EJW
ECON JOURNAL WATCH
Scholarly Comments on Academic Economics

ECON JOURNAL WATCH 15(3)
September 2018: 376–381

Lars Peter Hansen

Daniel B. Klein[1]

LINK TO ABSTRACT

Lars Peter Hansen is an American economist born in Urbana, Illinois in 1952, of parents with Mormon background. Hansen considered himself to be a late bloomer but then "shifted into a higher gear in college," Utah State, where he started in chemistry but discovered mathematics, political science, and economics. At the University of Minnesota, Hansen studied with two eventual Nobel laureates, Thomas Sargent and Christopher Sims, his "intellectual mentors." "I learned to think of macroeconomic models as restrictions on stochastic processes, random processes that evolve over time" (Hansen 2014a). In 1978 he gained a position at Carnegie Mellon University, and in 1981 at the University of Chicago, where he has since remained. Along with Eugene Fama and Robert J. Shiller, Hansen received the 2013 Nobel Prize in Economics for "their empirical analysis of asset prices."

Writing in the *New Palgrave Dictionary of Economics*, Esther-Mirjam Sent (2014) discusses Hansen's scientific contributions under five headings: "Generalised Method of Moments Estimators,"[2] "Stochastic Discount Factor Models," "Econometric Evaluation of Asset Prices," "Expansion Empirical Analysis of Macroeconomics–Finance Relationship," and "Rational Agents Guarding Against Model Misspecification."

Hansen was the founding director of the Milton Friedman Institute at the University of Chicago, which, in 2011 after a merging of units, became the Becker Friedman Institute for Research in Economics, with Hansen serving in a leadership capacity to 2018. Hansen's scientific work is highly technical, and seems not to express or promote an ideological proclivity. As for popular discourse, Hansen

1. George Mason University, Fairfax, VA 22030. I thank Ryan Daza and Andrew Humphries for assistance.

2. Tabarrok (2013) and Leek (2013), prompted by Hansen's prize, introduce the layperson to the Generalized Method of Moments.

abstains. When asked about ideology, he is not forthcoming. "I view it as inappropriate for people to go inside of classrooms and spout their political views. That's not how you do good economics, and I think for the most part that's not how it's done" (Hansen 2013a).

The evidence is consistent with a broadly pro-market classical liberal perspective. When asked in an interview "Have you provided advice to governments or politicians? Do you have strong political views?," Hansen replied: "No, I haven't, and, no, I don't like to identify strongly with a political party. I'd say I'm fiscally conservative but the truth is I have a hard time figuring out these days which political party that's attached to. And I'm certainly socially liberal" (Hansen 2013b). I speculate that Hansen grew up familiar with a Mormon outlook, and in college and graduate school gravitated toward an image of rigorous science, among 'freshwater' economics research communities very skeptical of the governmentalization of social affairs. He has dedicated himself to community efforts, serving as advisor to sixty students (Hansen 2014a).

Hansen has often said that it is important that policy rules be simple, transparent, and certain:

> A long time ago in a rather different monetary policy environment than we have today, Milton Friedman argued that we need to have simple policy rules because there are long and variable lags in the transmission mechanism through which changes in monetary policy influence the macroeconomy.
>
> I would interpret that as saying, "We don't really understand the details of the transmission mechanism, and maybe there are dangers in pretending we know too much. Instead, maybe we ought to be doing something simple, to avoid taking too literally the complexities that a given model might have." Once I start looking across models and recognizing potential differences or similarities across models, I might well be led to do something relatively simple that works across the models rather than embracing some particular, more complicated approach based on taking this *one* model literally. …
>
> The more complex the environment, the harder it is for us to understand all those complexities, and the more we have to deal with some form of uncertainty as we think about the environment. It can be problematic when policy complexity itself adds to the underlying uncertainty in the economic environment and opens the door further to regulatory discretion. (Hansen 2015; see also Hansen 2014b, 6:30ff.; Hansen 2018, 2:30ff.)

When asked in 2013 about regulatory developments in light of the financial crisis, Hansen replied:

> Right now all these government departments are rushing together to put together quick fixes because that's their charge; they've got to figure out how to

> do financial oversight in sensible ways. But the models we had leading up to the financial crisis were not particularly well suited to it. And so what they're doing is to put a bunch of Band-Aids on existing models to try to repair them in order to get quick insight. …
>
> So-called systemic risk had of course been the buzzword for financial regulation and financial oversight. People were talking about measurements without even having yet really commonly agreed upon models of what the term was.
>
> I'm very concerned. Because if you really have knowledge gaps and you really try to do a lot of fine-tuning on things like this based on incomplete knowledge, you can do more damage than good. I really think in many of these cases, simplicity is far more important than trying to devise complicated solutions to things. (Hansen 2013b)

The interviewer asked "Would you be concrete, in terms of what you would prefer?," and Hansen replied: "I would rather have simple capital requirements for banks, for example. Given that we are going to be in this position of bailing out financial institutions, there has to be some form of financial oversight" (Hansen 2013b).

On the matter of climate change, Hansen has remarked:

> Another policy concern that should be almost dominated by uncertainty is climate change. The truth is our knowledge of climate change impacts remains rather sparse. That doesn't mean we shouldn't act. It may be prudent to act now because it'll be more costly to act later, but it's critical to recognize that we're designing policies based on limited knowledge. In political debates that's often stuck in the background. (Hansen 2013a)

Despite Hansen's ideological reticence, he agreed to be a guest on Russ Roberts's deep-dive podcast *EconTalk*, which is openly classical liberal (Hansen 2014c). Roberts tries to draw Hansen out, or even 'lead' the witness. Hansen remains rather reserved, but there is little in what he says that really pushes against Roberts's classical liberal drift. Here are some transcriptions of Hansen (2014c):

> We need to think about when can financial regulation lead to harmful effects, versus when does it seem to be necessary. So I do think that we've learned stuff; and I think we are going to learn more coming out of the financial crisis. But we've got a long ways to go.

> Fiscal policy, as it's been implemented, it's conceived of or implemented, there's no obviously big gains to be had there. And I personally think that for really going forward that fiscal challenges, long-term fiscal challenges are contributing to uncertainty in ways which we ought to be addressing. There

is always this notion that, well, let's go and do a bunch of fiscal stimulus now and worry about long-term budgetary consequences later. And there's this other component to that is the fact that—I think this is like, a quote of Milton Friedman's or somebody said, 'There's nothing more durable than a short-term increase in a government program.' Or, once you start these things they are hard to stop. I actually would have thought, or to me a more sensible approach to thinking about fiscal stimulus, would have been the following. Suppose that government has in place a set of projects, infrastructure projects that they've done cost-benefit analysis and that they think are really important to be done eventually. There's some flexibility in the timing and the like. Well, maybe in a time of economic downturn there's enough that that's a good time to be making these infrastructure investments, maybe if labor costs are down and the like, and then do sensible things. Now, this is premised on the fact that if the government would have had in place so-called 'shovel-ready projects' that you can document were of great importance and finish at the time. That's a different kind of perspective than people pushing for standard fiscal stimulus—let's just get the economy going by putting money out there. That lever, I agree, can be quite flimsy.

I'm always nervous when people say, 'Let's not worry about budgetary consequences now; we can always fix them later.' It's always later.

There is this concern that [as a politician or a policymaker] you're in the hot seat right now, and it's difficult often for them to have all the right incentives for long-term consideration. You're going to be sitting in the seat and watch things go bad, and so if you can push off the possibilities of bad things into the future, there's a temptation to do that. But let me pick up on another part of your story that I think is quite important, as well. Part of coming out of Dodd-Frank is that we now are going to be in the business of designating systemically important financial institutions. And I'm very concerned that this is going to become some type of politicalization. And as soon as these financial firms get designated as being systemically important, associated with that is some type of political government guarantees to not let bad things happen to them. And the incentive effects of that look to me to be quite problematic. And I know some of the systemically important firms that have been declared so far would have much preferred not to have that status, even though there may be some benefits attached to it. And when there's a suggestion that firms like Fidelity are going to become systemically important, and the like, I'm very, very nervous that the designation is going to be applied in a very, very broad way. Part of the ways to get enterprises to behave better is to at least let them *think* about the risk of failure. And that can be a very important market disciplining device. So, the real challenge is, how can we let these financial firms fail, without having so much fear attached to that. And I think there's also a concern that if we make this systemically important financial institution

> designation politicized, I'm just really concerned about that having bad consequences.
>
> I do think this idea, which I'm no expert in whatsoever, of working out very, very fast and efficient resolutions of financial institutions in ways that we don't have a fear of their consequences—the counterpart to bankruptcy, but done in a super-quick, fast way is quite important to going forward.
>
> There *could* be very big consequences [of climate change]. So maybe it's sensible to start doing things now just because of the possibility that there could be very dramatic consequences. I find that personally of some appeal, but would I love to quantify that or make it more of a systematic, formal statement.

Hansen has lent his name to a few petitions:

1. 2007 (Club for Growth), opposing protectionism[3]
2. 2008 (John Cochrane), raising concerns about government bailout of mortgages
3. 2013 (Larry Kotlikoff), supporting the Intergenerational Financial Obligations Reform Act (**link**)
4. 2017 (New American Economy), affirming the value of immigration (**link**)

Hansen writes in his autobiographical essay:

> Shortly after moving to Chicago [in 1981], I met my future wife Grace Tsiang, a graduate student in economics at the time… Grace's influence in my life is far-reaching. We introduced Grace's parents to the scenery and wildlife of Yellowstone and Grand Teton National Parks on a summer driving tour. While we were walking by Old Faithful, we passed other tourists on the narrow wooden walkways who recognized my father-in-law. A young couple from Taiwan had seen news stories there in which Grace's father, Sho-Chieh Tsiang, discussed his economic policy recommendations. While I was initially surprised, in retrospect I should not have been. Grace's father, along with Ta-Chung Liu, both Cornell University economists, were key economic advisors to the Taiwanese government in advance and during the "Taiwan Miracle," a time period of rapid economic growth. This set quite an example for how to use economic analysis in the policy sphere. (Hansen 2014a)

3. Petitions 1 and 2 are covered by Hedengren et al. (2010, 317), linking to data and petition text.

References

Hansen, Lars Peter. 2013a. Nobel-Prize Winner Lars Peter Hansen on How Economics Has Helped You [interview by Christopher Matthews]. *Time*, October 23. **Link**

Hansen, Lars Peter. 2013b. A Talk with Lars Peter Hansen, Nobel Laureate [interview by Jeff Sommer]. *Economix, New York Times*, November 16. **Link**

Hansen, Lars Peter. 2014a. Lars Peter Hansen—Biographical. In *The Nobel Prizes 2013*, ed. Karl Grandin. Sagamore Beach, Mass.: Science History Press. **Link**

Hansen, Lars Peter. 2014b. Consequences of Uncertainty. Presented at the University of Chicago Booth School of Business Europe Campus (London), April 1. **Link**

Hansen, Lars Peter. 2014c. Hansen on Risk, Ambiguity, and Measurement [interview by Russ Roberts]. *EconTalk, Library of Economics and Liberty* (Liberty Fund, Indianapolis), June 30. **Link**

Hansen, Lars Peter. 2015. Interview with Lars Peter Hansen [by Douglas Clement]. *The Region* (Federal Reserve Bank of Minneapolis), December. **Link**

Hansen, Lars Peter. 2018. Discussion Section with Kevin Murphy, Featuring Lars Peter Hansen: Unpacking Policy Consequences [interview]. April 11. Becker Friedman Institute for Economics at the University of Chicago (Chicago, Ill.). **Link**

Hedengren, David, Daniel B. Klein, and Carrie Milton. 2010. Economist Petitions: Ideology Revealed. *Econ Journal Watch* 7(3): 288–319. **Link**

Leek, Jeff. 2013. A General Audience Friendly Explanation for why Lars Peter Hansen won the Nobel Prize. SimplyStatistics.org, October 14. **Link**

Sent, Esther-Mirjam. 2014. Hansen, Lars Peter (Born 1952). In *The New Palgrave Dictionary of Economics*, online ed. London: Palgrave Macmillan.

Tabarrok, Alexander T. 2013. Lars Peter Hansen Nobelist. MarginalRevolution.com, October 14. **Link**

About the Author

Daniel Klein is the editor of *Econ Journal Watch*, a professor of economics at George Mason University (where he leads a program in Adam Smith), the JIN Chair at the Mercatus Center at GMU, a fellow of the Ratio Institute in Stockholm, the author of *Knowledge and Coordination: A Liberal Interpretation* (Oxford University Press, 2012), and an exponent of **liberalism 1.0**. His email address is dklein@gmu.edu.

Go to archive of Character Issues section
Go to September 2018 issue

Discuss this article at Journaltalk:
https://journaltalk.net/articles/5976