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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, 230pages, £14.95

'Animal Spirits' presents a rigorous case for the importance of 'confidence multipliers' and 'stories' in explaining recent market behaviour and of 'fairness' and 'money illusion' in preventing wages from falling in recessions to the market-clearing rate. Written in an accessible style, the book provides a very useful practical primer for policy-makers, practitioners and academics on many aspects of the current crisis. The authors also make a compelling theoretical case for macroeconomists taking more account of the role of non-economic motives and irrational responses.

There are many particular insights: for example, that the fateful switch in 2000-2007 from equities to investment in real estate (and credit) was partly caused by loss of faith in corporate accounting following the Enron scandal; while the depression of the 1930s was partly so protracted because companies feared to invest, given uncertainty about the political reactions of government to public disgust with capitalism.

There are also a few lacunae in the argument. In particular, the authors are unfair to Adam Smith's model, ignoring his emphasis in 'The Wealth of Nations' on sentiments such as fear and unease. Smith was much more concerned about the dangers of the visible hand of government causing debilitating fear and unease among entrepreneurs than he was eloquent about the optimality of the invisible hand of the free-market; and this lesson needs to be remembered. For Akerlof and Shiller, the destabilising nature of 'animal spirits' justifies government intervention; but, as Smith reminds us, if this intervention is seen as arbitrary and unpredictable, it may be self-defeating and undermine the confidence of savers and investors alike. Furthermore, Smith assumed that powerful moral sentiments underpin market interaction; and these good sentiments (like sympathy and trust) perhaps receive insufficient attention in 'Animal Spirits', despite the authors' emphasis on loyalty and a sense of fairness.

I have a couple of other quibbles with this excellent book. First, it seems odd to lump together confidence effects, a sense of fairness, corruption and anti-social behaviour, money illusion and cultural stories under the catch-all rubric of 'animal spirits'. Some are basic emotions, some moral (or immoral) sentiments, and others social or cultural frames of reference. This is not merely a semantic point: the differences between these disparate exceptions to economic rationality suggest differences in where we should look for answers - in psychology, applied ethics, or sociology.

Secondly, Akerlof and Shiller make a ringing call for macro-economic theory to take animal spirits seriously. But there are two ways of doing this: one is to co-opt into standard models the findings of psychology and sociology where they suggest systematic regularities (the option favoured by the authors); the other is to make clearer the boundaries of applicability of standard economic models and the need to supplement them with models from other disciplines when dealing with many facets of the economy. Which route economics takes matters. It is possible that disciplined cooperation between pure paradigms from different disciplines might be more fruitful in the end than continual re-engineering of the standard paradigm in economics.

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