

Discussion of Willett's The Roles of False Mental Models and Time Inconsistency Problems in the Generation and Prolonging of the Euro Crisis

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Some Philosophy

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This observation has important implications for economists' theories of sunspot equilibria.

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Cass and Shell (JPE, 1983) emphasized that there could be no sunspot equilibria if agents could insure against sunspot states. They showed that sunspots mattered if there was incomplete market participation, as in the model of overlapping generations.

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What is a Fundamental?

The Maria Bartiromo Market Hairdex

<http://www.dimgroup.com/stockjunkies/maria.html>

Maria Hair
Status

Market Analysis



When Maria's cowlicks go completely out of control, this means that something big is in the offing and it is going to be good news for the market. It might be a big merger, higher jobless claims or a drop in the prime rate, but certain follicles are especially sensitive to changes in the air. Get on the phone to your broker and BUY, BUY, BUY!



When Maria's hair gives you this "what, are you still holding equities?" look it is time you liquidated your position. Is it the end of the world? No, but you might consider battening the hatches and bracing for a serious market correction.

Willett's False Mental Models

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Willett's examples

1. German belief that excessive fiscal deficits were the only major problem.
2. Monetary integration is different from trade and financial integration

The Semantics of a False Mental Model

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We cannot buy insurance against marauding unicorns.

The Semantics of a Sunspot Variable Matters

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If the ECB just made it common knowledge that they are not in the business of reacting to fiscal policy, would the crisis evaporate?

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What happens when California loses competitiveness? It loses people and national political clout.

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Some other False Mental Models

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Some other False Mental Models

1. Only needed to worry about inflation and fiscal policy
2. Maastricht criteria were really enforceable
3. Did not need to worry about lender of last resort

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Tough nuggies for the Germans. Was für eine Unverschämtheit!

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- ▶ definition and implementation of monetary policy
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Further tasks

- ▶ Banknotes
- ▶ Statistics, in cooperation with the NCBs
- ▶ financial stability and supervision
- ▶ International and European cooperation

Tentative Conclusions

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What is my cure? The issue is not an economic one. Europe needs a popular election for President (Chief Fiscal Officer) of the Euro Zone. Let's see how much the European elites like real democracy.