“Lectures on complexity in Economics”

Profesor invitado
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Syllabus

This series of lectures has its origins in the book entitled "Complex Economics: Individual and Collective Rationality" I published in 2010. The main objective is to argue that the current crisis has put into sharp relief the incapacity of our modern theoretical models and, in particular our macroeconomic models to provide an adequate explanation of the sudden and large changes that take place in the economy. The course will provide an account of how we have come to be locked into models which have been declared by former Governor Trichet of the European Central Bank, by Lord Turner, the Director of the Financial Services Authority in the U.K. and Governor Bernanke of the Federal Reserve Board to be useless in times of crisis. They have called for new approaches and this course will provide an opening to such approaches and will draw on the lessons to be learned from other disciplines, such as statistical physics, biology, and the neurosciences. The main theme, using various economic examples, will be to argue that the basic problem has been to treat the economy as if the aggregate behaved like a (representative) individual.
As in other disciplines we have to recognize that aggregate phenomena, although derived from the interaction between individuals, do not have the same characteristics as those of individuals. Such systems, referred to as complex adaptive systems, have a dynamic of their own which may pass through abrupt changes without any exogenous shock. This theme has a long history in economics but its most eloquent advocate in recent times has been Thomas Schelling.

The standard explanations for the crisis given by those responsible for making economic policy invoke three themes, contagion, networks and trust, yet none of these has a place in modern macroeconomics. Yet they are features of complex adaptive systems, of systems of interacting particles, of social insects, of networks of neurons and of epidemic diseases for example. The economy should be considered as a complex adaptive system in which the agents constantly react to, influence and are influenced by, the other individuals in the economy. The message of the course is that coordination rather than efficiency is the central problem in economics. How do the myriads of individual choices and decisions come to be coordinated? How does the economy or a market, “self organise” and how does this sometimes result in major upheavals, or to use the phrase from physics, “phase transitions”? The sort of system described in this course is not in equilibrium in the standard sense, it is constantly changing and moving from state to state and its very structure is always being modified.

In this course we will examine examples including Schelling’s model of segregation, contributions to public goods, the evolution of buyer seller relations in fish markets, to financial models based on the foraging behaviour of ants. In particular we shall analyse some simple models which capture the way in which large scale movements emerge from the interaction between individuals who may not themselves be very important players in the economy.

ESTRUCTURA DEL SEMINARIO

PRIMER BLOQUE: PROF. ALAN KIRMAN (Université Aix Marseille-EHESS)

Lunes 18 de abril: Lecture 1 (AULA 31)
This lecture will be devoted to examining the basic foundations of modern theoretical economics. Starting from the observation that the current crisis was not forecast because it was not even possible within our standard models, we will then examine the road that has led us to this point.
- The history of economic theory from Walras to Arrow Debreu
• The switch from the idea of establishing relations between macroeconomic variables to the desire to found economic models on sound scientific principles, i.e on the behaviour of rational optimising but isolated individuals
• The idea of equilibrium and its relevance to the empirical evolution of the economy
• The fundamental theorems of welfare economics
• The problems of stability and uniqueness; the destructive results of Sonnenschein Mantel and Debreu
• The problem of aggregation; dealing with the heterogeneity of individuals.
• The appearance of the « representative individual » in macroeconomics.
• The problem of the direct interaction between individuals
• Game theory its insights and its limitations.
• The rationality assumptions, are they based on the observation of behaviour or on the introspection of economists?
• The influence of behavioural economics.
• Agent based models
• Lessons from social insects
• Rational expectations and its problems
• Self organisation: Do markets self organise and if so do they achieve an optimal state?
• The importance of coordination as opposed to efficiency.

Readings lecture 1

Martes 19 de abril: Lecture 2 (AULA 113)
This lecture will be devoted to examining how the way in which individuals interact influences economic outcomes. In most theoretical models little is said about who trades with whom, who communicates with whom and who sets prices for example.
We will examine the consequences of direct interaction. Then we will examine the role of the networks which govern that interaction and how these networks evolve. We will look at both deterministic and stochastic networks.
• The role of networks in the crisis. Haldane’s analysis
• The interaction of simple individuals can produce sophisticated results: some examples.
• The interaction of apparently rational individuals may not generate results which are “collectively rational”. Some examples.
• Economics and sociology: two very different approaches to the relationships between individuals.
• The role of networks in economic analysis. The notion of local interaction and of “neighbours”
• Given graph structures and their consequences.
• The importance of certain characteristics: connectivity and diameter for example
• Stochastic interaction with a given graph of relations.
• The dynamics of interaction on a fixed graph. Contagion and diffusion
• Stochastic graphs: in this case the graph itself is a random variable. Connectivity in random graphs.
• The emergence of networks; the choice of links to create or to destroy
• Strategic choice of links
• Emerging random graphs: the probabilities of links evolve over time
• An example: buyer seller networks.
• The identification problem
• The highly concentrated network of ownership of Transnational Corporations
• Clustering in networks. The example of citations.

Readings lecture 2
doi:10.1371/journal.pone.0025995
Miércoles 20 de abril: Lecture 3 (AULA 306)
In this lecture we will deal with markets as institutions and how their structure and organisation impinges on the allocations that they achieve. The main point here being that we cannot talk reasonably about market outcomes if we do not really specify how markets organise the interactions between the market participants. But this is largely absent from the theoretical literature. Following on from Douglas North’s remark, –“It is a peculiar fact that the literature on economics...contains so little discussion of the central institution that underlies neoclassical economics—the market.” (North, 1977, p.710) and the same thing is echoed by Coase, –“Although economists claim to study the market, in modern economic theory the market itself has even a more shadowy role than the firm” (Coase, 1988, p.7).

We will take a rapid look at some well known historical and anthropological studies of markets, Claire de Ruyt’s study of the agora in ancient Rome, its functioning, its structure and its rules.

John Padgett’s study of some markets in Florence, his comparison of the differences between the markets for wool and silk Clifford Geertz’s study of North African souks Theodore Bester’s study of Tsukiji, the Tokyo fish market.

Mitchel Abolafia’s study of Bond traders on Wall Street, Making Markets.

In particular we will concentrate on markets for perishable goods and a special example of these, fish markets which have a long history in the economic literature and for which we have a lot of empirical data.

- Fish markets: historical background
- The Marseille fish market: the data (every transaction over three years) pairwise negotiation and no posted prices
- Market properties and individual behavior
- Market organisation and its impact on price dispersion
- Price-quantity relations and their relation to “demand”
- A full-blown game theoretic approach??
- An approach in which agents follow simple behavioural rules
- The emergence of loyalty and trading relationships: a little formal analysis and some empirical evidence
- The Ancona fish market: 3 simultaneous Dutch auctions.
- Comparison with the results from Marseille.
- Other perishable goods markets.

Readings lecture 3

Jueves 21 y viernes 22 de abril: Lectures 4 and 5 (AULA 31 y 113 respectivamente)
These will be devoted to financial markets. We will take a look at the foundations of modern financial economics and in particular the extent to which those foundations are solid. We will also examine the role of financial networks and the problem of the fragility of interbank and international financial networks. Once we move away from the idea of a large anonymous market which processes all information efficiently we can see how phenomena of contagion and of bubbles and crashes can occur. We will examine examples of models in which agents switch between the rules that they use depending on the success of those rules and will show how this can lead to the sudden collapse of markets.

Readings lectures 4 and 5

**Lunes 25 y martes 26 de abril: Lectures 6 and 7 (AULA 31 y 113 respectivamente)**
These will be devoted to two topics. The first is the public goods problem.

**Public Goods**
Many experiments have shown that individuals contribute more to public goods than game theory would suggest. The basic problem of externalities will be examined and the “tragedy of the commons” analysed. The game theoretic solution, the Nash equilibrium will be compared with the social optimum. What has then to be explained is that individuals when playing a public goods contribution game initially give much more than in the Nash equilibrium. However, their contributions decline over time. This has led to the argument that they “learn to play Nash”. We will see that this conclusion fits the data at the aggregate level but not at the individual level.

- The basic public goods game
- A modified version with an interior solution
- The role of information
- Learning in games
- Results in different treatments
- The reinforcement learning model of Erev and Roth and the EWA model of Camerer and Ho.
- Aggregate v. Group behaviour.
- Group v. Individual behaviour.
- The difficulty that these results pose for the Fehr and Schmidt model.
- Individuals are noisy and do not base their behavior on a simple model of fairness

**Schelling’s Segregation Model**
Schelling’s analysis of racial segregation in urban areas is one of the pioneering articles in which there is a stark contrast between what he calls “micromotives” and “macrobehaviour”.
When individuals have relatively moderate preferences in favour of neighbourhoods with their own colour and move in consequence the result can be total segregation. Worse, if people actually prefer mixed neighbourhoods segregation can still occur. We will examine the basis for these results and will analyse a physical analogy and some generalisations of the original model.

- The basic model
- Individuals on a grid acting on the basis of local information
- The original utility function and alternatives.
- A physical analogy
- The income dimension
- Introducing a housing market
- Some empirical evidence

**Readings lectures 6 and 7**


**Miércoles 27 de abril: Lecture 8 (AULA 306)**

In the last lectures I will pass in review some recent models which illustrate both the Complexity view and the agent based model approach and then draw some conclusions.

- Learning in complicated situations, do such learning processes converge when agents are learning simultaneously? How do individuals learn to bid in auctions?
- How did man learn to rotate crops? A simple model.
- An application of the "El Farol" problem to that of market entry
- Identity and its importance in economics. Reconciling the philosophical and economic points of view. Can individuals learn to change their identity?

**Conclusions:**

The purpose of this course has been to examine the difficulties with current theoretical models of the economy, particularly macroeconomic models and to suggest an alternative approach. This would emphasise the importance of the direct interaction between individuals in the economy, and suggest that this is a central question not a peripheral
imperfection. Coordination is a more important criterion than efficiency. Such an approach limits the degree of rationality attributed to individuals and emphasises the difference between individual and aggregate behaviour. This approach allows us to analyse large endogenous changes in the aggregate without resort to exogenous shocks and explicitly recognises the possibility of the endogenous formation of bubbles and crashes. Such models undermine the idea that markets self organise in a stable and efficient way, and that they automatically attain equilibria, but they do have the merit of providing a basis for some of the most important economic phenomena of our time.

Readings lecture 8

General Readings (PRIMER BLOQUE)

Books which adopt similar approaches are the classic,

And a collection of earlier articles in
Just in case you might think that the crisis is new:


- Seeley T (2012), Honeybee democracy Princeton Princeton University Press

- Greenspan Alan, (2008), Testimony to House of Representatives Committee on Government Oversight and Reform, October 23rd 2008
- Trichet Jean-Claude (2010), « Reflections on the nature of monetary policy nonstandard measures and finance theory » Speech by President of the ECB, Opening address at the ECB Central Banking Conference Frankfurt, 18 November 2010.

SEGUNDO BLOQUE: PROF. DANIEL HEYMANN (FCE-UBA)

Jueves 28 de abril: “Expectativas, esquemas de aprendizaje y crisis macroeconómicas” (AULA 31)

Bibliografía

Viernes 29 de abril: “Modelos de agentes múltiples en contextos de mercado” (AULA 113)

Bibliografía

¡INFORMACIONES IMPORTANTES!

**Acreditación del seminario**
Para poder acreditar el seminario, es necesario cumplir con el 80% de la asistencia y presentar una monografía.
El trabajo final debe ser entregado de la siguiente manera, a menos que los Profesores que dictan el seminario particularicen otra metodología:
- Dentro de 3 meses siguientes a la finalización del seminario.
- Las monografías deberán ser enviadas al siguiente correo electrónico: cfaae@rec.uba.ar
- Una vez corregida por el profesor, el CFAAE confeccionará y entregará los certificados correspondientes.

**Centro de Documentación e Información - Biblioteca**
El CFAAE pone a su disposición su colección de libros especializados en ciencias sociales (un 80% en idioma francés) y un espacio de trabajo. El mail de la responsable Patricía Caraguel para cualquier consulta sobre la biblioteca y la bibliografía es bibliotecacfa@rec.uba.ar El horario de atención es de 15.30 a 19.30 hs., de lunes a viernes.