The power of expectations

Advertising tells us that wishes really can come true. With the right deodorant, anyone can be a cool guy. The new yogurt is guaranteed to make you slim. Paradise is waiting for you at the seaside resort. It is well known that advertisements tell fictional stories designed to arouse the expectation that the product in question is going to make us cool, slim, or feel rested and refreshed. Our author explains that the economic system as such functions in a very similar way. Stories play an equally vital role in the seemingly rational world of investors and analysts.

Nobody can predict if an idea can be realized, if a product will find a buyer.

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We think of the economy as the embodiment of rational thinking. Investors and entrepreneurs make decisions and maximize their returns based on sophisticated mathematical models, detailed calculations, and precise prognoses. At the beginning of the 20th century, the sociologist Max Weber referred to modern capitalism as an “iron cage” that forces all participants into a mode of rational calculation. To this day, we are familiar with this idea of the economy as a place of rationally calculated actions. It is conveyed in economics textbooks, as well as in statements explaining the decisions made by economic actors who strive to maximize profits.

However, at best this image reflects only a part of the modern economy. After all, the future is unknown and therefore uncertain. It is characterized by genuine novelty, by developments that are unique, and not part of what already exists. This was once true for the telegraph, and it is now true for artificial intelligence. Nobody can predict what discoveries will be made, whether an idea is technically feasible, and if there will be a market for the products based on it. All investment decisions are therefore based on assumptions whose correctness can only partially be evaluated and people are generally aware that they will often turn out to be wrong in retrospect. Even for less groundbreaking
innovations, decision-making situations can be so complex that it is impossible to consider all relevant influencing factors. This is only possible in the models in economics textbooks, with their many narrowly defined assumptions. In real life, players are unable to fully take all causal relations into account. This problem is further intensified by the social character of economic activities: unlike chemical molecules, the reactions of the players and their interactions cannot be predicted, in part because the players will behave differently when observed.

Nevertheless, decisions need to be made regarding innovation projects, capital investments, investment in professional qualifications, even decisions to purchase consumer goods. Actors do this based on expectations regarding future developments. However, these expectations cannot simply be derived from past experience. In addition, participants in modern economic systems do not simply follow traditions or conventions. Therefore how can we understand expectations, and the decisions driven by them, if a situation is characterized by fundamental uncertainty, and it is impossible to rationally calculate optimized decisions?

The answer is: as fiction! This might seem far-fetched at first. After all, economic actors would not want to waste their money on made up stories. On closer inspection, however, there is a striking correlation between the nature of fictional texts and the context in which economic actors make their decisions under uncertain conditions.

These decisions reflect the economic actors’ visions of a future world. As there can be no facts about the future, and the future does not simply behave like a continuation of the present, these assumptions are not a guaranteed flash-forward to the future present. Instead, imagined futures are stories used as “placeholders” that enable the actors to make decisions, as if the future was going to develop in the way anticipated. To do so, they must be convinced of the story: it must appear plausible to them, but it does not have to be accurate. Novels and fictional stories are also based on the author pretending that a certain sequence of events has taken place as described, and the readers go along with this assumption. Decisions made under the condition of uncertainty and, fictional stories have something in common: both authors and recipients have a broken relationship to reality. It goes without saying that there are also differences, in particular the fact that economic actors will critically question the story repeatedly, revising it as needed, if new facts become known, or if there are new ways for interpreting the situation. However, one thing is still true at the end of the day: expectations remain fictional, as there can be no future facts.

Innovations may well be the prime example of the fictional character of economic decision-making. In his *Theory of Economic Development*, Joseph Schumpeter recognized already in the early 20th century that any innovation exists only in the entrepreneur’s imagination to begin with. As an aspired ideal, so to speak. The entrepreneur adjusts demand for production factors, as though the innovation had already been realized, and – if successful – they thus transfer their imagination to the real world.
Schumpeter’s assumptions are confirmed by studies in which innovation processes are examined in practice. Innovation processes start with “promissory stories” – promises used to illustrate a particular technological future that is often presented as being inevitable. An agenda is created in which the path towards this future is shown, and in which the individual actors are assigned their roles, much as in a novel. If a story appears plausible, scientists, government funding, and private investors will follow it. The current discussions about artificial intelligence are an example of this type of narrative motivation for present-day decisions based on an imagined future.

At the beginning of innovation processes, nobody knows if they will be successful. There is no knowledge about the finished product, but only an imagination from which a hype can develop, if the vision is considered to be credible. However, such a hype is not simply irrational enthusiasm, but an essential prerequisite for the dynamics of capitalism. To find out whether an idea is just a pipe dream or could actually be realized, it is often necessary to mobilize significant resources. Scenarios and forecasts are drawn up, usually backed up by a wealth of figures. The story of a possible future emerges, and if the players find it sufficiently plausible, funds are made available to allow the idea to be tested. According to the organizational researcher James March, organizations must succeed in creating shells in which “craziness is protected.”

One might assume that basic research also takes place in such shells. The results and likelihood of success of such research are extremely uncertain. In particular, it is impossible to predict if and to what extent it will result in marketable applications. From a purely rational point of view, basic research is bound to struggle. Any practical use that can be expected from it appears too uncertain and too distant. So why invest in something that has at best vague prospects of economic success? Such objections may be understandable, but they remain problematic. After all it is not only innovation, but the entire dynamics of modern economies that depends to a considerable extent on scientists, entrepreneurs, investors, and consumers daring to make decisions, whose likelihood of success is unknown and that will incur considerable costs if they fail. If they do succeed, however, they are the drivers of capitalist dynamics. Researchers as well as research organizations react to these circumstances, by outlining how central societal problems can be solved through a future discovery, or by highlighting the purpose-free character of scientific knowledge. In doing so, they legitimize the use of resources despite the uncertainty of success. Societies react to this by providing state funding to cover a large share of the costs of basic research, to enable it to take place despite a lack of short-term commercial pressure.

When it comes to private companies, it is start-ups in particular that use fictional expectations to facilitate their innovative activities. In the search for capital, they have to pitch their ideas to potential investors, who will make their investment decisions based on an oral presentation and submission of a business plan. For start-ups, the product that is being sold often does not even exist, since the funds being sought are intended to create it. Nevertheless, business plans contain detailed descriptions of future turnover, market shares, and the costs of competing products. These figures are, however, merely more or less plausible assumptions: stories about a future that the parties involved picture as if they have already been realized. In this sense, all business plans represent a disrupted relationship with reality. Competition is largely about competing for the more convincing story.
What is true for innovations is true for the capitalist economy as a whole. The entire dynamics of modern economies are heavily dependent on scientists, entrepreneurs, investors, and consumers making decisions whose likelihood of success is unknown. Decisions regarding career choices are characterized by a wealth of fictional expectations regarding one’s own future position, which is imagined in the form of a future that has already been realized. A doctoral student sees themselves as a professor; a business student as the head of marketing at a large company. The entire monetary system is based on the fictional expectation that figures in bank accounts or on bank notes, although valueless in themselves, can be traded for valuable goods in the future. Every monetary system depends on this collective fiction. Currency crises show how fragile such expectations can be. Consumer decisions are linked to notions of a future life with the product in question. This anticipative consumption is fueled by travel brochures, car catalogs, movie trailers, lottery tickets, or product presentations from the computer industry, where the motives for purchasing decisions are presented as anticipations of the future.

However, it takes more than just any random story to achieve credibility. Fictional expectations in the economy are subject to ongoing critical review, not least in the markets. Is Tesla going to be the car manufacturer of the future, or will the share certificates just be waste paper a few years down the line? The term capitalist dynamics encompasses phenomenal economic growth, as well as economic crises that have been occurring time and time again, ever since the initial spread of capitalist economic principles. Crises occur if expectations that were considered to be credible suddenly appear unreliable. Markets lose their faith that Greece’s sovereign debt will be paid back; consumers no longer see a brand as reflecting their desired social identity. Turnarounds like this are not triggered simply by new information. Much more frequently, it is a new interpretation of established information or – in the case of consumer goods – a new hype that makes existing products look outdated.

The imagery of worlds that do not exist but that are to be created shows that human beings are capable of fiction. This may well be the most fundamental ability of humankind. It is in this very ability that creativity is expressed, and it is this creativity that has been driving the incredible growth dynamics of capitalism ever since its beginnings in the Italian trading cities. However, this also creates new problems. Among these are the vulnerability of economic systems, whose development is based on the credibility of stories. This also includes the possibility of fraud: take Elizabeth Holmes, for example, chairwoman of the former showpiece company Theranos in Silicon Valley, who, despite knowing it to be false, convinced her investors with the story of the expected further development of her revolutionary blood analysis device. After a journalist from the Washington Post found out about the deception, the company’s valuation fell from nine billion dollars to zero.

It also holds that narratives are used deliberately, to create a future. While the future cannot be predicted, it can be shaped through prophecies whose narratives motivate decisions. This can lead to a stabilization of the economy, for example when currency crises are prevented, or when politicians “guarantee” in public speeches that bank balances are safe. This power to influence expectations was used by both President Roosevelt in the 1930s and Chancellor Merkel in 2008.
Techniques for predicting and creating credible narratives of future development can also be used to serve political, ideological, or business interests. Examples of this are industry representatives fighting the introduction of minimum wages by forecasting rising unemployment figures, or populists prophesying that taking in refugees will lead to an Islamization of German society. Technological visions, such as those currently being propagated by a handful of players in Silicon Valley, always contain social development models, generated by these technologies, but which largely evade social debate. This shows that a politics of expectations exists. Control of our visions of the future is among the most important tools of power; and this is true historically, as well as in the present day.

If economic decisions are not thought of as being determined rationally, but as the result of futuristic visions that are ultimately contingent, this will also lead to a new understanding of the economic sciences. Since the 19th century, economics has been modeled after physics. It has been assumed that there are economic laws, in the same way that there are natural laws, and that the economy tends towards an equilibrium, much like the equilibrium of forces in physics. However, if the participants’ interpretations play a decisive role for economic dynamics, and future developments are determined by the plausibility of stories, then economics should not be modeled after physics, but after hermeneutics – the study of interpretation. Nature does not tell any stories, while the economy is based on them. As in all social action, participants in the economy act based on the meaning a situation takes on for them. The situation needs to be “read”, and of course this also involves mathematical models. The Nobel Prize winning economist Robert Shiller speaks of “narrative economics.” If this proves to be true, it is the disciplines dedicated to the analysis of structures of meaning that deliver the model for understanding the economy: the humanities and social sciences.

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