Episode 8

Narrative Economics Part 1

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Nobel Laureate Robert Shiller, interviewed by Rob Arnott, expounds on the importance of narratives in driving economic events.

This Conversation is based on

Narrative Economics
(January 2017)

Robert Shiller

Read in NBER

Robert Shiller, PhD Sterling Professor of Economics, Yale University

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Conversations

Rob

Bob, thank you very much for joining us. It's a privilege to have you joining our Research Retreat. We went through a number of interesting topics today. I'm looking forward to tomorrow. I think it's going to be a good day.

Over the last few years, you've been working in an area that you call narrative economics. You've got a book coming out shortly entitled *Narrative Economics: How Stories Go Viral and Drive Major Economic Events*. Take me through what you mean by the term narrative, and how you think narratives drive major economic events.

Robert

It's a long story. Narrative is often taken as a synonym for a story, but it isn't quite a synonym. It refers to a telling of the story, particularly tying it to something important, with maybe a moral. A good narrative is one that is engaging and contagious. People want to repeat the story, and when it goes live, it can go viral. I think narratives are very important formers of thought. Most people don't discuss economic theory, but they tell stories, and implicit in the story is some theory.

Rob

So, let's use as an example—the financial crisis. You were one of the folks who, in some way, saw it coming. You indicated that in your concerns about housing. And before the bursting of the tech bubble, you wrote *Irrational Exuberance,* a wonderful book. And we were pointing out that valuations were reaching levels that were implausible to justify.

I remember back then the valuations were extreme, much like we're seeing today in some of the stocks, but certainly not all of them. What do you think is going on in the narratives that are driving today's markets? Do you see bubbles forming in stocks, in real estate, in bonds, in all three? And what lessons should we expect to learn from those narratives?

Robert

Well, the problem with narrative research is that it still is impressionistic. I can tell you what I think is the story. I think we need more attention to science, a more systematic basis. For example, use digitized data sets and search over them and use quantitative evidence to analyze the changing narratives. We can now do this.

The reason I'm writing this book about narrative economics is to put some kind of research programs, some kind of coherence, to the study of narratives so that people wouldn't be too free to just indulge in their speculations. But the problem is that markets are really driven by narratives, which are elusive and ill formed. They change in time, their details change. They're often attached to celebrities, but the celebrity disappears, and a new celebrity replaces the old one.

I think we are at the beginning of a new era in which economics is going to be better at answering questions like the one that you just gave me.

Rob

In your 2017 presidential address to the American Economics Association, you challenged your audience, the economics profession, to engage in serious quantitative study and research into the topic of narratives. What do you think is happening right now in that field that you think is of particular interest? Where do you see strides happening? And what do you anticipate in the coming half-dozen years?

Robert *I would go out further than a half dozen. This is an ongoing phenomenon that will take decades. There are people using machine learning to detect patterns, often short-run patterns in data that I suppose they may use advantageously. I'm thinking more as a long-term investor. I'm thinking about big issues, like democracy and fake news and things like that, that are not going to be modeled well because there aren't enough data.*

I think we still have a role for more humanistic research. Let's look back and understand how people were thinking during some other episodes to see whether it's a model for what's on now. And then use computers, again, as a way of sorting through data and providing hunches as to what might be happening.

Rob What happened in the financial crisis and the real estate sector is reminiscent of the bank runs of the Great Depression. And you've studied the Great Depression. What do you think was the role of narratives in allowing the Great Depression to be as great as it was, specifically?

Robert *Right. That's the big question. Why was it so bad? The stock market crash of 1929 developed into a narrative of immediate and profound significance. It was contagious partly because of moralizing. There was this moral outrage just waiting for something to happen. I looked at sermons on the Sunday after October 28, 1929—very moralizing, "See, I told you so." The first thing was the crash. It wasn't bank runs, that came a little later.*

Rob Yes.

Robert *In the past there'd never been such a drop. It was partly because it was the biggest one-day drop ever. Partly because stock price indices were available and they could document it.*

Rob Right.

Robert *There was a moralizing element. Christina Romer in her study of the Great Depression remarked that, based on evidence of retail sales, consumer purchases dropped off dramatically right after the crash. You can see that there was a story, and you heard it in your church of all places. The story of the 1920s was about being fake, phony. That people were selfish and show-offs. And that was a strong narrative.*

Rob Yes, and in some ways, a dangerous narrative because, firstly, spending is an important part of the macro economy. So if spending falls off a cliff, you've got a problem. And, secondly, how do you measure prosperity? It's in terms of people's resources and what they do with those resources.

Robert *So, the government didn't correct GDP; they started in 1929. They backdated it a little bit. But the way people saw the Great Depression was with their own eyes and the stories of their neighbors. So, in 1929, you saw an immediate reaction. And that led to layoffs because people weren't spending—within months. Walking down the street, you'd see beggars. In the past, you would ignore them, thinking they're just professional beggars—you know. They're good for nothing. But your neighbor next door got laid off, and he has four children. And he's been everywhere looking for a job, and there's just nothing available. Now he has ended up on the street selling apples. So that was a story which was very contagious, that led people to think, "Let's cancel our vacation this year. We can't do this. We could lose our job any moment."*

End of Part 1

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