PROPOSAL: RESEARCH ON BEHAVIORAL MACROECONOMICS

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I want to continue a line of research this summer that I have been working on for some years on the topic of behavioral macroeconomics, that is, on the impact of human psychology on the aggregate economy.

A central issue is consumer confidence or investor confidence. Confidence is a state of mind or perception of the economy defined by positive expectations of economic success, and leads people to take actions that might lead to a higher level of economic activity as measured by macroeconomic aggregates. If people lack confidence, then they may not take any steps to improve their economic lives because they believe they will be doomed to failure. Economic booms and recessions *seem* to be related to changing confidence, but confidence is not now a central construct for macroeconomics.

Many people believe that changes in the level of confidence are profoundly important for the success of an economy, but the economics profession has not been convinced. The level of confidence is many-faceted, difficult to describe in the simple terms that the producers of indexes of consumer or business confidence often imply. There are various statistical attempts to measure confidence, and I have been doing survey questionnaire work over the years, but have not had adequate time to study the results and tie them in with other results. The results need also to be tied into literature on social psychology or sociology.

Related to the issue of confidence is the issue of identity and self esteem. People appear to fear economic contraction largely because it can derail their personal careers, and their sense of being a valued person and a contributing member of society. There is a large psychological literature on self esteem, which I would like somehow to tie into macroeconomic theory. I need someone to read about these things and think about them with me.

Asset markets, such as the stock market or the housing market, have large movements that appear to be tied up with changes in psychology. The current (or should one say recent) housing price boom is a clear example. This boom, well underway when the post-stock-market bust recession of 2001 began, seems to account for the mildness and short duration of that recession. The housing boom seems to have been a largely psychological phenomenon. And yet conventional macroeconomic theory does not take account of this psychology. I want someone to help me assess the qualitative evidence on this point, moving beyond the kind of evidence that is easily quantified, as by compiling survey evidence or by reading contemporary accounts of past recessions, and discussing them with me.

My intention is to have weekly scheduled appointments with just the ROME student and me, to discuss such issues, and between these meetings the student will research the issues that arise at each meeting.