
BOOK REVIEWS



Mark Kritzman, Senior Editor

“FINANCE AND THE GOOD SOCIETY”

By Robert J. Shiller, Princeton University Press, 2012

(Reviewed by Bruce Grantier for Journal of Investment Management)

Robert J. Shiller is the Arthur M. Okun Professor of Economics at the Cowles Foundation for Research in Economics and professor of finance at the International Center for Finance, Yale University where he has taught for 25 years.¹ He is also a research associate at the National Bureau of Economic Research and serves on various committees in an advisory capacity related to the futures index he cofounded—the S&P 500/Case–Shiller National Home Price Index. He has written several books including the very popular “Irrational Exuberance” and is

famous for his early recognition of the US housing bubble, in which his orientation to behavioral economics contributed to his insights. I am fortunate to have heard him speak on a number of occasions and found him—as I hope the reader will agree from this book—a very broad-minded, insightful, and innovative economist.

On the cover, the book gets accolades from noted economists at Harvard, Stanford, Technion—Israel Institute of Technology, and London School of economics. These convey an accurate summary of Shiller’s contribution: steeped in understanding of history, highly relevant to finance and society, not afraid to uncover the controversial topics, and—a bonus—“a feast of ideas and facts... not just interesting but entertaining.”

In this review I propose to outline the central theme which runs throughout “Finance and the Good Society” and then illustrate the scope of the book by discussing a number of chapters, which to me, were the most interesting, insightful, and although sometimes controversial, appear to have the greatest impact on society. The book has 18 chapters devoted to “roles and responsibilities in finance” (e.g., CEOs, investment bankers, traders, financial engineers, regulators, and philanthropists). These are followed by 12 chapters on “finance and its discontents” (e.g., risk taking, debt and leverage, speculation, sleaziness, and ownership of capital).

Central theme

The central theme of this book was inspired by Shiller’s many years of teaching finance,

combined with the desire to help his students understand the financial system in our society, a field in which they are considering devoting their careers. In short, the book is about whether financial capitalism is leading society in the right direction, not just in our lifetimes but the lifetimes of our children. The book's definitions in the Introduction greatly illuminate the discussion. Here Shiller's knowledge of history and etymology comes to the fore. "Finance", commonly thought of as the science and practice of wealth management, has origins generally associated with completion as in Latin "*finis*". Historically, completion of contracts was a process which originally included reviewing what *goals* had been met. Throughout the book, the "architecture of goals" (i.e., the means for meeting goals) in finance reappears. The term "good society" has long been used by philosophers, historians, and economists to describe that society to which we aspire, one which is egalitarian, respectful, and appreciative to all members. The term "financial capitalism", which emerged in the 1930s in USA with the formation of large financial institutions, is the concept that finance, originally accompanying capitalism, evolved into the engine driving capitalism. This evolution accompanied

the global spread of capitalism, eclipsing communism in the process, and is still rapidly changing through the expanding scope of markets, innovation, and information technology. The concept of financial capitalism in Shiller's book is key; as he says, it provides a working theory to help guide the discussion of finance and the good society.

Roles and responsibilities in finance

I imagine this part was intended to give Shiller's students a prospective on his views. I picked several to briefly review—the ones I liked best: good insights and valuable conclusions. Despite the Enron and Madoff experiences, the many roles of financial leadership in society (whether in small businesses, school systems, cities, corporations) are critical as those who fulfil these roles are the stewards of society's assets, entrusted with management and cultivation thereof.

CEOs are a unique group, bringing their own ideas or incenting others to do so, setting goals, values, and culture for the organization, and ultimately taking responsibility for the results. The chapter includes good discussions on various forward-looking issues including succession, incentives, and others.

The discussion of roles goes on to include investment managers, bankers, investment bankers, mortgage lenders, and traders (all quite good), but the chapter on market designers and financial engineers was especially interesting. Shiller gives the example of Harvard Professor Alvin Roth (and recent Nobel Laureate with Lloyd Shapley) who designed a more efficient market system for kidney transplants and in doing so greatly improved the supply to needy patients. Shiller cites another example of pairing mates—a theoretically complex and intimate challenge. He concludes that this type of modeling can and should be undertaken by financial engineers to improve market efficiency.

A chapter on lobbyists, I thought, was a "must read"—quite revealing, disturbing, and indicative of serious need of reform. Unlike the CEO chapter which was inspirational and uplifting, this was the opposite. It includes a depressing discussion on the unbalanced power of lobbyists, a brief history of lobbyists and what activities have now become illegal, and reform of lobbying and lobbyists. The chapter (like the rest of the book) contains solutions and this one was on how lobbyists can benefit society. While their function is valid, it must

be more closely monitored and regulated.

Finance and its discontents

This part may have gotten its name from Sigmund Freud's book "Civilization and Its Discontents". Referring to this book, Shiller notes we cannot go forward without understanding our discontents—which in finance have mainly to do with human nature's drive to be not just aggressive but yearn for something more.

A chapter on the impulse for risk taking discusses people's desire to gamble and bet on lotteries, despite the mathematically poor odds. Shiller presents a very interesting outline on the growing field of neuroscience which deals with the biological stimuli to the brain resulting from financial risk and return experiences. To a large extent, these neurological influences are beyond our control and dealing with the problems they create requires both an understanding of the problem and the environment in which it occurs—i.e., in the case of finance, risk management.

There are two excellent chapters on financial speculation and bubbles which discuss and illustrate discontents further. While financial speculation

contributes to market efficiency, it is difficult to channel into positive or productive pursuits. Shiller readily admits there is no simple answer to this. Speculative bubbles have had severe costs to society going back thousands of years. Needless to say, on the topic of housing, Robert Shiller has certainly made a name for himself, with his knowledge and understanding of both history and behavioral science. The chapter reviews behavioral shortcomings which make us bubble prone plus discusses some wider topics such as non-financial bubbles, wars and bubbles, and the significance of bubbles. His conclusions include bubbles are frequent, regulation is difficult, and recognition is probably the best solution.

The dispersal of ownership of capital is key in the history of financial capitalism. Shiller reviews a number of landmark steps in the evolution of dispersal of ownership of capital namely historic land reform, home ownership in UK and USA (including incentives under Roosevelt's New Deal) and recently even China, investment portfolio ownership, and employee business ownership. Shiller concludes that in the future we need to be vigilant to prevent the concentration of economic power

and continue to work to disperse ownership of capital even further.

The final chapter in the book, and this part on finance and discontents, has to do with the "great illusion"—then and now. The historic "great illusion" Shiller refers to was that identified by British MP, Norman Angell in 1910. He correctly refuted the illusion that military conquest brings prosperity and well-being, despite universal acceptance of this theory at the time. Angell's vindication was not long in coming as the ultimate proof was quickly borne out in World War I. Shiller's version of the "great illusion" in business today is that the popular notion of corporations and wealthy individuals have an interest in "conquest", analogous to the military conquests of the original "great illusion". Shiller's view is that "life satisfaction" (making a good product, helping customers, providing jobs) is ultimately a more rewarding pursuit and nowhere in financial theory does it say that people should value making money above other pursuits. In this concluding chapter, Shiller returns to his students and reminds them that, hard as it may seem to believe, there are many reasons to go into finance other than making money.

Conclusion

This book, written over Shiller's some 25 years of teaching economics and finance, is an excellent contribution to improving our awareness and understanding of "finance" and the "good society". While written and laid out with his students in mind, it certainly applies to all in finance. We may have spent

our entire careers in finance, or have been affected by some way by the worst financial crisis since the Great Depression and we no doubt all aspire to a "good society". On that note, I would like to just add that the CFA Institute Board of Governors Planning Committee approved a new Mission and Vision Narrative in May 2012. The mission is a statement of purpose for the whole organization and

includes for the first time the addition: "for the ultimate benefit of society".

Note

¹ You can find one his online courses—Financial Markets (all 25 lectures and exam!!), plus the syllabuses of Macroeconomics, Advanced Macroeconomics, and Behavioral and Institutional Economics, at: <http://www.econ.yale.edu/~shiller/course/index.htm>.