BOOK REVIEW

George A. Akerlof and Robert J. Shiller.

Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters for Global Capitalism. (Princeton: Princeton University Press, 2010, ISBN: 978-0-691-14592-1, 230pp., $16.95)

This book appeared against the backdrop of a near meltdown in the U.S. economy and the election of Barack Obama as President of the United States. Because candidate Obama championed stimulus spending to repair the economy, there was anticipation that the release of *Animal Spirits* would coincide with a renewed enthusiasm for the economics of John Maynard Keynes inside 1600 Pennsylvania Avenue.

More important than the timeliness of the book was the legacy that it leaves behind. This book helps us to understand as never before how macroeconomics really works.

The authors suggest that Keynes' animal spirits drive the economy, especially the troublesome fluctuations that free market economists have never been able to adequately explain. By "animal spirits" Keynes meant the restless and inconsistent elements in the economy, particularly how we relate to uncertainty or ambiguity. These are mental phenomena that are often irrational or non-logical, and beyond the interest of most economists. For this reason, animal spirits remained an unarticulated portion of Keynes' classic *General Theory of Employment, Interest and Money*.

As 2009 began, it was obvious that thirty years of a virtually unregulated free market economy had not resulted in great prosperity but had brought the U.S. and the world to the brink of financial disaster. Thus, some economists looked to an old hero in Keynes to right the ship. Social science, meanwhile, accumulated 75 years of knowledge since Keynes' *General Theory* to help us better interpret the animal spirits and how they guide the economy.

First and foremost among the animal spirits, according to the authors, is confidence in the economy. As they rightly note, such confidence is not gained through a highly rational process of feeding data into computers and assessing the results. More likely it is a gut check, a feeling, an instinct of some kind that the economy will go well. More than that, it is a deeply intuitive trust that the economy will prosper. These feelings, as the authors point out, are non-logical processes.

Second, the setting of wages and prices depend largely upon concerns about fairness, something that does not typically concern economists. Third, when the economy is going well there is a temptation toward corruption and anti-social behaviour. For too long, corruption has been treated as a rare event. The corrupt individuals are replaced and economic life moves on. But there has been too much corruption over the years and a broad range of legal instruments enacted to combat it. Why then, does it persist? It is because temptations toward corruption play a role in the daily operation of the macro economy. Fourth, money illusion occurs when the public is confused about things like inflation or deflation, and does not reason through its effects. Finally, our sense of reality of who we are and what we are doing is intertwined with the stories of our lives and the lives of others. These collective stories play an important role in the economy.

It stands to reason that any book that helps us understand the economy will also be able to provide relatively straight answers to essential questions about macroeconomics, and the book does not disappoint in this regard. Why do economies fall into depression? In the two most significant depressions in U.S. history, fundamental changes in confidence in the economy, the willingness to press pursuit of profit to antisocial limits, and changes in the perception of economic fairness were vitally important influences.

Much to Akerlof and Shiller's credit, they do not discard all previous understandings of economic theory to arrive at the answers they document. At a fundamental level of economic performance, free markets do work. It is the corrections or adjustments that have caused us the most pain, and we are now in better position to analyze the active features of these adjustments because of animal spirits.

As everyone now knows, history interceded to ruin the authors' dream of becoming trusted advisors to the new President. Voter backlash against the growing federal deficit lead to Democrats being shellacked in the 2010 elections and the President beating a hasty retreat toward neo-liberal policies of his predecessors. As a result, America may be in line for a much longer recovery than originally planned due to the abandonment of Keynesian economics in mid-stream of Obama's first term. This matters little in the end, because the legacy of this book as a restarting of the conversation about how capitalistic economies really work is one that will last far beyond the Obama Administration and several successors.

The future is bright for the field of behavioural economics. As behavioural economists get to know the animal spirits better, we will gain a more nuanced comprehension of how the animal spirits direct the economy. This book is not just a renewal of a conversation but the beginning of a research agenda. There is an immense potential for interdisciplinary work between behavioural economists, psychologists, sociologists, social psychologists, and criminologists that could be beneficial to all parties. An alliance between behavioural economics and sociology, for example, could lend sociology a much needed sense of legitimacy. In return, sociology could assist behavioural economics to better understand those episodes of overconfidence – manias - as well as the panics which signify the bursting of the bubble. Such an examination might result in critical questions being asked of business leaders earlier in the game as the bubble is growing. Painful though the questions might be, asking them could lead investors away from a ruinous downfall. The authors probably know that with these kinds of inquiries, economics could renew its reputation as the dismal science. Even so, the economics they portray is energetically infused with human qualities. Whether economics can be a human science is the debate that lies ahead.

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