Narrative Economics

Author: Robert Shiller

I approached this book with high hopes. Not only is Shiller a winner of the Nobel prize in economics, but I have long thought that stories are important in framing the choices that we make and the heuristics that we operate with. We know from the work of Kahneman and Tversky that the way that options are organised makes a difference to how we perceive them – bets with the same expected value are treated differently if they are couched in terms of the risk of loss or the risk of gain for example.

So it's an interesting and fruitful hypothesis that stories, narratives, drive the framing of our choices. A good potential current example might be that the story that masks protect against viruses leads me to look at the variety of mask I might acquire while I completely neglect to look at the research on the much greater importance of regular hand washing because that is not a narrative that I have been exposed to.

A further question could then be about how a narrative spreads, and what its power might be. Here we can immediately go back to the virus story which the coronavirus narrative – or Covid19 as the particular new version is named – has made more familiar to us. Epidemiologists have long modelled epidemics in terms of the infection rate, recovery rate and death rate. It currently appears that Covid19 may be highly infectious, but also with a relatively low death rate. This means it could become pervasive, with continuous reinfection and waves of its appearance. This analogy with disease is the source of the ideas behind Robert Shiller's book (and are described in more detail in an appendix).

Shiller is a widely respected author and his house price index has had practical influence as well. He won his Nobel prize for work on asset prices and their predictability, alongside Eugene Fama and Lars Peter Hansen. His work on asset bubbles is probably well known to SPE members, and so probably is the book Irrational Exuberance, published in 2000. I admire his work.

All this is why I opened this book with high expectations and enthusiasm. Sad to say, I was disappointed. It is true that the book has some fabulous examples of narratives which have taken hold. He talks about bitcoin and how it became fashionable, as well as bimetallism (negative marks to those of you who do not know that the Wizard of Oz is about bimetallism) and the gold standard. He shows how narratives develop through time and evidences their rise and fall in google ngrams and other newspaper and print records. It's all fascinating stuff and also very salutary to see how often yesterday's truths become today's irrelevancies or even lies.

What I miss, however, is some thoughts on how to contextualise these important ideas and knit them into the mainstream of economics. I absolutely agree with Shiller that narratives are important. I also agree that they reflect the concerns of our time. We shouldn't be surprised about this. Keynes' General Theory was a response to the unemployment challenges of his times, while Friedman responded to the challenge of the then pervasive inflation problem. Their work generated professional narratives which culminated in debates about the effectiveness of different kinds of policy reaction. In those debates it is pretty clear that a social position mattered as much as that of economic theory in influencing the perspective from which individuals look at a problem.

It's not enough to describe and to evidence the rise and fall of particular ideas and narratives, it's also necessary to see how they fit into and affect wider circumstances. Shilller starts by describing the bitcoin boom and how it has waxed and waned. Bitcoin itself has spun out numerous alternatives and competitors. What is not clear is where and how what could have been a blip of eccentricity became so mainstream. So the content of the narrative also needs explication. Was this part of a reaction against capitalism, alongside the Occupy movement? Or was it a more neo-liberal distrust of government? Only by looking carefully at the content of the narrative can we address this, which in turn can give clues about possible future directions of travel. Shiller says that we need to analyse narratives to get better predictions, but I'm not clear this is possible. My own analysis of the history of the Phillips curve shows that there appear to be regimes of the unemployment/inflation trade off over time which bear no obvious economic rationale. Narratives could help explain the different regimes but I'm not convinced it would help predict the next regime shift.

At any one time, there are many narratives competing for our attention. And our attention is limited, which is why we use heuristics to help decide what to pay attention to. In 1981 I was convinced by a narrative which said that Margaret Thatcher's policies were too draconian and signed a letter to that effect with 363 other economists. I now think that I was wrong. I have become instead convinced by a narrative which says that much of the pain was inevitable as structural forces battered the western economies, and that the forcing of a change of focus in the economy actually produced more competitiveness and set the scene for a revival of the economy. I find it remarkable that so many have stuck to an outdated narrative and blame an outstanding leader for making it possible to survive forces outside our control. I suspect misogyny!

I therefore think it is the shift in narrative which deserves attention if we are to use it as a focus of policy and decision making. Shiller identifies some perennial narratives which influence economic decisions, such as the benefits or otherwise of trade unions, the role of automation, thrift versus consumption, the role of money, panic versus confidence. The long quotes describe the incidence of the different attitudes to these issues over time. But what is missing is looking at the points where these narratives shift and how that happened, particularly the economic circumstances where this happens.

A good example is the shift from 'Keynesianism' to 'Monetarism'. The use of 'ism' of course shows how these approaches are potentially belief systems as much as scientific approaches. To document the process of narrative shifts alongside economic statistics and policy decisions would be even more fascinating that the narrative descriptions already in the book.

So you should read this book, but it is only a baby step on the road that we need to tread. Perhaps I should not have been so optimistic about this first effort and have been carried away by my respect for Shiller. Perhaps I need to follow it up!

Date: February 2020