

Economics of Human Resource (HR) Decisions, Productivity and Efficiency

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Abstract

The Make or Buy decision forms the cornerstone of managerial economics wherein the decision to outsource key processes compared to doing them in-house is taken based on the relative benefits and downsides of such decisions. For instance, let us take the example of the current trend among the Western companies to outsource their manufacturing to China and services to India. Behind this decision is a calculated attempt at evaluating whether it is cheaper to get the work done offshore or do it onshore. This evaluation is based on what is known as an opportunity cost. In this case, if a Western firm feels that the time and money spent in making the goods or services in their country can be employed elsewhere leading to more profits, it would then outsource such activities. On the other hand, if the Western firms think that by outsourcing the activities, they stand to lose out economically, then they would rather make the goods or services in their own countries.

Keywords: Economics of Human Resource, Development Economics, Productivity and Efficiency

1.0 INTRODUCTION

Similarly, HR managers have to decide whether they need to hire permanent staff or contract staff for particular jobs. If they hire a permanent resource, in addition to the basic salary and other allowances, they would have to pay social security, healthcare benefits, paid leaves, and other perks. However, hiring a resource on contract means that they would simply have to pay the agreed amount to the agency that is responsible for placing him or her. Of course, the cost and the economics are not the only aspects as other variables such as the level in the hierarchy, the perceived value added by the resource in addition to the availability or otherwise of the skill sets are to be taken into consideration. In addition, the relative costs of such value addition also form part of the economical matrix used for evaluation.

1.1 The Economics of Full Time vs. Contract Hiring

Increasingly, HR managers prefer to hire contract resources rather than full time employees because the ongoing economic downturn means that there are more workers in the market for even premium skills as well as the firms hiring such workers are also under cost pressures. Indeed, the fact that firms are doing everything possible to cut down on additional costs means that the Make or Buy decisions are increasingly being skewed in favor of the Buy side. In addition, hiring resources on contract is useful to tide over temporary shortages in demand which means that in the place of a full time resource who cannot be fired at will, the firm can simply cancel the contract or not extend it in case of the contractual resource. Further, they do not have to worry about paying healthcare, social security, and other benefits that full time resources have to be paid.

1.2 Outsourcing HR Processes

The Make or Buy decision is also in action as far the HR processes are concerned. In recent years, many firms have outsourced their payroll, hiring, event management, and public relations functions to external agencies to keep costs down. Whereas these activities were earlier being handled by the HR, nowadays many firms contract outside vendors to handle these functions. Again, the rationale for this is simple. The firms can focus on the essential functions instead of handling the noncore functions and at the same time, can cut costs as well since these functions are usually seasonal, periodic, or one time in nature. For instance, hiring is done in many firms on a seasonal basis whereas payroll is periodic meaning that it is end of the month activity, and event management and public relations are sporadic or one time in nature meaning that the firms do not lose out by outsourcing these functions.

1.3 The Concept of Core Competency

Closely related to the Make or Buy decision is the concept of core competency. This term which was coined by the legendary management expert, C K Prahalad, refers to the advantages for firms to focus only on their core functions and outsource everything else. In the case of the HR activities discussed above, it has become the trend in many firms for the HR manager to focus on people engagement and people enabling rather than devote time to the peripheral activities. Even in the case of the HR processes, it has become the norm to do only the core processes and entrust external vendors for the noncore processes. The concept of core competency drives outsourcing whether in the West or in the East with the difference being the degree and the nature of the activity being outsourced. It is also the fact that most firms are engaged in identifying what processes are peripheral and what processes are core to the firm.

2.0 ECONOMICS OF HUMAN RESOURCES: PRODUCTIVITY AND EFFICIENCY

2.1 How Productivity and Efficiency are the Root of HR Decision Making

Who does not like productive employees who can get the work accomplished in less time than others and hence, be able to take on other tasks? Further, who does not like to be productive especially if they are on contract to a company and hence, are paid according to how efficient they are? Moreover, which manager does not like his or her employees to add more value through efficiency? Finally, which organization does not reward its productive employees over less productive ones? These are the questions that Human Resources (HR) managers and the managers in organizations confront when they have to decide on hiring, firing, and rewarding employees. Indeed, with technology becoming all pervasive and ubiquitous, employees are realizing that if they have to retain their jobs, they have to ramp up on their productivity. They are also realizing that competition from freelancers and contract workers who can do more in less time and also are cheap to the organization because the firms do not have to take care of other benefits except basic salary means that the full time employees in many organizations are feeling the heat.

2.2 How Productivity and Efficiency Work in the Real World

Before we proceed further, let us look at how efficiency and productivity play out in the workplace. Some employees get work done in lesser time when compared to their peers. For instance, if a particular employee takes 10 hours to do the task which other employees perform only in 15 to 20 hours, the former would be looked upon favorably by the managers because this employee can be made to work on more tasks in the time saved. Further, if a particular employee increases the value added to the organization by taking initiatives such as designing tools for increased efficiency, he or she is adding more value than the others and hence, he or she would be rewarded accordingly. Apart from this, if a particular employee takes fewer breaks as well as does not browse the web and check Facebook all the time, then the organization is likely to view these employees as more valuable assets when compared to the others. Indeed, the chances of these employees being fired are lesser or even nonexistent when economic conditions worsen. As can be seen in the way many companies across the world are retaining their top performers and letting go of the ones who are less efficient and productive, it is clear that the workplace of the future would be dominated by the ultra-productive and ultra-efficient workforce.

2.3 The Impact of Technology

No discussion on productivity and efficiency is complete without discussing the role of technology. Just as machines replaced workers in the mass manufacturing assembly lines and just as computers replaced even the most highly skilled employees in the past, now it is the combination of advanced computers and robots to replace the knowledge workers. The fact that the knowledge workers or the workers who were employed in the services sector felt that by virtue of adding more value than the earlier workers whom they replaced, they were secure is now being questioned. As the AI (Artificial Intelligence) algorithm based computers and robots are being introduced into firms, it is no longer the case that even the most valued adding employees can take their jobs for granted.

2.4 Moore's Law and Exponential Change

The point here is that technology follows the Moore's law wherein the pace of change is such that the trends that are visible now would be replaced by newer trends within a time period of one to two years. Therefore, what the professionals who are already working and those aspiring to enter the corporate world have to remember that in times when dizzying change is the norm, it pays to improve and enhance one's skills on a continuous basis so that they are not left behind in the rat race with the changing trends. Further, the fact that organizations are always looking to cut costs and boost profits means that one cannot expect charity from their managers and their organizations.

2.5 Emerging Threat from the Temps and the Casuals

I have discussed how workers are threatened by more productive colleagues as well as threatened by technology. Another emerging threat to full time employees is from the growing army of freelancers and contractual employees. As mentioned earlier, organizations do not have pay these workers anything more than the basic cost as healthcare, social security, and paid leave do not apply to them. This means that more and more, HR managers would be apt to shift to freelancers and contractual employees over full time workers. This also means that in the future, the existing workforce would be facing and confronting all these trends at the same time which would indeed be exhausting to contemplate.

2.6 Protecting oneself from being replaced

If what has been discussed so far sounds alarmist and gloomy, we would suggest talking to older workers and those retired who in their times have had to confront computers and outsourcing replacing their jobs. Further, we would also suggest considering the waves of change that have happened in the corporate world wherein the first casualties of any change were the slow moving who were simply replaced with the faster and more agile newer entrants. The lesson for aspiring workers and the existing workforce is not to be tensed up or feel alarmed but look for ways and means to augment their productivity in addition to learning new skills or methods to add value by contributing in other areas than the regular work.

3.0 THE ECONOMICS OF HUMAN RESOURCES MANAGEMENT: HIRING, FIRING, AND REWARD SYSTEMS

3.1 The Changing Emphasis of HR Decisions

Despite the widespread impression that Human Resources is distinct from the other profit generating and economic functions such as Production, Sales, Marketing, and Core Competency driven work, the HR function is indeed driven as much by concerns over hiring and retaining the best talent as well as empowering and engaging them as it is by cost concerns as well as profitability imperatives. Indeed, one can go as far as to say that the HR function is increasingly becoming profit driven and cost conscious considering the heavy emphasis on cost cutting and increasing profits in recent times. Further, most firms now have the HR departments as cost centers meaning that they have to account for the expenses incurred and corresponding and concomitant profits generated in the same manner in which other functions operate. Moreover, with the emergence of the Digital Economy, the HR function too is redefining itself regarding functioning from economic incentives and profit-driven concerns.

3.2 The Economics of HR Decisions

Thus, this means that the hiring, firing, retrenchment, downsizing, employment, and reward and recognition processes are increasingly based on cost calculations and profitability concerns in addition to the traditional drivers such as hiring the best talent, retaining the performing employees, and firing the laggards. Indeed, even the reward and recognition systems are now based on purely cost and profitability concerns, given the scarce resources that many firms have in the context of the current economic climate. Thus, HR managers can no longer argue with the line managers and executive personnel about people driven decisions, and instead, they too must fall in line with the cost concerns and profitability driven imperatives. This means that hiring is based on how much the employee cost the respective unit and firing and retrenchment are based on how much costs can be saved.

3.3 Whom to Hire is now based on Cost and Profitability Concerns

For instance, many multinational corporations now have individual units as cost centers where the line managers and the unit heads prepare budgets for hiring decisions which are then communicated to the HR managers. After this, the HR managers in consultation with the line managers and the unit heads draw up a budget and a plan wherein the costs of hiring are apportioned to the HR and the respective units, and the compensation and perks costs are based on how much the units can afford. Thus, hiring is no longer an isolated or distinct activity and instead, is a holistic and systems driven approach that involves multiple levels of consultation and coordination between the HR department and the line and unit managers. Indeed, hiring in most firms nowadays is done by first estimating the costs of the recruitment process which is in turn driven by which hiring method is the most cost-effective. Once the initial screening and sifting through the resumes is completed, the hiring process then moves on to the next stage where close coordination and consultation between the units and the HR department based on how much the potential recruit expects and how much the firms or the unit managers are willing to pay.

3.4 Poor and High Salary Employees Take Note

Similarly, retrenchment and firing now entails cost calculations wherein the unit managers and the HR managers meet to decide on whom to retrench based on which quartile or the percentile of the Bell Curve the employee belongs to and how much costs can be saved by retrenching the employee as opposed to how much costs are incurred if the employee has to be retained. Indeed, most firms in the aftermath of the Global Economic Crisis of 2008 and the ensuing economic downturn are basing their retrenchment decisions solely on cost concerns which means that employees are no longer fired based on the percentiles they belong to and instead, the employees whose performance is bad and who cost more compared to other low performers are fired. Thus, economics trumps other concerns meaning that employees who fare poorly and who also take up resources are more likely to be fired than just employees who are at the bottom of the performance quartile. Indeed, this trend can be described as the emerging model of Human Resources with its emphasis on cost-driven and profitability drivers of decision making.

3.5 High Performers and Economics of Reward and Recognition Systems

Apart from this, the reward and recognition systems too are being driven by cost concerns which means that at the end of the appraisal cycle, the unit managers and the HR managers sit together to finalize the bonuses and the pay hikes based both on the Bell Curve as well as the costs and economics of giving bonuses based on performance and the budgets available. Thus, this means that once the total budget is finalized, the unit managers divide it into individual bonuses wherein the top performers are rewarded based both on the percentile they belong to as well as how much the other top performers earn in relation to each other. Indeed, the performance bonuses are now determined based on how "valuable" the employee is to the firm and how much losses the firms would have to absorb if the employee leaves in contrast to how much the firms would gain if the employee is rewarded and stays on to scale greater heights.

4.0 THE ECONOMICS OF HUMAN RESOURCES IN THE INFORMAL ECONOMY

4.1 Nonexistent Rules in the Informal Economy

The informal economy operates in a very different way from the formal economy. Whereas the latter is structured and governed by laws and regulations, the former operates pretty much on the rules made by individual players and in a "make as you go" manner wherein on the spot rules and by the job rules are the norm. Thus, human resources in the informal economy are managed differently from the formal economy. For instance, workers in the informal sector do not have health benefits, social security, salaries that are paid into bank accounts or even job security since they are hired for short-term work as well as are expected to work according to the norms of the employer rather than any adherence to Federal or State rules.

4.2 Economics of Employment in the Informal Economy

This means that the economic aspect of managing human resources in the informal economy is based on the immediate demand and how much supply of labour is there at that particular moment. As an example, think of a construction site where the Mason and the Contractors hire labour for the day or a

week and at times, for a month. Indeed, such hiring is always for the immediate need and not out of any long-term commitment from the employers. Thus, the term daily wage workers are used to describe the employment of casual labourers on a short term basis. Daily wage workers are paid at the end of the day, and they do not earn anything if they do not turn up for work the next day. Thus, they neither have the luxury of taking leaves nor have the protection of social security benefits to see them "through a rainy day". Indeed, daily wage workers are usually those who live on the margins of the economy in a very precarious situation, and this is the reason some contemporary sociologists and economists refer to them as the Precariat Class or those whose work and lives are precarious and who migrate from other places to places where work is available.

4.3 The Emergence of the Precariat Class

Indeed, a key feature of the economics of human resources in the informal economy is that labour is always on the move searching for places where work is available, and hence, they owe no allegiance to any particular place. This makes the task of regulating the informal economy as well as putting in place safeguards to such Precariat to protect them from the vagaries of seasonal employment that much more difficult. Talking about seasonal employment, the economics of the informal economy is such that employment is always determined on a seasonal basis wherein if the contractor has a need for a particular month or two, he or she hires the workers, and if they do not have any need during a particular month, they simply do not hire anyone.

4.4 Multiple Layers of Intermediaries

In addition, the informal economy is also characterized by multiple layers of intermediaries and middle persons wherein it is often difficult to trace the actual hirer of the workers. For instance, a construction site might have a contractor who subcontracts the work to a Mason. The Mason, in turn, might outsource the work to another intermediary whose job is to find the workers who are needed. This person might then contact the actual manager of the workers who can mobilize such workers from either his native place or through contacts with other labour providers. This maze of intermediaries means that the workers get a fraction of the wages that formal economy workers earn. As the various intermediaries take their cuts, eventually, the workers get a raw deal. This is also known as arbitrage of employment wherein intermediaries hire those workers who are cheaper from a particular place or from a subcontractor who can provide cheap labour and send them to sites where labour is expensive. The difference in the daily wages between these two places is what the arbitrage or the profit is for the eventual hirer.

4.5 Labour Pools are more Important than Individual Workers

As mentioned earlier, these aspects of the informal economy mean that labour is always on the move and has precarious employment that is seasonal in nature. Thus, this Precariat neither has a fixed place of residence nor do they have consistent work throughout the year. The economics of the human resources in the informal economy is such that individual workers matter less than the combined labour pool from which such workers are hired. Further, with no protections, the workers too flit from site to site as well as from contractor to contractor thereby having no identity documents or address proofs leading to them being included in any governmental schemes that are much more challenging.

4.6 The Gig Economy and the Future

Indeed, while all this is usually mentioned about physical work labourers, the emerging digital economy or the sharing or the gig economy might work on similar lines in the future. In other words, while these are early days for Uber drivers and Task Rabbit workers, in the future, they might too be in a situation akin to the daily wage labourers without any permanent benefits or the luxury of protections from the seasonal nature of their work.

4.7 Strategies to Overcome Labour Market Shortages

4.7.1 Labour Market Shortages in the International Context

Labour market shortages are created whenever there is a gap between demand and supply for some particular skills, job, role, or occupation. For instance, in the 1980s, there was a shortage of skilled workers in the Persian Gulf countries because of which the governments in those countries took steps to address the shortage by opening their doors to immigrants from other countries. Similarly, there was a shortage of IT (Information Technology) professionals in the United States in the 1990s and the last decade. The answer again was to pursue to an immigrant friendly policy and to encourage the large scale migration of IT workers from India and other countries to the United States and other Western countries.

4.7.2 Labour Market Shortages in the Domestic Context

While the above examples refer to labour shortages in the international context, there are instances where there such shortages have been met from the domestic labour pool. For instance, India has long suffered a chronic shortage in the jobs related to IT and other services sector despite having a sizeable graduate population which is among the world's largest labour pool. The reasons for the shortage of skilled workers in IT and other allied sectors was because many of the professionals were emigrating to the West and in addition, the domestic labour pool was unemployable in the sense that though the Technical institutions such as the Engineering colleges were churning out graduates in large numbers, many of them were simply unemployable meaning that despite having a degree, they did not have the skills necessary to work in the IT firms.

4.7.3 Strategies to Overcome Labour Market Shortages

The answer to this labours shortage in India was to expand the recruitment base by including non-Computer Science and IT graduates in the eligible pool of workers. For instance, many Indian IT firms resorted to recruiting graduates from all branches and then training them so that they have the required skills for the jobs. While this is a far from ideal situation and the solution was stopgap, it went a long way in addressing the chronic shortage of workers in the IT sector. Indeed, the numbers of graduates from other disciplines who were recruited into the IT firms was so huge that the joke, Trespassers will be recruited began to be identified with the Indian IT sector. The point to note here is that this is a simple demand and supply equation wherein whenever there is excess demand, companies tend to look for all available alternatives to address the demand.

4.7.4 Temporary and Permanent Labour Market Shortages

Labour market shortages can be temporary or permanent. An example of a temporary shortage is the kind that was discussed about the Gulf region earlier wherein a shortage of skilled and semiskilled workers was addressed by bringing in guest workers for the shorter term. After the jobs were done, most of these workers had to return home or be replaced by other workers since those countries did not really want to have workers for the longer terms in the occupations that were hired for. Further, this model was extended to the whole world wherein temporary shortages for workers were met by simply bringing in workers from high population countries such as India, Philippines, and other Asian countries. The rationale for the continuous replacement of workers was that in sectors such as construction and heavy industry, there was always a demand and a churn which meant that workers were needed for shorter term durations.

On the other hand, longer term labour market shortages such as the ones experienced by the West and the United States in particular meant that their strategy was to create and nourish a pool of professionals in high skill and high value jobs such as IT for the longer term since these jobs created value as the professionals progressed. The economics of addressing labour shortages are indeed driven by purely commercial considerations as whenever there was a need for low skill and low value jobs, workers were brought in for the shorter term, and whenever there was a need to invest in social capital and build a workforce that added value with time, such professionals were accorded permanent residency and were paid handsomely so that all parties benefit.

4.7.5 Criticism of the Present Strategies

However, there has been much criticism about these strategies and especially the ones such as the Indian IT firms hiring non IT graduates to tide over the labour market shortage. For instance, the common refrain that is heard is that if all engineers work in IT, who will build the bridges and who will work in the manufacturing sector that is so crucial to the success of these countries. In addition, such strategies have also been criticized because they introduce distortions in the labour market wherein policies put in place by the governments to train engineers to work in industry fail because these engineers have been employed in the IT sector. In other words, addressing supply shortages in one sector can lead to problems for other sectors.

5.0 CONCLUSION

As can be seen from the preceding discussion, the Make or Buy decision dominates the economics of managerial decision making and the HR function is not immune to this. To understand how the Make or Buy decision impacts individuals as well, the decision to use public transport versus own vehicle, the decision to make food in the house versus ordering from outside, the decision to call a handyman to fix the plumbing, electricity, or to attend to other fixes, are all driven by the cost benefit analysis of whether it is cheaper to outsource versus make it oneself. Indeed, the fact that one can save time by outsourcing rather than fixing these issues ourselves means that the time saved can be put to more productive uses. In conclusion, the economics behind decision making is to maximize the returns from the decision whether it is something as simple as calling in the plumber or as complex as whether to outsource the organizational functions.

Thus, it would be fair to say that most HR decisions now are based on economic considerations alone and this is something that potential and current employees in any organization have to be cognizant of if they want to decide on their employment options. The economics of human resources in the informal economy are such that work is flexible and employment is fungible - meaning that nothing is permanent and the only imperatives are the need to cut costs and make profits in as short time as possible by all the stakeholders.

Therefore, the clear insight that we gain from the discussion so far is that unless all stakeholders come together and create longer term strategies to address labour market shortages, the end result would be that the labour market is going to be skewed in favour of one sector or the other. Moreover, the strategies discussed in this article would result in the semi-skilled and unskilled workers losing out in the longer term once the need for them is over. In conclusion, addressing labour market shortages is a vast topic and this article touched upon some salient aspects of the topic.

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