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Book Review

[Book Review of] Investment, growth and employment : perspectives for policy, Ciaran Driver ... (eds.) : London, Routledge, 1999

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ently, France is experiencing a strong improvement of its fiscal stance, and the same is true – while to a lesser extent – for Germany and Italy. By contrast, the structural problems on the supply side are still on the top of Europe's agenda, and too little progress can be seen in this field.

As regards methodology, the volume is not really sophisticated. In this respect, the sole exception is the paper by *De Grauwe et al.*; as already noted, this paper is the only one that combines quantitative results with explicit and original theoretical foundations. All papers, however, are very well written and can be quickly read even by undergraduate students. This is also true for the chapter on ECB strategy despite my bad feeling arising from its overly advertising nature. In my opinion, the book should merit a place on reading lists dealing with the economics of EMU.

Franco Reither

Driver, Ciaran, and **Paul Temple (eds.)**, *Investment, Growth and Employment: Perspectives for Policy*. London, New York 1999. Routledge. XV, 354 pp.

This book originates from a conference held at Imperial College London in 1997. The book is organized in three parts and there are 17 chapters, including three overview chapters written by the editors, which summarize the main ideas underpinning the contributions. These overview chapters place the ideas in the context of the relevant literature at the opening of each part of the book. Chapters 1 – 6 in Part I analyze determinants of investment, Chapters 7 – 10 (Part II) the consequences of investment, and Chapters 11 – 17 discuss policy lessons in Part III.

In Chapter 1, *Ciaran Driver* and *Paul Temple* present an overview of aspects of modern investment theory. They review three developments, which they regard as the most influential ones: (*i*) the development of dynamics and q-theories, (*ii*) the incorporation of constraints (distinguishing between micro- and macro-constraints) and (*iii*) models of investment under uncertainty. The literature is surveyed in an accessible manner, avoiding unnecessary maths, and provides useful references to the primary literature in the area. The chapter also presents a very useful brief overview of the contributions of the chapters collected in Part I of the book.

Brian Henry, Andrew Sentence and *Giovanni Urga* set out to tackle an ambitious task, namely to account for the peculiarities in the development of UK manufacturing investment in the 1980s and 1990s. They aim to provide possible explanations for the observed trend of increasing investment in the 1980s and early 1990s, but a substantial decline after 1996. To this end, the authors first present theoretical issues, describing numerous models of investment behavior which lead to various specifications for investment equations which can be estimated empirically. The models are based on the standard quadratic adjustment cost framework and incorporate dynamics and expectations. The results of estimating a number of empirical specifications indicate the importance of the role of financial effects and expectations for investment. In particular, models incorporating measures of liquidity and profitability are able to account for much of the changes in investment behavior. Furthermore, it is shown that expectations are important. It is not obvious, however, that the authors are actually able to fulfil their ambitious task, namely, to account for the sharp slump in investment in UK manufacturing after 1996. As they admit themselves, accounting for this might be a fruitful area for further research.

In Chapter 3 *Jean-Bernard Chatelain* develops a theoretical model which shows that firms facing an endogenous debt ceiling (with the debt-equity ratio endogenously depending on the level of expected future profits taken as collateral) may have a higher investment-to-cash-flow sensitivity than other firms for which this is not the case.

The model is elaborated upon in great detail throughout the course of the chapter, which means that the reader has to master some mathematical notations. The theoretical model is estimated using data for French firms over the period 1989–1994. In transforming the theoretical model into an empirical specification, Chatelain faces a problem familiar to many empirical economists, namely, finding the right proxies for the variables specified in the theoretical model. The main issue of interest is whether a firm constrained by a debt ceiling behaves differently from other firms. To investigate this, Chatelain splits the sample of firms into those facing a ceiling and those who do not. In doing so, he measures the existence of a debt ceiling in two ways, namely as (*i*) an increase in the debt ratio and (*ii*) high productivity (implying that the interest rate on current debt is lower than marginal productivity). As with many empirical proxies, it is debatable whether these measures are appropriate or whether better proxies could have been employed. The empirical results, however, provide some support for the theoretical model advanced by Chatelain.

Rina Bhattacharya and *Paul Hope* are interested in examining the effect of uncertainty on firm's investment decisions. They investigate this issue using data for 103 UK manufacturing industries over the period 1980–1992. The authors acknowledge the difficulties of modelling uncertainty in investment decisions and opt for an ad hoc approach whereby they include an uncertainty term in a standard investment equation. The uncertainty term is derived from a survey of manufacturing firms and consists of the percentage of firms answering affirmatively to a question of whether they feel that uncertainty may be a likely factor to limit capital expenditures over the next year. While it is arguable whether such an ad hoc approach is the most appropriate approach to this issue, it certainly is a novel way of tackling an issue that has proved difficult in the literature. The empirical results suggest that uncertainty has a negative effect on investment in UK manufacturing.

In Chapter 5, *Simon Peck* and *Paul Temple* look at the effect of corporate governance, i.e., the way in which firms are organized and controlled, on investment behavior. The form of corporate governance is of importance in a principal-agent framework where there is informational asymmetry between the agent (manager) and the principal (owner). The authors compare structures of corporate governance in four countries, namely the US, UK, Japan, and Germany and review the empirical evidence available in the literature. They conclude that there are important differences in investment behavior of firms in different systems of corporate governance.

Otto Toivanen, Paul Stoneman and *Paul Diederen* return to the problem of uncertainty for investment behavior. They analyze the effect of uncertainty, measured as volatility in macroeconomic variables such as prices, output and interest rates on investment in new technologies. The industrial robotics sector is chosen for analysis. In their empirical estimation, using panel data for 16 countries over the period 1981–1993, they find that volatility has impacted on the diffusion of the new technology, i.e., the total stock of robots in these countries. The effect of different measures of volatility are found to differ, however. Volatility in inflation impacts positively on the adoption of robotics technology, while volatility in the price of robots slows down the diffusion of the new technology.

Ciaran Driver and *Paul Temple* introduce Part II with an overview chapter in which they place the subsequent contributions in the context of the relevant literature. Part II is concerned with consequences of investment, and Driver and Temple choose to focus on two aspects of these: spillovers and the relationship between capital investment and employment. The three following chapters, which comprise Part II of the book, address particular aspects of these issues.

Jerry Coakley and *Andrew Wood*'s chapter looks at the determinants of growth and in particular at the role of investment for growth. They formulate an empirical equa-

tion relating output per worker to investment and other explanatory variables. They proceed to estimate the equation using time-series data for six OECD countries. The results suggest that there is a long-term relationship between output per worker and investment.

In Chapter 9, *Ray Barrell* and *Nigel Pain* examine the implications of foreign direct investment (FDI) for the economic performance of host countries. They provide detailed data on the importance of FDI for a number of OECD countries and discuss the determinants of FDI. Their main contribution is the analysis of the impact of FDI on technological progress in the host country. To this end, Barrell and Pain estimate labor demand and capital stock equations and incorporate FDI as an explanatory variable in their model. Time-series data for Germany is employed in the analysis. They also investigate cross-sectional evidence for the United Kingdom, the United States, and France. Their findings suggest significant positive spillovers from FDI on the economic performance in the countries analyzed, a result which is in line with the recent findings by Borensztein et al. (1998) on the relationship between FDI and economic growth.

The alleged "super-neutrality" of equilibrium unemployment with respect to productivity is the starting point for the work by *James Nixon* and *Giovanni Urga*. They are particularly concerned with the conditions necessary for the result of no long-run relationship between equilibrium unemployment and the determinants of the capital stock to hold. The argument proceeds from a theoretical supply-side model, over estimating factor demand and wage equations using UK data, to simulations of the entire structural model. They conclude that the assumption of "super-neutrality" appears overly restrictive.

Part III, which is concerned with policy lessons, is introduced by *Ciaran Driver* and *Paul Temple* with their survey of key policy issues. Among the various questions they ask are whether there is a case for investment policy to create jobs and what policymakers can do to promote investment – arguably questions which are very relevant today. The subsequent chapters discuss policy issues in more detail.

The contribution by *Ciaran Driver* and *David Shepherd* examines the relationship between supply constraints on capital and labor on price movements over time. Their results show that capital shortages have an effect on price movements, which suggests that investment may have an effect on inflation. This is surely a policy issue worth considering.

Michael Sumner's analysis of the long-run effects of investment incentives, using data for the UK for 1955–1994, echoes a frequently found, though somewhat unsatisfying, outcome. He concludes that no firm conclusions as to the effectiveness of investment incentives can be drawn.

In Chapter 14, *Kate Barker* outlines the position of the CBI (Confederation of British Industries) on investment policy in Britain. Her contribution gives an insightful overview of employers' (who after all, are the main players on the supply side) views on investment issues and policy. Her view is that investment in Britain is too low, but that there are a number of policy options for government to stimulate investment on the supply side, using taxation and improved flows of information between investors and firms.

Jonathan Michie reflects on the link between investment and employment. He acknowledges that unemployment is affected by labor market phenomena (for example, as regards wage fixing or the quality of the workforce), but he also reminds us that there is a supply-side impact on unemployment. This supply-side impact prevails despite there being no automatic link between capital stock and employment. He asserts, however, that they are surely related.

Ian Brinkley and *Soterios Soteri* open their chapter with the assertion that investment levels in the United Kingdom are too low relative to other major industrialized countries. They proceed to present evidence to support this statement and also discuss

possible remedies, such as promoting economic stability, using fiscal policy and public investment.

In the final chapter, *Jaewoo Lee* compares the investment performance of four European countries (France, Germany, Italy, UK) with the United States and finds that the United States has exhibited far higher growth rates of fixed investment over the period 1975–1995. Disaggregating the economies into goods-producing and services-producing sectors, he finds that the poor investment performance of European countries relative to the United States is mainly due to poor performances in the services-producing sector, while there are no obvious large differences in the goods-producing sector. This suggests the need for further research to analyze services-producing industries and the reasons for their poor investment performance in more detail.

To summarize, the book presents a very useful compilation of papers on investment, tackling this broad topic from very different perspectives and using many different techniques. While the majority of the contributions are empirical, using econometric techniques, there are some notable theoretical contributions to the literature, as well as purely verbal discussions of policy issues. The majority of the papers are concerned with investment in the UK, and a recurring theme is the assertion that there is underinvestment in the UK. It is argued that in order to attain the same level of productivity that prevails in the major EU economies, such as France and Germany, increases in investment are needed. The book is, however, not solely concerned with the United Kingdom; a number of papers look additionally at the experience of other major EU and OECD countries.

As is common with books which have evolved out of conference papers, the variety of the contributions included means there is no common theme that connects all papers, but the division into three different parts is very useful, and papers within the parts are, to greater or lesser extent, related to a common theme. In my view, the papers in Part II are the most interesting, as they present well-crafted analyses of the consequences of investment, both domestic and foreign, on employment and growth. However, the other two parts are also highly readable and, of course, readers with different preferences and interests may prefer different parts of the book.

Reference

Borensztein, E., J. De Gregorio, and J. W. Lee (1998). How Does Foreign Direct Investment Affect Economic Growth? *Journal of International Economics* 45 (1): 115–135.

Holger Görg

Goss, Barry A. (ed.), *Models of Futures Markets.* London, New York 2000. Routledge Studies in the Modern World Economy. XXVII, 170 pp.

This volume with six chapters on welfare, rationality, and integrity in futures markets is a very interesting project which tries to cover all major aspects of this type of risk-sharing market. The objective of this book is to provide new analysis and evidence on the issues of welfare, rationality, and integrity in futures markets. Topics discussed and developed range from the gains from futures trading, their existence in emerging markets, over noise trading, exchange rate forecasting, microanalytics of price volatility, and the impact of regulatory instruments on price formation in this market.

The book consists of seven chapters. Chapter 1 contains an introduction. Chapter 2 (*Derek Francis*) studies the gains from futures trading in a market economy. The analysis differs from the traditional literature which emphasizes risk-shifting and risk pre-