Economics and Teaching

Microeconomics: Behavior, Institutions, and Evolution. By Samuel Bowles. Roundtable Series in Behavioral Economics. Princeton and Oxford: Princeton University Press; New York: Russell Sage Foundation, 2004. Pp. xi, 584. $49.50. ISBN 0–691–09163–3.

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There's a new microeconomics on the block, and it's not the microeconomics you were taught in school. The new microeconomics takes seriously that many markets and contracts are incomplete, that agents are differentially informed, that much that is pertinent to their interactions is not verifiable or admissible in a court of law. While those first elements would shock no one trained in the past thirty years, the new microeconomics goes much further, allowing that people sometimes display social preferences such as concern over fairness, a desire to reciprocate when treated well, and a desire to punish when taken advantage of. More radically, still, this new microeconomics takes institutions as not only critical, but variable and scarce, and it treats their evolution and selection as a central problem of economics. Indeed, this new microeconomics sometimes takes preferences or institutions as the variables to be explained, modeling selection

of agent types and institutional outcomes under relevant evolutionary pressures.

In giving this microeconomics what is perhaps its first textbook-style and textbook-length treatment, Samuel Bowles makes only modest claims for the completeness of the new paradigm. In the introduction, he cites J. S. Mill's famous 1848 howler: "Happily, there is nothing in the laws of Value which remains . . . to clear up; the theory of the subject is complete." Writes Bowles in contrast: "This book conveys no such reassurance. Our understanding of microeconomics is fundamentally in flux. Little is settled. Nothing is complete." (p. 19). In the concluding chapter, where he summarizes key elements of the "evolutionary social science" he sees emerging, he readily admits that there "is no unified paradigm of this name, but rather a disjointed set of approaches, many of which are rather rudimentary" (p. 478). Such modesty is becoming, and in some respects apt, but should not give the wrong impression: there are already many promising tools in Bowles's paradigm-building kit.

The book is divided into three parts. Part 1, "Coordination and Conflict: Generic Social Interactions," introduces game theory, presents elements to be used in later chapters, and discusses methodological issues. Chief among the latter are the nature of preferences and the two-way relationship between preferences and institutions, a subject of much discussion in part 3. Chapter 4, on coordination failures, discusses common property, public goods, and other coordination problems, and considers how social preferences sometimes help to solve them. Chapter 5, "Dividing the Gains to Cooperation," introduces Nash and other bargaining models and discusses the conflict between cooperation and competition that looms large throughout the book.

Part 2, "Competition and Cooperation: The Institutions of Capitalism," treats the more traditional topics of microeconomics in distinctive and sometimes novel ways. Chapter 6, "Utopian Capitalism: Decentralized Coordination," lays out the Walrasian general equilibrium model and carefully discusses its limitations. Exchange under more realistic conditions, such as incomplete information about quality, is analyzed in chapter 7. Chapters 8 and 9, among my favorites in the book, discuss labor and credit markets, elaborating the "contested exchange" framework developed by Bowles and frequent collaborator Herbert Gintis. Like its somewhat more staid cousins, the Shapiro–Stiglitz unemployment model and the Stiglitz–Weiss credit market model, the contested exchange approach depicts a world in which markets don't clear and prices determine effort or quality. For Bowles, the terms of the exchange, rather than being settled by a handshake, are worked out through time under the influence of "short side power." Chapter 10 discusses why the institutions of a capitalist economy are as they are, e.g., why firms controlled by capital-providers hire workers rather than workers organizing firms and hiring (renting or borrowing) capital.

Part 3, "Change: The Co-evolution of Institutions and Preferences," is the least traditional part of the book. As its title suggests, the aim is to understand how preferences shape institutions, how institutions shape preferences, and how both could have emerged from human biological and cultural beginnings. Economic history, growth, and development provide examples for discussion, and the text takes lengthy excursions into the preagricultural world of 100,000 to 11,000 years ago. Why study the coevolution of institutions and preferences? Because, argues Bowles, they're of fundamental importance to real world economic and social outcomes. He begins the book with the puzzle of why the lush Bangladesh and wealthy Moghul India of the fourteenth and fifteenth centuries sank into poverty while the relatively poor Europe of that period grew, along with some of its colonial offshoots, to be the economic leaders of today's world. The answer, he suggests, is the "emergence and diffusion of a novel set of institutions that came to be called capitalism [which] brought about a vast expansion in the productivity of human labor in Europe and not in Bangladesh [or India]."

Capitalism is not, argues Bowles, simply the substitution of fully defined property rights and contracts for custom, community, and state. Rather, it's a dynamic mix of new, yet never contractually complete, arrangements, with long-present human motivations ranging from greed to reciprocity and vengeance, bolstered by effective states, legal systems, and communities of the workplace, neighborhood, and interest group. Understanding the system's emergence and functioning requires not only the old invisible hand

model and its protagonist, *Homo economicus*, but also models of how trading partners establish trust, why workers respond positively to job rents, and why people participate in civic and political organizations. And for this, one needs to know how reciprocity, the tendency toward "altruistic punishment," and other "social preferences," could be supported by a human gene pool that from a simplistic evolutionary standpoint seems inconsistent with survival-of-the-fittest principles.

Although Bowles's work helps to set out a research agenda that will take decades to explore, the book offers many of the necessary tools, a number of interesting starts, and ample food for thought served up with rich perspective on the histories of both the ideas and the substantive questions at issue. It may not become next year's core graduate micro text in most universities. But whether as a companion to a more conventional text, or as an entrée in its own right, it's an intellectual meal to relish.

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Econometric Theory and Methods By Russell Davidson and James G. MacKinnon. New York and Oxford: Oxford University Press, 2004. Pp. xviii, 750. ISBN 0–19–512372–7.

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The authors have previously written a graduate level econometrics textbook entitled *Estimation and Inference in Econometrics*, which was published in 1993 by Oxford University Press. The present book covers many new topics and is at a slightly less advanced level. Because of the adjustment in the level, the authors occasionally refer to their older book for more details or more precise derivations of results. Therefore one wonders whether both books will remain competitors in the market of graduate level econometrics textbooks. If the older book disappears, it may also reduce the value of the present one.

The present book assumes a good bit of prior knowledge in statistics and econometrics. Although the prerequisites are often briefly reviewed, this is done at a level which will not be easily accessible to students without some background knowledge. As the title suggests, the book focuses on the theory and methods and not on applied econometrics. Given the lack of empirical examples except in the exercises, it is clearly helpful for a student to approach the book with some background motivation.

The first ten chapters and thus almost two thirds of the book cover the foundations by focusing on important methods of inference for econometrics. After an introduction to the linear regression model (chapters 1 and 2), estimation by ordinary least squares (chapter 3), hypothesis testing (chapter 4), confidence intervals (chapter 5), nonlinear least squares (chapter 6), generalized least squares (chapter 7), instrumental variables (IV) estimation (chapter 8), the generalized method of moments (GMM) (chapter 9), and maximum likelihood (ML) estimation (chapter 10) are treated. Some of the material in these chapters is quite standard but the presentation is often a bit nonstandard, which makes the text unique and interesting as a textbook. For example, there is a long discussion of the geometry of the linear regression model. There may be students who prefer that to a purely algebraic treatment. Also, confidence intervals are introduced via tests. This way some common misconceptions about confidence intervals may be avoided more easily than with a "classical" introduction. On the other hand, understanding how to interpret and use confidence intervals does not necessarily become easier.

A big plus of the treatment in the present volume is the introduction of simulation and bootstrapping methods at a very early stage. These important tools are presented here by experts with admirable insights. I like especially the discussion of bootstrap confidence intervals in chapter 5. A small problem in this chapter is perhaps the unfortunate example for the delta method on page 206, where the asymptotic properties of an estimator of $\theta = \theta^2$ are to be inferred from those of an estimator of θ. The delta method can be used unless $\theta = 0$. This case is also a very nice example for the bootstrap interval given in (5.54) to be unsuitable because it will contain the true parameter value with probability zero whenever the confidence level is less than one. Unfortunately these problems are not discussed or pointed out by the authors and the example is presented as one for rather than against these methods. Generally, the exposition is quite insightful, however, and even advanced methods like the method of simulated moments (chapter 9) become accessible.