Animal Spirits: How Human Psychology Drives the Economy and Why It Matters for Global Capitalism. By George A. Akerlof and Robert J. Shiller. Princeton University Press, 2009.

Published: *Economic Affairs* 30(3) (2010): 98–99.

It has been a while since I had such an awful time reading a popular book on economics – especially a book by economists of such intellectual calibre as George Akerlof and Robert Shiller.

Although I do not entirely share their political persuasions, I have a great admiration for both authors. Akerlof's famous 1974 article on asymmetric information was ingenuous in its ability to tease out powerful implication from simple assumptions and common sense (largely non-mathematical) logic. He has also written great articles on such topics as labour economics and the economics of divorce.

I also enjoyed Shiller's *Irrational Exuberance*, which – despite the title of the book – is an excellent analysis of the imperfections of investment markets. It is worth noting that in the concluding chapter of that work, Shiller does not advocate extensive government intervention, which he believes is unlikely to do much good to solve the problems he discovers, but instead argues for freer markets and the development of a wider range of investment instruments.

How come, then, am I so disappointed – annoyed, almost horrified – by *Animal Spirits*? The answer is that the book is a most unfortunate piece of popularized economics, which combines sound reasoning and good arguments with such anti-market rhetoric and pro-government policies as are, quite simply, not supported by the theoretical arguments.

First, let me mention the good things. The authors show that trust, fairness and morality are fundamental for economic relations. They also point out that most people are confused by price inflation and make choices because of it (although Akerlof and Shiller are rather slow to blame governments and central banks for inflationary monetary policies!). Finally, in an enlightening discussion they argue that powerful social narratives – impressions and stories of what is happening in the world – have a major bearing on the way people look at reality and make economic choices.

I could not agree more. I only wonder whether the authors are making too much of the supposed novelty of these points. This stuff may not be taught in Varian's *Intermediate Microeconomics*, but that should not be the only frame of reference on the state of the art.

What are the problems? Firstly, Akerlof and Shiller support an extreme version of Keynesian macroeconomics and policy, apparently based on the assumption that the recent crisis has unconditionally vindicated Keynes's theory – and that everyone else was just wrong. Judging by both the discussion and the references cited in the book, the authors seem blissfully unaware of the significance of the Austrian school theory of money, credit and business cycles, and how significant it has been for understanding (and, indeed, predicting!) the recent crisis.

This, what I believe is a mistake on the authors' part, might be assumed to be nothing but an innocent error. Yet there is reason to doubt that interpretation, for the second problem of the book is that many a poor argument is masked behind an aura of intellectual superiority and arrogance. Repeatedly, the authors claim, without proof, that no other (good) explanation has been given for this or that observation, including economic depressions, differences in savings rates and departures from the simplistic life-cycle hypothesis, unstability of stock-market prices, and poverty among ’minorities’ (i.e. Afro-Americans). As a matter of fact, several such explanations have been given and should be taken into account when assessing the explanatory power of the animal-spirits model proposed by Akerlof and Shiller.

The third flaw concerns terminology. Keynes’s famous term ‘animal spirits’ is at best a rather funny way of talking about commonsensical aspects of human nature – aspects which are perfectly compatible with a deeper notion of human *rationality*. In any case it is difficult to see in what sense *any* of the mentioned features of human conduct and attitude – the importance of morality, the confusion due to inflation, and power of narratives – could be classified as *animal* behaviour. Surely, they are specifically *human phenomena.*

At worst the expression is misleading and dangerous, because it produces (at least in the mind of the unreflective reader) the impression that, indeed, ‘people’ are irrational and ‘they’ (not I) need a strong, interventionist government to protect them from harming themselves. Unfortunately, such a conclusion is not a mere product of my paranoid imagination. Combining the three problems outlined earlier gives rise to the fundamental sentiment of the book, which can only be summarised as *hyper-paternalist*.

This sentiment is revealed most explicitly in Keynes’s idea (explicitly approved of by Akerlof and Shiller) that the government should view and treat its citizens in the same way as parents view and treat their children. One only wonders what effect (none?) the authors expect such a treatment to have on the moral and intellectual maturity of citizens.

The book was written at the right moment – or the wrong moment, depending on your point of view. It was right as the book really captures the anti-business, greedy-capitalist, hurrah-big-state mentality that is so popular today, when public authorities are looking for easy solutions and scapegoats. And, for that same reason, the book was written at the wrong moment.

Oskari Juurikkala, University of Helsinki