

Economists as Worldly Philosophers

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Yale University

Hitotsubashi University, March 11, 2014

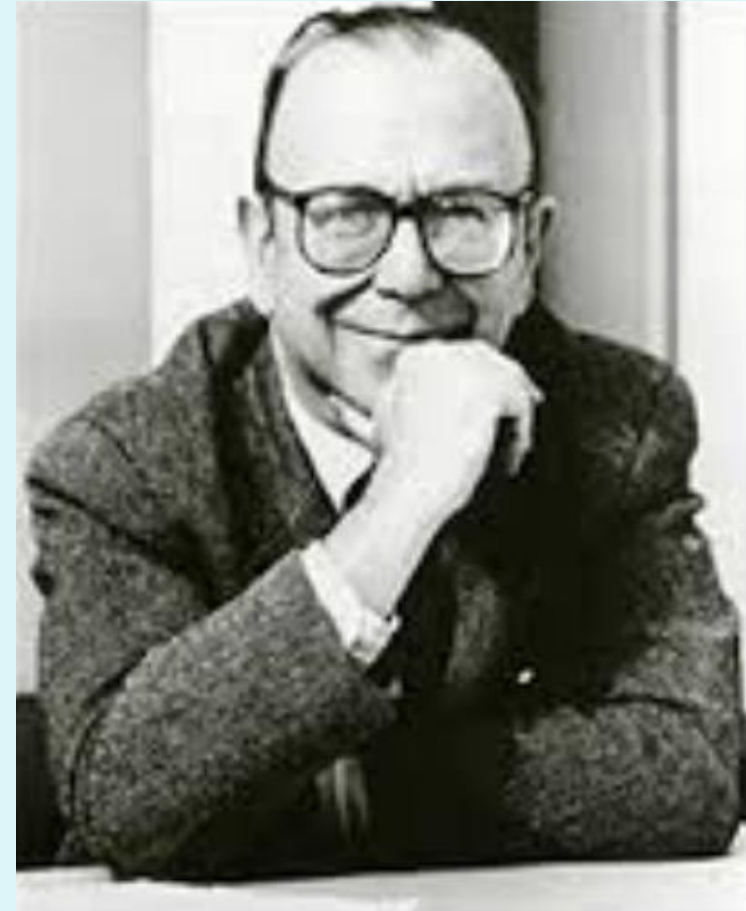
Virginia M. Shiller

- Married, 1976
- Ph.D. Clinical Psychology, University of Delaware 1984
- Intern, Cambridge Hospital, Harvard Medical School, 1980-1
- Clinical Instructor, Yale Child Study Center, since 2000
- Private practice with children, adults, and families



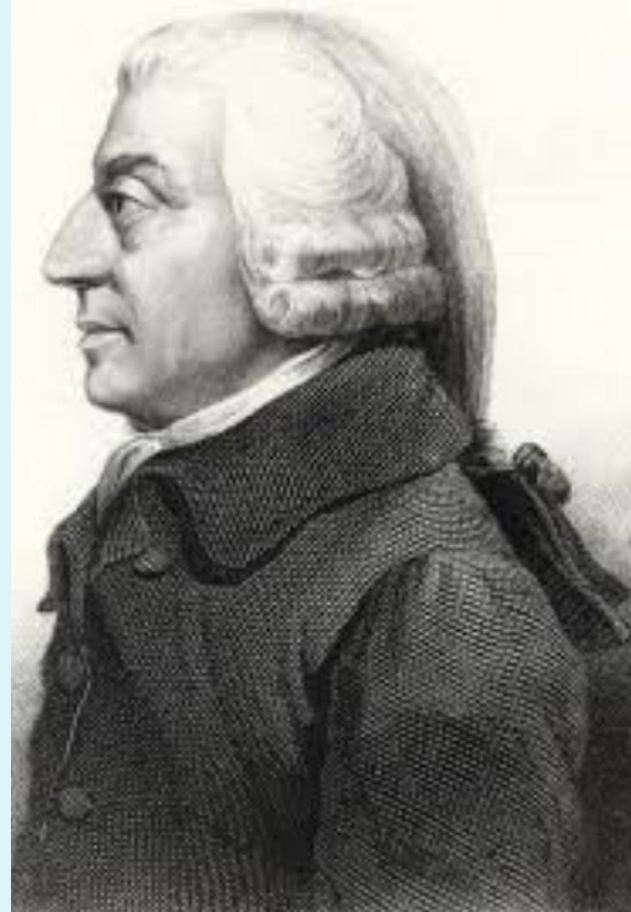
Robert Heilbroner 1919-2005

- His book *The Worldly Philosophers: Lives, Times and Ideas of the Great Economic Thinkers*, 1953, sold four million copies
- *Adam Smith, Henry George, Karl Marx, John Stewart Mill, John Maynard Keynes, Thomas Malthus*



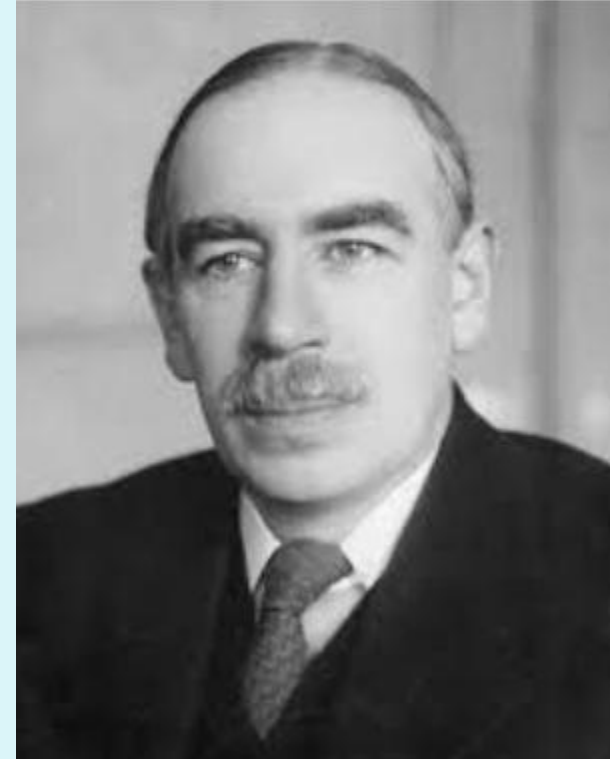
Example: Adam Smith

- *Theory of Moral Sentiments*, 1759
- *The Wealth of Nations*, 1776
- Did not shrink from moral judgments, e. g., frugality



Example: John Maynard Keynes

- *Economic Consequences of the Peace*
- *The General Theory of Employment, Interest and Money, 1936*

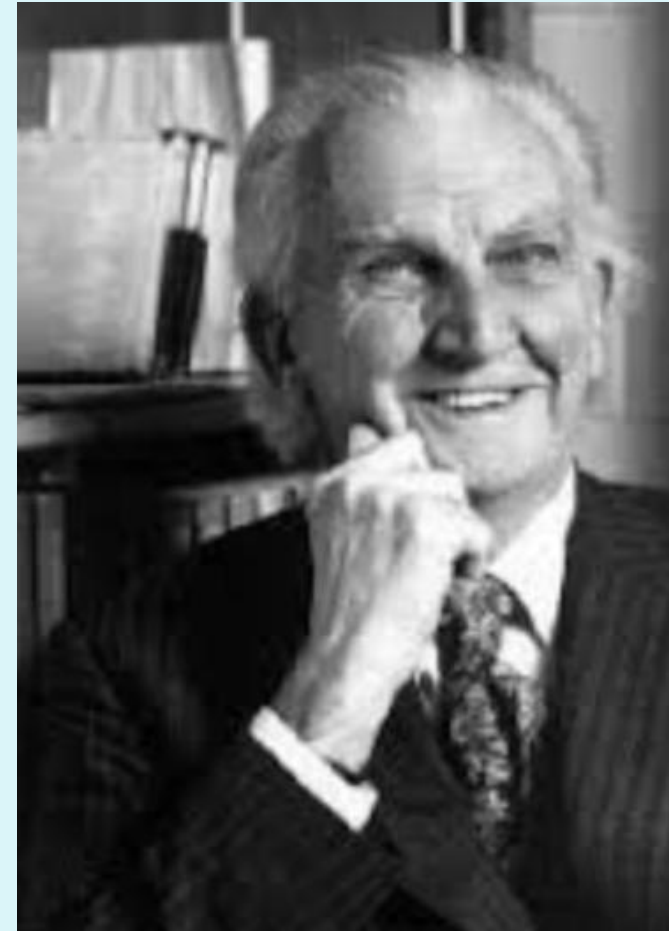


Economics as a Moral Science

- The kinds of questions economists are asked to opine on are inherently moral
- Moral calculus requires insights into the complexities of human behavior
- A plea for behavioral economics and a broader focus for economic research

Kenneth Boulding 1910-1993

- “We cannot escape the proposition that as science moves from pure knowledge toward control, that is, toward creating what it knows, what it creates becomes a problem of ethical choice, and will depend upon the common values of the societies in which the scientific culture is embedded, as well as of the scientific subculture.”



Boulding on the Theory that People Maximize Utility of their Own Consumption

- That there is neither malevolence nor benevolence anywhere in the system is demonstrably false.
- “Anything less descriptive of the human condition could hardly be imagined.” (from American Economics Association Presidential Address, 1968).

Specialization in Academia

- “Political economy has come to mean a group of sciences. Formerly, it was supposed that any person of ordinary intelligence could teach political economy . . . Now it requires a combination of specialists to present the results of the most recent researches in every department of economics.” *Baltimore Sun*, 1892.

John Muth and the Rational Expectations Revolution

- Coined term “rational expectations” in 1961. Later wrote:
- “It is a little surprising that serious alternatives to rational expectations have never really been proposed. My original paper was largely a reaction against very naïve expectations hypothesis juxtaposed with highly rational decision making and seems to have been widely misinterpreted. Two directions seem to be worth exploring: (1) explaining why “smoothing” rules work and their limitations, and (2) incorporating well-known cognitive biases in an expectations theory (Kahneman & Tversky). It is really incredible that too little has been done along these lines.”

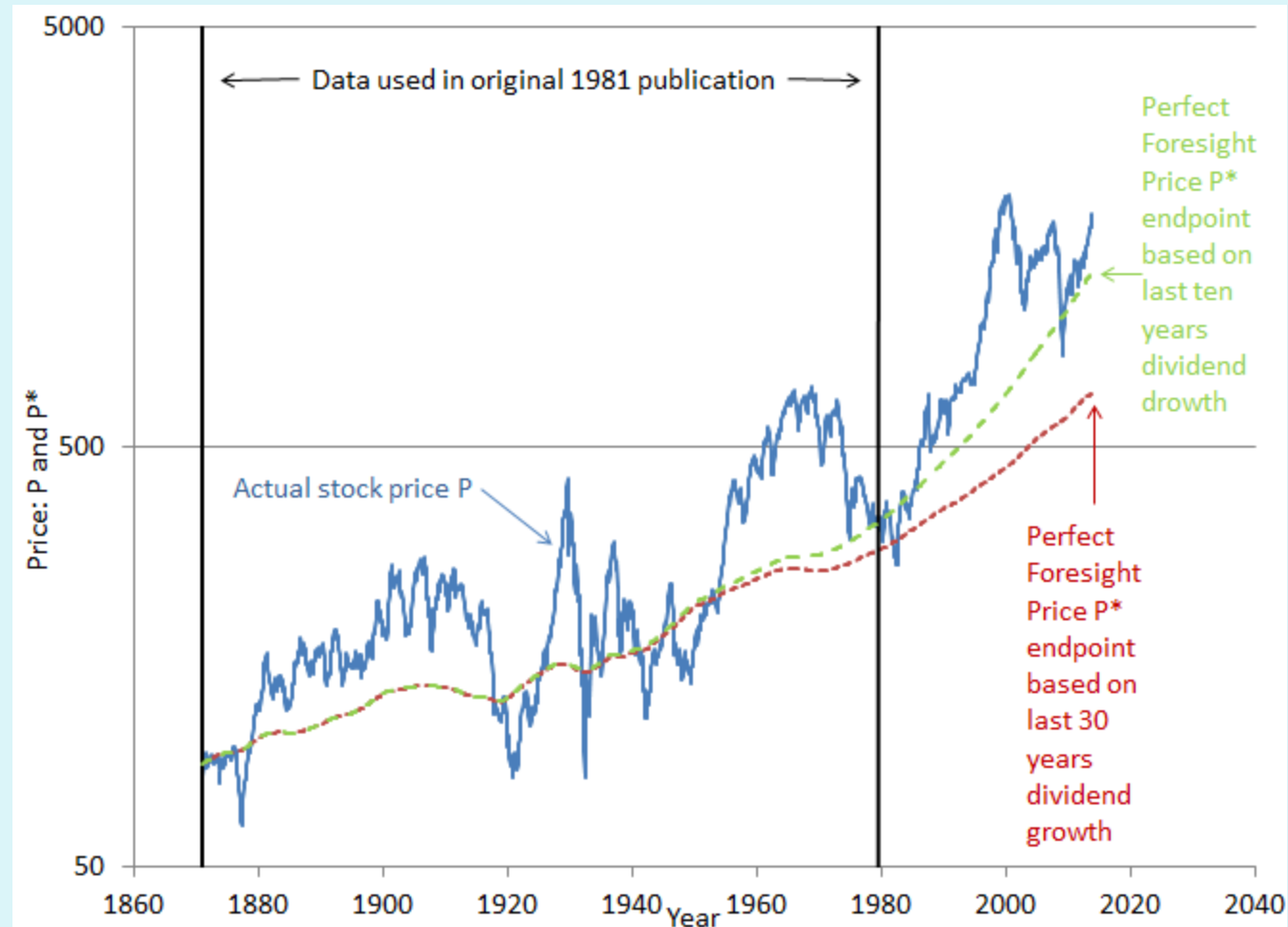
Other Rational Expectations Theorists Who Are Expressing Doubt about Extreme Models

- Christopher Sims “Implications of Rational Inattention”, 2002
- Thomas Sargent and Lars Peter Hansen *Robustness*, 2007
- Lars Peter Hansen Nobel Lecture, 2013

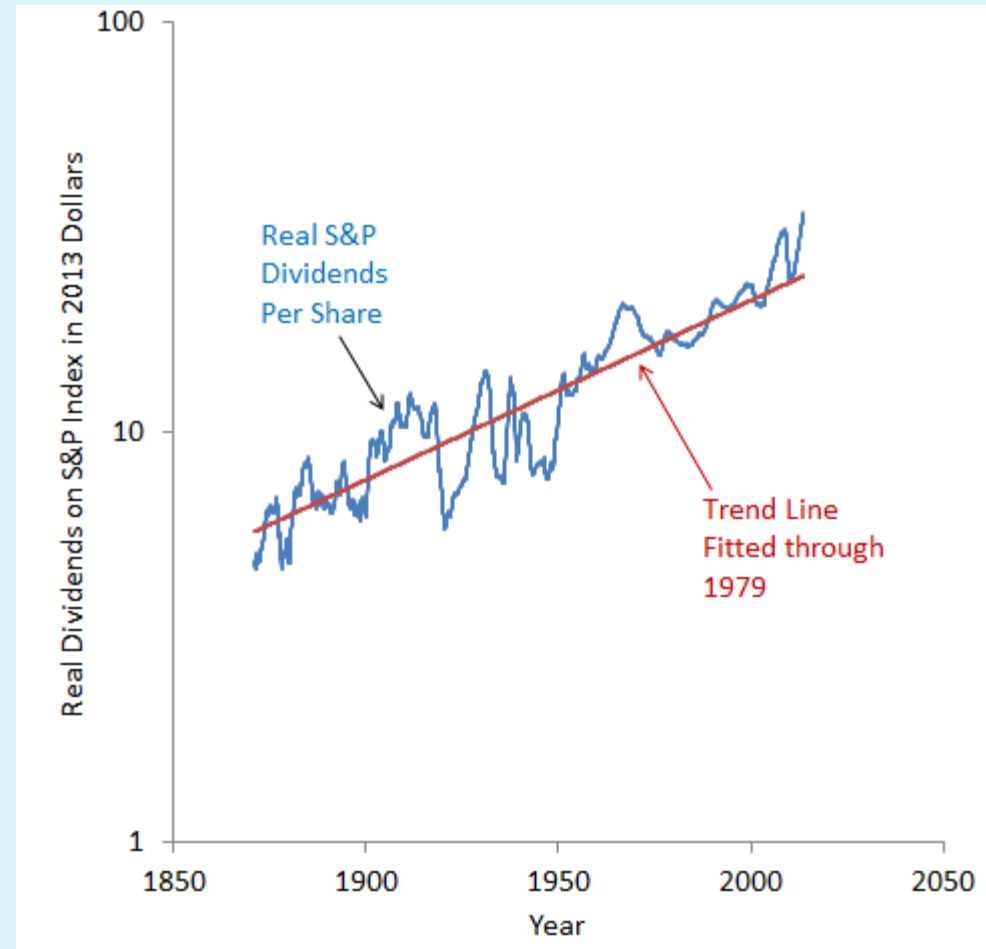
Real Stock Prices 1871-2013

Actual (Blue) and Ex-Post Rational (Red)

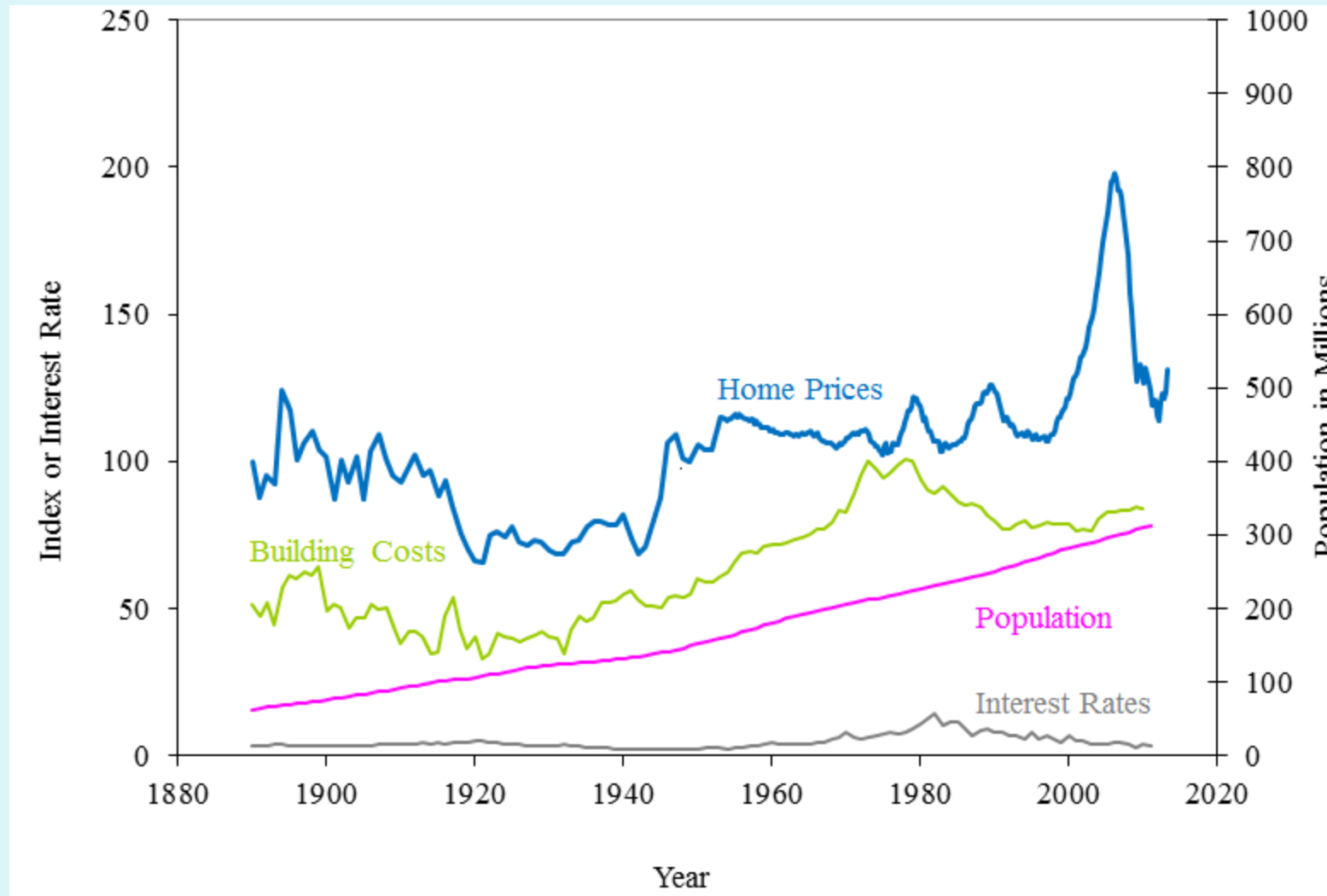
Based on Shiller (Am. Econ Rev. 1981)



Real S&P Composite Dividends Per Share 1871-2013



USA Real Home Prices and Housing Fundamentals 1890-2013

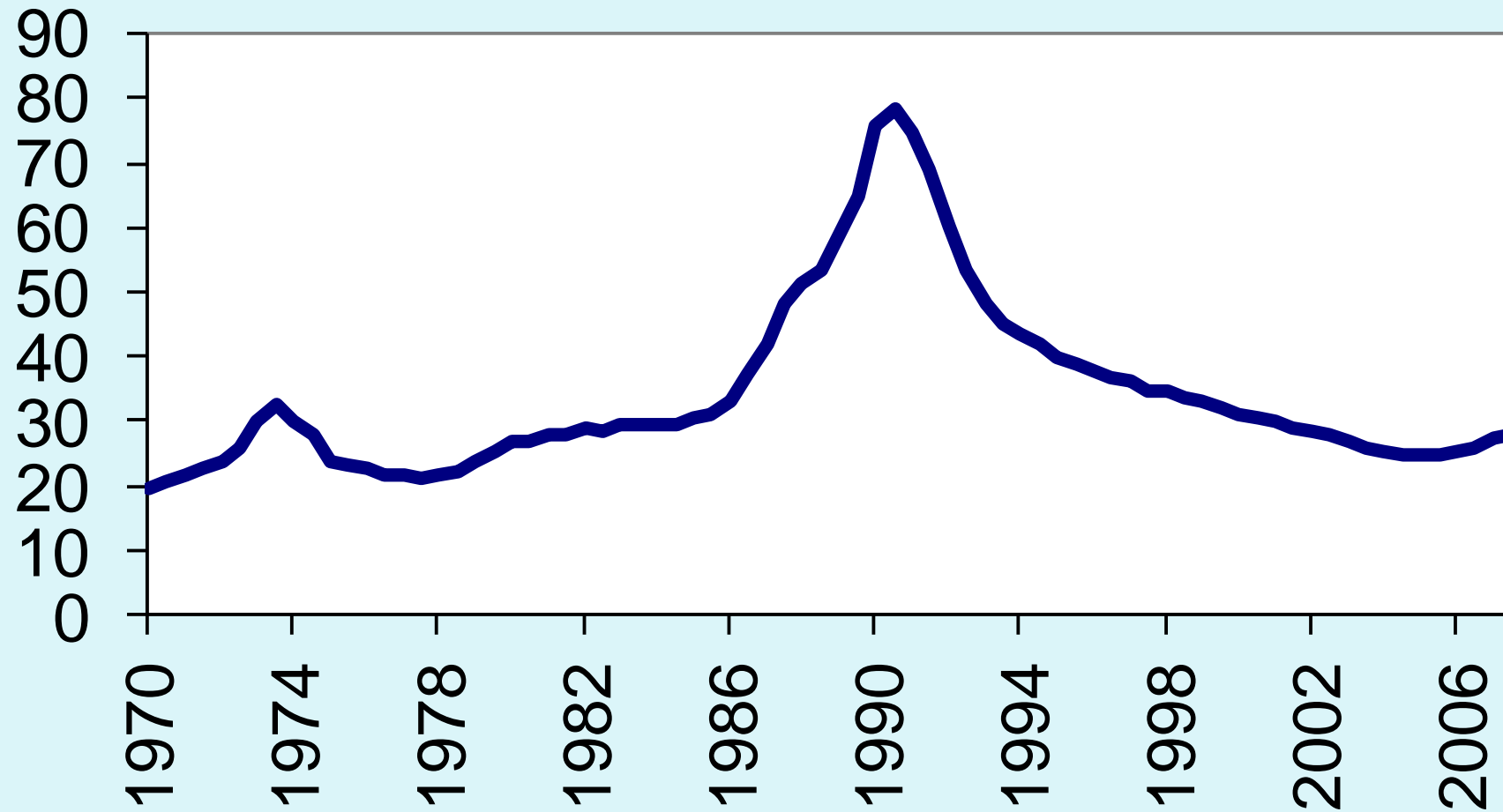


Stock Market Bubble in Japan in 1980s

Nikkei 225 Jan 1984-Jan 2009



Real Estate Bubble in Japan in 1980s: Real Urban Land Prices 1970-2008



The Behavioral Finance Revolution After 1990

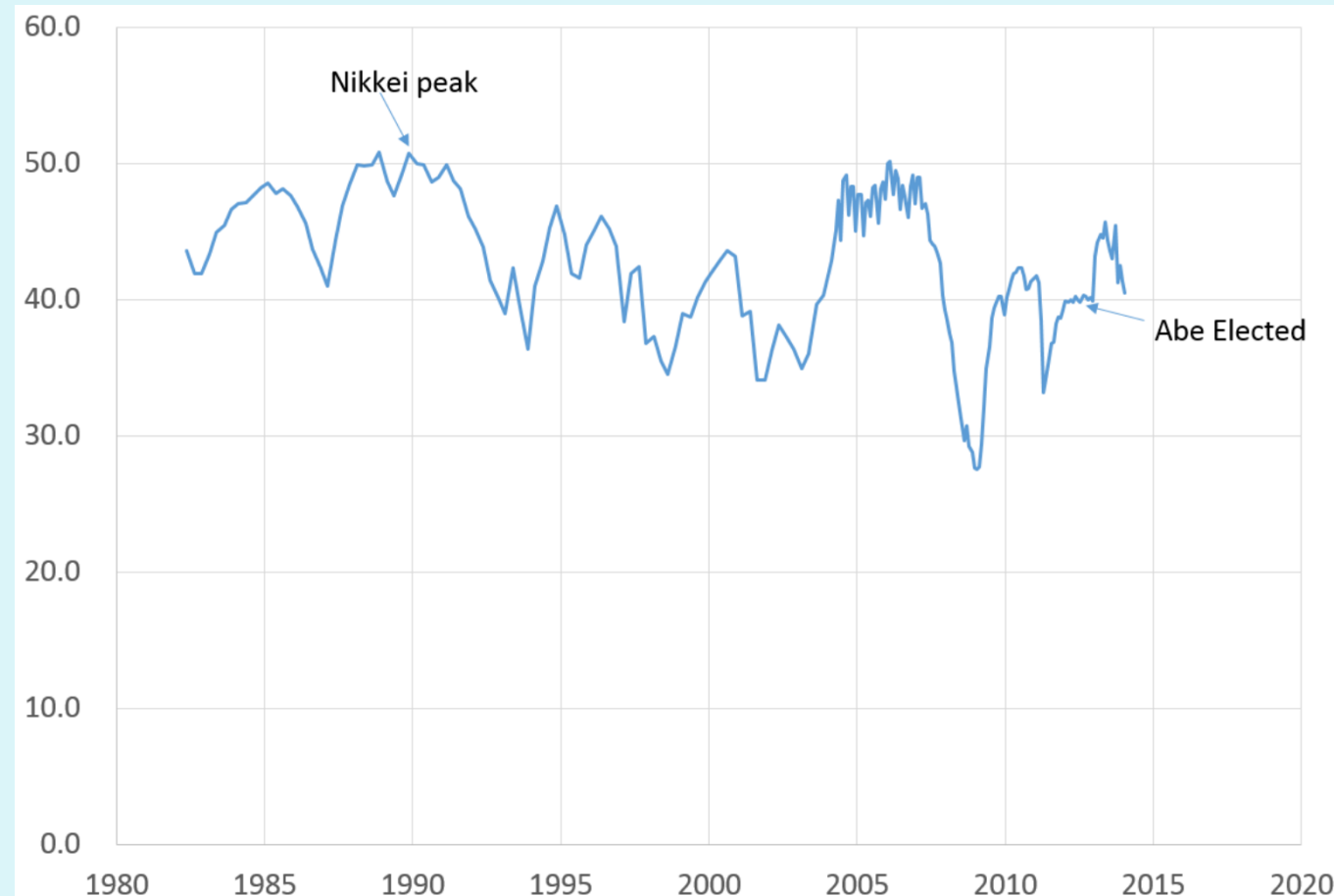
- Sociology: Collective consciousness Durkheim (1893), collective memory Halbwachs (1925)
- Social psychology: *Groupthink* , Janis (1971)
- Selective attention: William James 1890
- News media, Internet, as amplifier of social epidemics
- Even population biology, epidemiology, and neuroeconomics are coming into play

Abenomics and Worldly Philosophers

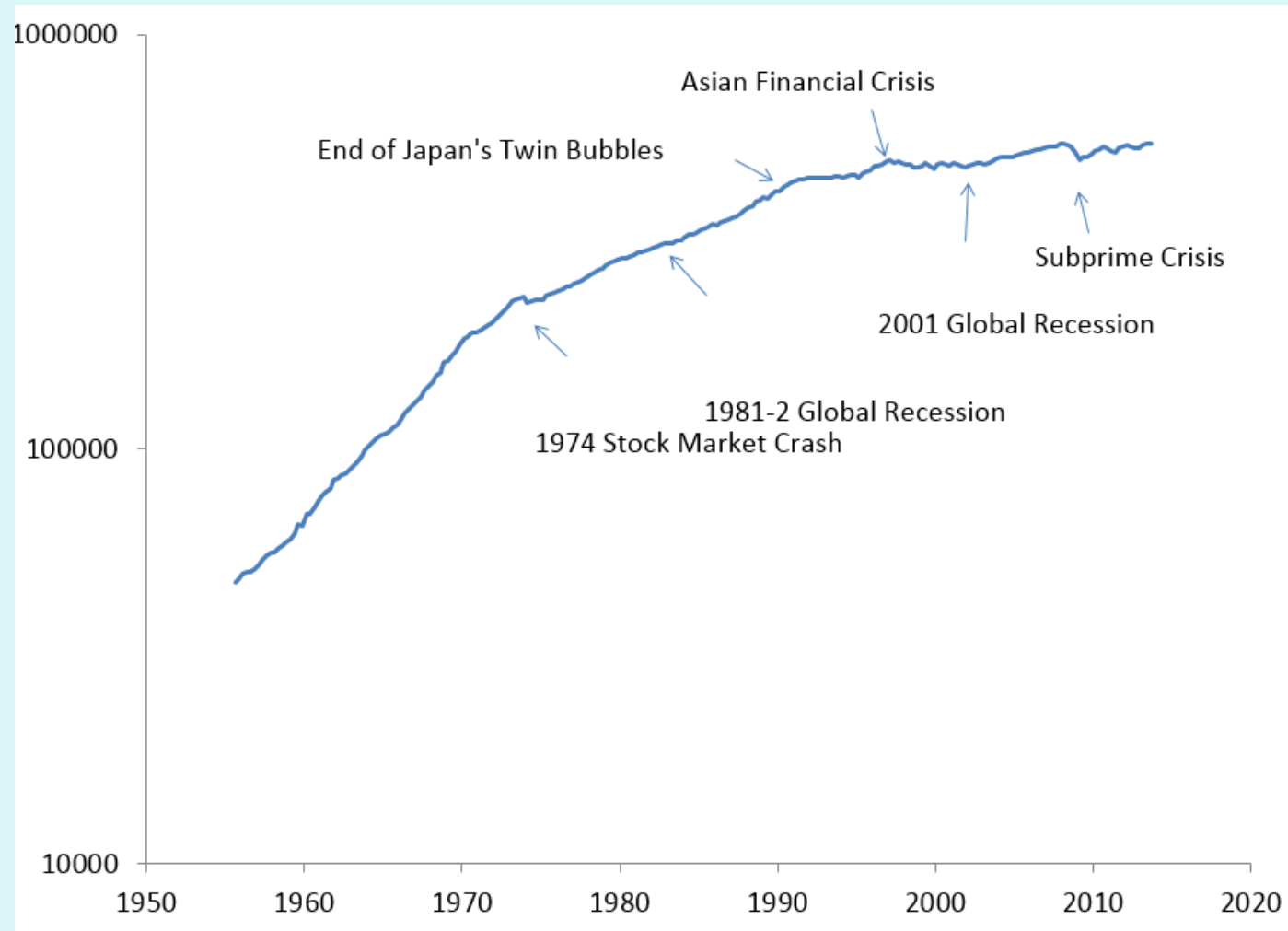
- Upon his 2012 election, a huge surge in Japanese confidence
- Surge was short lived
- Animal Spirits vs. Abenomics

Japanese Consumer Confidence Index 1982-2014

<http://www.esri.cao.go.jp/en/stat/shouhi/shouhi-e.html>

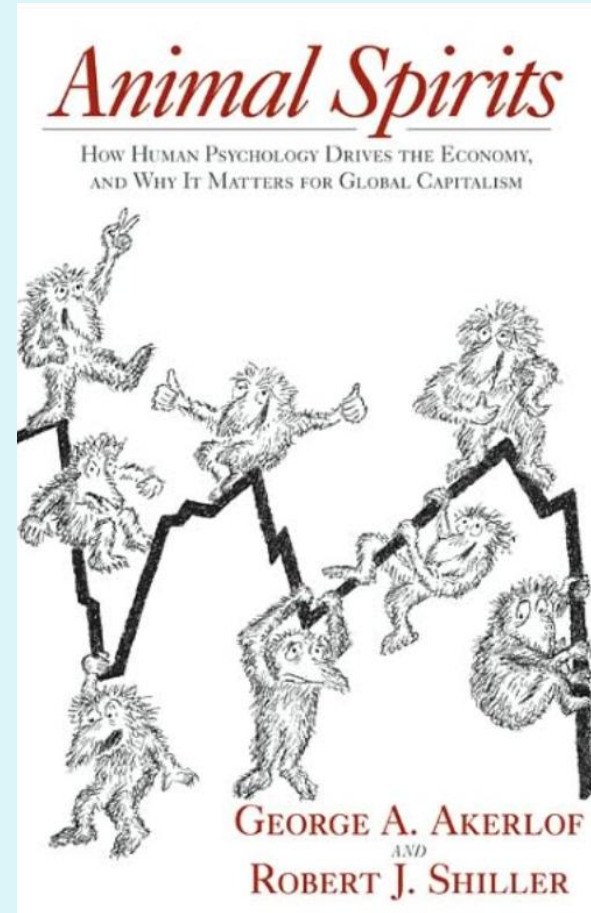


Japan Real GDP, Log Scale



Animal Spirits, Akerlof & Shiller, 2009

- Animal spirits involves more than just confidence
- Stories
- Identity



Milestones in Economic Thinking

- 1936: Keynesian Revolution was substantially a behavioral economics revolution
- 1970s: Rise of mathematical economics, efficient markets theory, rational expectations
- 1990s-2000s: Behavioral economics revolution
- 2010s: Neuroeconomics revolution
- The future: need a broad focus in economics, reflecting all aspects of human behavior, including moral and political impulses