

QUESTIONS FROM THE FLOOR

GEORGES ROCOURT: My question concerns your comments on rational expectations and their non-validity in an operational sense. I am a bit confused on one aspect and perhaps I didn't understand how you addressed this. You have said individuals cannot correctly formulate expectations about the future using a rational-expectations methodology, yet your original quote from Keynes said that money is in fact the vehicle that mediates the present to different expectations in the future. What is, in your opinion, the correct methodology or praxis for individuals creating a vision of the future? Without that, they cannot make decisions, can they? Or am I missing something?

BOB GEBHARDT: Leading from the previous question, I would ask if there is an important role for equity markets in returning some form of discipline to the banking sector. This carries on from the previous speaker as well, who didn't even mention bank equity in discussing the sources and uses of bank funds. There was reference to bank profitability by the previous speakers but no discussion of equity in the private ownership of banking, assuming that one day equity value does return for the major banks.

SKYDELSKY: You know, I am really quite surprised by the first question, i.e., "How can you make decisions without having correct expectations about the future, or some basis for forming such?" I make them all the time and so do you, actually, but you don't teach that they can be made. I think Keynes was trying to bring economic theory closer to the way we actually behave rather than construct models, platonic models on how we would behave if we had perfect information and so on. How do we decide whether to go into the stock market today? We form an expectation of what its value will be in six months, a year, five years or whatever. And if you ask, "On what basis are you forming that expectation?" A rational-expectations person would say — let's assume this is his first foray — that today's price reflects the correct value of the stock; you have no expectation except that any subsequent information is going to alter your expectation of what it will be. You have absolutely no areas of doubt, but in fact that's not how it happens; you are taking a gamble. I know from my own experience on boards of a couple of companies that when we have these discussions we always end up by saying we do not know but we have to act, we have to decide. Now, one of the reasons we hold cash in periods of great uncertainty is to postpone having to decide. In other words, the flight to cash is a barometer of our mistrust of our own calculations about the future, and this actually links directly into the second question, "What about profitability of bank equity?" We invest because we have certain expectations about the income streams which will be generated by the investment over often a long period. On what are these based? Keynes suggested the following. First of all, they are based on what other people believe. Secondly, we believe that the situation as it now is will continue into an indefinite future; we do very, very crude extrapolations and these he called conventions. We believe certain conventions, and one of them is that we do what other people do. Have you noticed that all forecasters herd together? That's not because all of the people who forecast market values have correct information about the value of the shares, it's because they look at each other's forecasts, thinking, "I'll be out of things if I say something very different, and I may lose my job as forecaster." That's actually how it works. Now, in my judgment, what empirical evidence is there for expectations-based economics? You can't have empirical evidence. As Einstein (I mean Einstein!) said, "Not everything that matters can be counted, and not everything that can be counted matters." It's an impossible question to try to answer. You could do some sort of empirical about what you base your expectations on. You probably would then develop some empirical, but has anyone presented empirical evidence to confirm the rational-expectations hypothesis? Of the two hypotheses, many of our decisions are based on uncertain expectations and many of our decisions are based on rational expectations. I would say without any further appeal to empirical evidence that one is much more intuitively plausible than the other. And that would be the basis, that would be my default position.