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Psychological barriers to a healthy economy

Book Review: 'Animal Spirits'

BY [PATRICK S. DUFFY](#), MONDAY, JULY 13, 2009.
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No doubt, many people remember the extent to which real estate investments became a primary topic at cocktail parties from the late 1990s through 2006, fueled in large part by books whose rationale was simple: If you think a house is a good investment, so will someone else, and homeownership is the best way for the average American to build wealth.

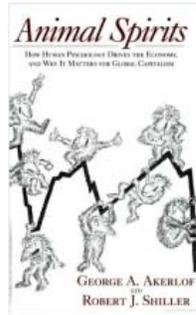


Image courtesy [Princeton University Press](#).

The fact that such books rarely compared the historical inflation-adjusted returns of housing prices (which averaged 0.2 percent per year from 1900-2000) to other investments was a minor inconvenience, as they were instead filled with a variety of success stories that seemed to shout, "See? This could be you, too!"

The "Animal Spirits" authors note that many consumers have shared a strong intuition that home prices -- as "they're not making any more land" -- can only go up (an argument that's been used to defend real estate booms for more than a century).

Emboldened by books such as "Are You Missing the Real Estate Boom?" by former National Association of Realtors economist David Lereah in 2005, it's easy to see why the so-called animal spirits could motivate all but the most conservative investors.

At the same time, a huge push by the U.S. Department of Housing and Urban Development at the beginning of the decade to boost homeownership led to the lowering of credit standards by Fannie Mae and Freddie Mac, which in turn gave subprime lenders the justification to promote their loan products with little regard to normal underwriting standards.

In the end, Akerlof and Shiller argue that it was a combination of cultural and psychological forces -- given credibility by institutional backing -- that allowed these animal spirits to lead the housing market's unsustainable boom.

So what do the authors say we can do to prevent these spirits from rising up again and assuming control of the housing or financial markets? For starters, they think we're on the precipice of another major shift in the stories people tell about how the economy works, with some previous ones including the election of Ronald Reagan, the end of the Great Depression, and the period following the Civil War



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In this next shift, Akerlof and Shiller envision a move away from the "invisible hand" theory of largely unregulated markets to an economy in which government will play a stronger role.

Since the primary challenge of this will be to avoid stomping out the type of innovation and risk-taking that gives capitalism its strength, both individuals and government will have to assume more responsibility in learning how the economy works when making decisions on saving money, making investments in the stock market or in housing, and the role of pension programs such as Social Security.

For the savvy real estate agent or broker, this shift in awareness of economic pitfalls could also provide a rare opportunity -- that of becoming a trusted adviser in addition to assembling listing data, showing homes, and shepherding clients through the sales process.

Because as the Internet and other technologies continue to eat away at the protected tools agents have used for decades, success will come to those who understand economics and human psychology as much as the best comps, school scores and crime statistics.

[Click here to listen to Patrick Duffy's interview with co-author Robert Shiller.](#)

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What's your opinion? Leave your comments below or send a [letter to the editor](#).

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