Rational Expectations and belief narratives: a tentative research proposal

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Rational Expectations, Narratives and Beliefs

Recent work (e.g. Schiller, Akerlof, Benabou, Tirole amongst others) have highlighted the role narratives (beliefs about the future based on different interpretations on history and the present market conditions) play in determining aggregate, intertemporal market outcomes.
At a rational expectations equilibrium, it is common knowledge that economic agents agree on the realization of market outcomes in every possible future contingency and use all publicly available information (including information revealed via prices) to form beliefs and coordinate actions.

Bubbles

Shiller (2017): "In a bubble, the contagion is altered by the public attention to price increases: rapid price increases boost the contagion rate of popular stories justifying that increase, heightening demand and more price increases. In a stock market bubble, these might be stories of the companies with glamorous new technology and of the people who created the technology. In a housing bubble, clever people making a fortune flipping houses. There can also be price-to-GDP-to-price feedback, if speculative price increases stimulate purchases and hence more increases, price-to-corporate profits-to-price feedback, and price-to-regulatory laxity-to-price feedback, all mediated by changing narratives".
Modelling the conditions under which competing narratives (alternative beliefs about the link between history, current and future market outcomes) co-exist and understanding their role in intertemporal trade requires a step beyond rational expectations paradigm.

Some broad research questions

How do (possibly conflicting) narratives (heterogeneous beliefs about the future, based on different interpretations on history and the present) impact on asset valuation, resource allocation and aggregate outcomes in intertemporal markets?

Under what conditions do such heterogeneous beliefs lead to endogenous fluctuations in economic activity?

What is the role (if any) of policy?

What factors determine the efficacy of, and the welfare trade-offs associated with, policy interventions that aim to stabilize expectations in intertemporal markets?

A tentative research proposal

- Develop new solution concepts for large markets and games in intertemporal settings which allow for rationalizable heterogeneous beliefs about future market outcomes to co-exist and co-evolve with market outcomes.
- Apply these solution concepts to quantifiable, dynamic, behavioral models to characterize the conditions under which the behavior of agents with conflicting narratives lead to asset price bubbles and aggregate fluctuations in economic activity.
- Collect new data (and where possible use existing data) on heterogneous beliefs (using a variety of methods (surveys, lab experiments, lab experiments in the field, field experiments, IV analysis, regression discontinuity design, archives, machine learning to analyze texts/social media etc) in intertemporal settings to generate empirical regularities and quantify the effects of competing narratives on market outcomes and economic welfare.