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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.
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Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters for Global Capitalism provides an interesting and timely critique of traditional economic theory and discusses applications of behavioural economics to various economics crises, including the current US economic crisis. In the first part of the book, Akerlof and Shiller describe animal spirits as 'noneconomic motivations' comprised of aspects of confidence, fairness, corruption, money illusion, and 'stories we tell ourselves,' and outline why the presence of these behaviours leads to failures in market capitalism. They contend that, because human behavior is influenced by animal spirits, humans do not behave rationally; therefore, economic theories fail to predict human behavior accurately. The second part of the book illustrates how these irrational animal spirits affect economic decisions by answering eight questions that deal with various economic failures.

Animal Spirits is provocative. The authors provide clear explanations and extensive documentation so that a general audience with an interest in economics can stay engaged. Given current levels of economic upheaval, this book should find wide appeal. The evidence that human psychology drives the economy is persuasive and provides the reader with a different perspective on the economic crises of our day. The authors provide a broader view of economics than the 'cold economic calculus that economists think should be at the root of all economic behavior' (p. 104). This book is important and useful in understanding some of the limitations of the economic theory of rational expectations. Incorporating animal spirits into macroeconomic theory is an improvement because it provides a more realistic depiction of our world.

As they outline flaws in widely accepted economic theories, it could seem that the authors are arguing against capitalism. However, they make it clear in the book that they are against unfettered capitalism. Like John Maynard Keynes, they recommend government involvement in the economy. Specifically, they state that government should 'set the conditions in which our animal spirits can be harnessed creatively to serve the greater good' (p. 173).

The book challenges economists to extend analysis to include more realistic assumptions about human behaviour. While the recommendation is valid, the book fails to provide enough detail explaining how to account for animal spirits in modelling human behaviour, and, therefore, how to improve decision making. While it is worthwhile to explain behaviours that cause traditional economic theories to fail, it is important to incorporate the variables into models in order to improve predictive ability and lead to better decisions and policies. However, because animal spirits are not easily categorised or measured and are complex and interactive variables, the effects are often not clearly observable until hindsight. This could make it impossible to include them in traditional mathematical models. The challenge then is figuring out how to include animal spirits in decision-making models, and this requires an interdisciplinary approach. The reader is left questioning how this might be done.

Akerlof and Shiller state explicitly that they do not provide detailed answers to specific questions about dealing with today's economic crises. Instead, they call for an understanding of animal spirits and a realisation that markets require government involvement in order to prevent such crises from happening again. This book provides 'the background story' from which policy makers need to move forward. While it seems clear that government involvement is required, it is also important to keep in mind that government committees and commissions are also made up people who possess these animal spirits. This aspect of animal spirits should be included when constructing new models of decision making, and this was left out of their discussion.

Animal Spirits is a good book to use in a senior-level, undergraduate economics course where students already have a strong background in traditional economic theory because it takes the reader beyond that level to a more realistic look at the world around us. Students would be required to extend their understanding of economics by incorporating elements of psychology and sociology. Interestingly, such a class might not help prepare the economics majors for a standard economics programme in graduate school, but it might help prepare them for jobs in government and public administration. This book would also be useful for an interdisciplinary, upper-level seminar course where students in economics, psychology and sociology discuss strengths and weaknesses of analysing current economic and social problems from each of those perspectives.

An interdisciplinary focus like that provided by Akerlof and Shiller enriches one's understanding of society's problems. The book should be read by anyone who seeks a clearer understanding of human behaviour and how it affects the economy. Perhaps more people would find the study of economics interesting if the theories were based on more realistic assumptions. If this also leads to more accurate predictions from economic analyses, it would be invaluable in terms of preventing future economic crises.

Reviewed by

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