

## Hermalin's Response to Cowen's Comment on "At the Helm" in *Marginal Revolution*

Although delighted to learn that Tyler Cowen is following my research, I thought his discussion of my working paper, "At the Helm, Kirk or Spock? Why Even Wholly Rational Actors May Favor and Respond to Charismatic Leaders," was arguably misleading. (For a link to Professor Cowen's discussion go to <http://marginalrevolution.com/marginalrevolution/2014/05/why-do-we-respond-to-charismatic-leaders.html>; for a link to my paper, go to <http://faculty.haas.berkeley.edu/hermalin/WorkingPapers.html>.)

Professor Cowen includes the following quote from my paper, "Because a more charismatic leader is more inclined to make an emotional appeal *ceteris paribus*, sober responders are less pessimistic about the state when a more charismatic leader makes an emotional appeal than when a less charismatic leader does." He then goes on to ask, "Would this same reasoning also imply we should choose intrinsically panicky leaders, because then, if we see them panic, we would think the real underlying situation isn't so bad after all and we are simply witnessing their innate propensity to panic? Yet no one would buy that version of the argument." Although Professor Cowen suggests the answer to his question is "yes," the answer is, in fact, "no." There are two reasons why "no" is the right answer. First, if we assume that a leader panics independently of the underlying situation, then panic can convey no information. Moreover, if, when panicking, she fails to report information, then panic acts to suppress valuable information, to the detriment of the organization. So intrinsically panicky leaders are either neutral or bad; hence, we don't want to choose them.

The second reason is more subtle. Let's suppose that a panicky leader is more inclined to panic when the situation is bad. Specifically, compare two leaders, a nervous type who panics if the state falls below  $\theta_h$  and a braver type who only panics if the state falls below  $\theta_\ell$ ,  $\theta_\ell < \theta_h$ . Then Professor Cowen is right that panic is a less bad signal when we see the nervous type panic than when we see the brave type panic. But this doesn't translate into the organization wanting a more nervous leader. Why? Well, unless panic induces more effort from some followers than does calmness (an unlikely scenario), the only relevant effect remains the destruction of information: this effect is always detrimental to the organization. Charisma is different than panic insofar as emotional appeals from charismatic leaders induce greater effort from at least some followers. This effect offsets the destruction-of-information effect. Even that, though, is not enough to guarantee that a more charismatic leader is preferable to a less charismatic one. An additional element is needed, namely that the leader be what I call "savvy"; that is, able to choose strategically (rationally) what kind of appeal to make to her followers. Panic, by definition, is inherently irrational.

Later, Professor Cowen writes, "I will instead suggest that we (sometimes) follow charismatic leaders because they have high social intelligence, and most of all because other people are inclined to follow them." The "instead" is unfortunate because it would seem to suggest that my paper doesn't consider

behavioral factors. The truth is quite the opposite: the entire model rests on the supposition that there some fraction of followers who are inherently inclined to respond to charisma or charismatic leaders. Indeed, the paper goes on at length concerning the evidence for that phenomenon.