Journal of Behavioral and Experimental Economics xxx (xxxx) xxx–xxx

Contents lists available at ScienceDirect

Journal of Behavioral and Experimental Economics

journal homepage: www.elsevier.com/locate/jbee

Book review

How We Misunderstand Economics and Why it Matters, David Leiser, Yonatan Shemesh. Routledge Taylor & Francis Group, London and New York (2018). 165p (xiv) suggested retail price of book 978-1-138-93893-9

David Leiser is an expert in economic psychology who has written numerous papers about citizens‘ naive perception and understanding of the (economic) world around them. A special emphasis rested on markets (Leiser and Beth Halachmi, 2006) and macroeconomic phenomena like inflation (Leiser and Drori, 2005) or - more recently – on economic and financial crises (Leiser et al., 2016). In 2017, David Leiser and Yhonatan Shemesh published a book on laypeople's (mis)understanding of economics. This book provides a throrough and yet easily accessible review of literature. Only occasionally do the authors refer to their own research. Instead, they cover research conducted by many scholars – mostly psychologists. A special focus rests on empirical studies that use data from surveys and experiments.

The book is organized in 10 chapters. The first three chaptes serve as introduction to the more specific chapters 5–9. In chapter 1, the authors sketch empirical evidence showing that laypeople entertain views on important economic phenomena that fundamentally contradict the views commonly accepted among economists. Chapter 2 lays out some fundamental characteristics of in which laypeoples‘ reasoning about the economic differs from the lines of reasoning used by economists. First laypeople‘ inference stops at the direct effects while indirect effects are ignored. For instance, they tend to ignore the fact that rising wages lead to rising prices. Moreover, laypeople do not think in terms of equilibria. Chapter 3 sketches different concepts from psychology that may help to explain the limitations in economic reasons among laypeople. Leiser and Shemesh describe a concept from cognitive psychology that builds on an analogy from computer science and differentiates between long-term memory and short-term working memory. Next they introduce the concept of „Thinking, fast and slow“ as well as the so-called intentionality bias. According to the latter, humans tend to overemphasize the role of individuals‘ intentions in explaining phenomena at the aggregate level. In the second half of chapter 3, the authors show that these concepts help explain why laypeople ignore aggregate and equilibrium effects. Furthermore, they have the potential to explain numerous well-established biases in economic decision making – among them opportunity cost neglect, the halo effect or the denial of trade-offs. The illustrations in chapter 1–3 are somewhat eclectic – and the authors readily admit that they are. At the same time, they serve their purpose to prepare the reader for what I consider the main question of the book: How do laypeople reason about specific economic phenomena?

Chapter 4 addresses this question for the two macro-economic phenomena of unemployment and inflation. Leiser and Shemesh review a number of studies showing that laypeople attribute unemployment to mixture of individualistic, societal and fatalistic factors. The literature identifies clear differences in the causal structure leading to unemployment among laypeople depending on their political orientation. The chapter reproduces visual representations of the principle causal structures found in the literature. These representations are very informative for economists because they can compare the causal structure as perceived by laypeople to the causal structure inherent to the standard economic models.

Chapter 5 turns to a number of studies on the so-called „good begets good-heuristic“. While these studies show that laypeople do not generally deny the existence of trade-offs, they clearly show that laypeople expect trade-offs where economists do not see them and vice versa. These discrepancies pertain to the relationships between important macro-econmic measures like GDP-growth, unemployment and inflation. Thus, households in real life entertain expectations that are fundamentally different to those held by the representative households inhabiting most macro-economic models. As the impact of macro-policies – especially monetary policy – strongly depends on citizens‘ expectations, macroeconomists should be deeply worried when reading this chapter.

In chapter 6, Leiser and Shemesh discuss the role of metaphors and intuitive theories in laypeoples‘ thinking about the economy. The most common metaphors used when reasoning about the functioning of the economy see the econonomy as machine or living organism. Leiser and Shemesh argue that these metaphors are omnipresent - in the media as well as in laypeople's reasoning. And they point at a number of severe pitfalls of using these metaphors. They also show that laypeople overestimate the degree to which behavior – especially behavior harmful to others (e.g. raising prizes) – is deliberate and driven by the intention to hurt others. Though the research sketched here is closely linked to the concept of mental models (Johnston-Laird, 1980; De Kleer and Brown, 1983), the authors do not point the reader to this link, nor do they elaborate on it. This is somewhat unfortunate because the concept of mental models builds on a way of thinking that economists may feel familiar with.

Chapter 7 turns to laypeoples‘ view on capitalism. Leiser and Shemesh show that differences in citizens‘ view on capitalism do not merely refer to differences in the assessment of the efficiency-equality trade-off. Instead, the fundamental view on the acceptability of self-interest and greed as a motivation play an important role. Furthermore, divergent views on the „Locus of Control“ are crucial. In the eyes of an economist, the Locus of Control looks like a measure of citizens‘ beliefs regarding their own role in the world. However, economists have to learn that psychologists interpret subjects‘ view on the Locus of Control as part of their personality. We will get back to this below.

Chapter 8 compiles interesting studies on laypeople's view on wealth and money. Again, the views differ fundamentally from the economists‘ view. And again, Leiser and Shemesh convincingly show that these differences are economically and politically meaningful. The policy implication seems straight forward. Improving financial and economic literacy seems an appropriate measure to improve welfare. However, chapter 9 points at a well-established strand of liteature showing that this conclusion is overoptimistic: While superior financial literacy is associated with financial prosperity, increasing financial

https://doi.org/10.1016/j.socec.2018.10.008
Received 29 October 2018; Accepted 29 October 2018
2214-8043/

literacy does not raise prosperity.

In the final chapter 10, the authors turn to the implications of the insights generated in the earlier chapters of the book. According to them, the fact that laypeople misunderstand economics has to be taken as given. They do not see the solution in economic training or more economics at school. Furthermore, they argue that the degree to which existing economic models of human behavior are ignorant of this misunderstanding is one prominent reason why the predictions of economic theory are often substantially of the mark. To improve the predictive power of economics, they suggest that economists should account for laypeoples‘ misperceptions.

An economist by training, I read the book through this particular lense. The authors did not have to convince me that substantial progress can be made if we open the black box of a representative individual's reasoning about economic phenomena. A better understanding of how laypeople perceive the structure and functionality of the economic environment in which they act helps us to develop more adequate models – both in micro- and macroeconomics. These models can help us to predict citizens reactions to public policies more accurately and – based upon this knowledge – design better policies. Furthermore, it can help to gain a deeper understanding of why voters often oppose policies that economists consider helpful and/or support policies not considered helpful.

On page 125, the authors address the economists among the readers directly and point at one crucial difference between the economic and the psychological approach to human decision making: The economist insists that the preferences and beliefs are distinctly different things that have to be separated carefully. When asked to locate personality traits in the model of human decision making, economists generally think of them as stable characteristics of a person – some sort of prior beliefs – that may influence both preferences and beliefs. Psychologists consider this notion to be a serious oversimplification. In their understanding, traits are not stable but they depend on subjects‘ mood and may be modulated exogenously e.g. through priming. Adopting this view would fundamentally shatter the economic approach to decision making – even for those who accept that humans are boundedly rational and will thus make decisions that do not systematically maximize expected utility. Given the analytical power of the clear distinction between concepts like beliefs, preferences and traits, it remains to be seen whether it will be necessary to give up this distinction when developing models of human decision making that account for the evidence compiled by Leiser and Shemesh.

In sum, the book by David Leiser and Yonatan Shemesh provides an excellent introduction to the existing empirical research in this field. It is an easily accessible and inspiring starting point especially for economists who want to learn what psychology has to offer.

References

De Kleer, J., Brown, J.S., 1983. Assumptions and ambiguities in mechanistic mental models. In: Gentner, D., Stevens, A. (Eds.), Mental Models. Erlbaum, Hillsdale, pp. 155–191.

Johnson-Laird, P.N., 1980. Mental models in cognitive science. Cognit. Sci. 4 (1), 71–115.

Leiser, D., Drori, S., 2005. Naive understanding of inflation. J. Socio Econ. 34 (2), 179–198.

Leiser, D., Beth Halachmi, R., 2006. Children's understanding of market forces. J. Econ. Psychol. 27 (1), 6–19.

Leiser, D., et al., 2016. Differing conceptions of the causes of the economic crisis: effects of culture, economic training, and personal impact. J. Econ. Psychol. 53, 154–163.

Ivo Bischoff

Faculty of Economics and Management, Public Economics Unit, University of Kassel, Germany Nora-Platiel Strasse 4, Kassel 34109, Germany

E-mail address: bischoff@wirtschaft.uni-kassel.de