How Risk Shapes States and Markets

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A Course in Four Sessions

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Much of our political discourse revolves around projecting and responding to emotional signals to shape how we choose to be governed in a democratic society. Complex issues often are reduced to simple phrases and slogans in an effort to guide public opinion and governmental action. At the same time, since public intervention in the economy involves taxation, borrowing, and spending involving scarce resources, there is a need for a rational framework in making public decisions that does not revolve around emotional manipulation.

Economists like to think they have a way to address questions of how government intervention can work to the greater good either by a reduction in scope in some areas or an expansion in others. Yet the grammar of politics and economics is so varied as to seem almost intelligible one from another. Economists use carefully crafted models to replicate an underlying theory of rational behavior as a standard from which public decisions can be made. Because economic models so often rely on a formalistic and formulaic approach to how decisions are made, there often is a gap between the insights that economic analysis can provide and the emotional langage that so often shapes our political discourse.

Nowhere is this gap more critical than when it comes to our attitudes toward risk. These attitudes are complex and far from uniform across the population, and how they play out in our discourse on public policy can often confound the claims of rationality put forth in economic theories and models.

What we now have is a possible solution as to how we frame our public choices on which economic decisions are based. For some time, economists have turned to the insights from social psychology to reframe our approach to theories, models, and public guidance. Out of this process we have seen the emergence of behavioral economics and behavioral finance. Thus far, these evolving disciplines have enriched the tapestry of economic theory, but we are not yet at a point where we can overcome the gap that exists between the emotional discourse of politics and what risk-informed economic analysis can accomplish. In this course, we will examine these themes and point to how in the process we may craft a different narrative concerning the economic functions of government that transcends traditional modes of reference. In so doing, we may move beyond what many consider to be the poverty of politics as opposed to the politics of poverty.

We take up our approach to states and markets in the presence of risk in four sessions. We list them below in terms of topics and references to be covered.

Session One – Standards Models of Economic Analysis and Political Science

1. Economics as an academic discipline of the Social Sciences – Orthodoxy vs. heterodoxy in standard textbook treatments as dependent on underlying assumptions about rationality in human decisions. Assumptions of rationality in institutional decisions – competition vs. imperfect competition defined in relation to the principle of economic efficiency. David Ricardo (1772-1823), Alfred Marshall (1842-1924),
2. Defending economic theory and normative models through expanded assertions of the scientific method – Minimization of normative value judgments from the framework of rational economic decision-making. Adam Smith (1723-1790), John Stuart Mill (1806-1873), Karl Marx (1818-1883), Vilfredo Pareto (1848-1923), Léon Walras (1834-1910), Abram Bergson (1914-2003), Paul Samuelson (1915-2009), Kenneth Arrow (1921-), Gérard Debreu (1921- 2004), Milton Friedman (1912-2006).

3. Political discourse often revolves around emotional appeals to underlying principles of freedom, liberty, and justice in fulfilling human potential. Economic and social costs are essentially excluded from political discourse as debates on these values play out in decisions on the size and functions of government. Nicolo Macchiavelli (1469-1527), John Winthrop (1587-1649), Thomas Hobbes (1588-1679), John Locke (1632-1704), Montesquieu, Charles-Louis (1689-1755), Thomas Jefferson (1743-1826), Patrick Henry (1736-1799), Judith Sargent Murray (1751-1820), Abigail Adams (1744-1818), Sojourner Truth (1797-1883), Abraham Lincoln (1809-1865), Frederick Douglas (1818-1895), Theodore Roosevelt (1858-1919), Franklin D. Roosevelt (1882-1945), Martin Luther King, Jr. (1929-1968), Barry Goldwater (1909-1998), John F. Kennedy (1917-1963), Ronald Reagan (1911-2004), Michael Walzer (1935-), Ron Paul (1935-), Barack Obama (1961-), Hillary Clinton (1949-), Bernie Sanders (1941-), Donald Trump (1946-).

Session Two – Insights from Psychology Inform Our Attitudes Toward Risk.

1. Rational economic decisions under risk – Allowing for risk to enter in economic decisions does not in and of itself eliminate the notion of rational decision-making, and is grounded in the notions of expected utility and expected profit maximization. Daniel Bernoulli (1700-1782), John Von Neumann (1903-1957) and Oskar Morgenstern (1902-1977), Howard Raiffa (1924-2016), Joseph A. Schumpeter (1883-1950), John B. Taylor (1946-).
2. Insights from experimental psychology reveal underlying traits of human decisions that reveal the role of emotions in shaping how individuals and groups arrive at an underlying assumption of rationality, but in fact reveal inconsistencies in human decisions. Malcolm Gladwell (1953-), Dan Ariely (1967-), James Surowiecki (1967-), Michael Lewis (1960-), Michael Shermer (1954-), Shankar Vedantam (1969-), Nicolas Nassim Taleb (1960-), Richard Herrnstein (1934-1994), Amos Tversky (1937-1996), Daniel Kahneman (1934-), David Brooks (1961-).
3. Decision tools to manage risk in the context of rational behavior – Louis Bachelier (1870-1946), Fisher Black (1938-1995), Myron Scholes (1941-), Robert Merton (1944-), Don Ross (1962-), Nick Wilkinson ( ), Edward Cartwright ( ).

Session Three – Market Failure and Government Failure in Standard Paradigms

1. Market Failure and the economic functions of the public sector. Robert Kuttner (1943-), Francis M. Bator (1925-), Arthur Cecil Pigou (1877-1959),
2. Government Failure, Public Choice, and the economic functions of states and markets. Condorcet, Marie Jean, Marquis (1743-1794), Borda, Jean-Charles (1733-1799), Anthony Downs (1930-), Kenneth J. Arrow (1921-), Duncan Black (1908-1991), Mancur Olson (1932-1998), James Buchanan (1919-2013), Gordon Tullock (1922-2014), Bryan Caplan (1971-), Anne Krueger (1934-), Elinor Orstrom (1933-2012).

Session Four – Reshaping the Public Discourse through Behavioral Economics and Finance

1. Political legitimacy remains a core consideration in any treatment of government intervention in the economy. Behavioral economics and finance may provide a foundation for a reconstitution of political legitimacy
2. What key elements and rules can help decide on the optimal size of government in the presence of variable attitudes toward risk? Rationality reconsidered in the context of political economy.
3. Economic functions of the public sector in the presence of risk. Robert J. Shiller (1946-), Maurice Godelier (1934-), Amitai Etzioni (1929-), Cass Sunstein (1954-), Thomas Piketty (1971-), Anthony B. Atkinson (1944-2017), Philippe Aghion (1956-).