NARRATIVES IN ECONOMICS

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Abstract

Narratives in economics describe how storeys "enliven themselves" in human society, and these stories cause and stimulate disruptive events in the economy. The concept is motivated by the development of increased communication on social networks, as well as worldwide experiences from the pandemic situation since 2019. The fundamental question is why some narratives will take hold in economies and societies, but the vast majority of these narratives will fade away. In the environment of economic theory, it is very interesting that all four basic macroeconomic approaches, which gained popularity in the twentieth century, have evolved dynamically similar to the COVID-19 pandemic or the Bitcoin " epidemic". These are the IS-LM approach (Hicks, 1937), the multiplier-accelerator model (Samuelson, 1939), the overlapping generations model (Samuelson 1958) and the real business cycle model of Kydland and Prescott (1982). Ten years after their initial publication, three of the four listed methodologies have fully reflected in economic theory and practice. Through their contributions to conferences and written publications, academics create the space for a new paradigm throughout the aforementioned period of commencement of the ideas. The media presents the theorem throughout the subsequent step. The third stage starts when the general public tries to explain why their cutting-edge general education is important.

Key words: Mainstream Economics, Narratives, Behavioral Economics

JEL Code: E70, E71

Introduction

Economic theory now fully embraces the behavioral economics methodology. But it remains the minority viewpoint in the realm of the original mainstream New Keynesian economics. It depends on how the supposedly novel behavioral instrument is used. The nominal and real rigidities, as well as the behavioral approach to the labor markets, are all parts of quantitative economics (and also the quantitative approach to finance). Most notably for the theory of the consumer, however, many traditional economists consider some behavioral methods to be useless. All behavioral economists need to be encouraged to consider themselves followers of the classics in the mainstream.

This article's main objective is to introduce a novel behavioral economics idea, narrative economics. We were referring to the novel method used by economic storytelling, economic narratives (Shiller, 2020). In essence, economic narratives explain how stories "enliven themselves" in human society and how these stories trigger and fuel disruptive economic events. The idea is inspired by the emergence of more intensive social media communication and is also based on experiences from the pandemic situation around the world since 2020.

1 Quantitative or behavioral economics and finance?

Investors and other economic agents are often perceived as being more irrational than rational, according to behavioral economics and finance. They make poor decisions as a result of these cognitive mistakes. The impossibility of arbitrage in an economic sense is the foundation of quantitative finance theory.

The dynamics of demand for physical financial products quickly wipes out any arbitrage profit. Demand growth causes an increase in the present price, which raises predicted profitability, and market dynamics cause the profit opportunity to vanish. Investors that foresee the aforementioned scenario earn more money by holding the asset. The described rule is consistent with many other financial and economic postulates, including the law of one price, the expectation hypothesis, and the efficient market hypothesis. It is also consistent with the dynamics of perfect competition and the tendency towards normal (zero) economic profit at the level of a sub-firm.

Generally speaking, behavioral finance theory does not support the findings of quantitative finance; rather, it undermines them. Investors are perceived as being more sensible than rational. These investors are subject to their own emotions, other cognitive constraints, and personal restraints. Psychological biases then have an impact on decisions.

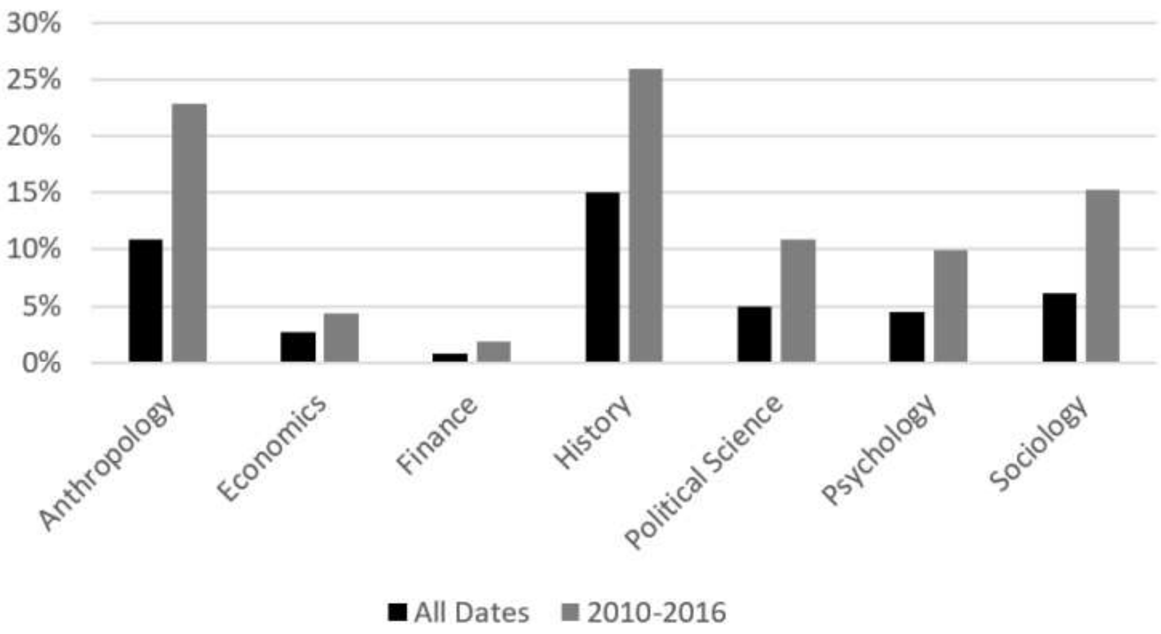
When considered collectively, these investors result in errors of judgment that influence poor choices. Finally, the DSGE modeling system incorporates the complete approach, both the behavioral approach and the quantitative approach. It should be noted that while behavioral economics is viewed inside macroeconomic theory in New Keynesian traditions with rigidities and many other behavioral characteristics, quantitative economics is primarily represented by the notion of efficient markets. In the notion of Hansen and Sargent (Hansen and Sargent, 2013), both the financial markets and the real economy are taken into account in an aggregate system of the DSGE type.

Many modern applications of economic theory and finance theory, including the experiments of Kahneman and Tversky (Kahneman and Tversky, 1984), the idea of "keeping up with the Joneses," Pastor and Veronesi's (2009) theory of rational bubbles, and many others, exhibit the described approach. The fundamental principles of behavioral economics are represented by the ideas given.

Additionally, during the past few years, projects from the field of practical behavioral economics have been favoured in the field of Czech basic research in economics (GAČR projects) (more than 30% of recognized projects are from the field of behavioral economics and innovations, climate change, etc.). The two ideas discussed are two fundamental approaches that frequently cross paths, starting with the efficient market theory on the one hand and the so-called "animal spirit" on the other. In the theory and application of macroeconomics and finance, these notions already undermine one another.

Shiller (2020) introduced the idea of narrative economics. He adopted the notion and was informed of the advantages and disadvantages of the narratives approach to conventional economic theory and finance. As often as Shiller (2020) has so far demonstrated contemporary empirical and theoretical tendencies. JSTOR counts the percentage of all articles in each field that contain the term "narrative" for the full database on the left and exclusively for the years 2010 to 2016 on the right. This is shown in the following illustration:

Fig. 1: Percent of articles that use the word "narrative"



Source: Schiller (2017)

2 New Concept or the lived reality?

The essential issue is why some narratives in economies and societies gain traction while the vast majority of these tales disappear. In the context of economic theory, it is very intriguing that all four fundamental macroeconomic approaches became popular in the twentieth century, dynamically permeating like a contagion into economics, economic policy, and, of course, society, in a manner akin to the spread of the COVID-19 pandemic or the bitcoin "epidemic".

We have watched the COVID Pandemic's effects and the growth of the Bitcoin market as they have changed over time. A larger portion of the COVID-19 outbreak may have spread throughout the population months before it was initially recognized in China. However, even though there was no scientific proof of this, it was the single factor that affected the economies of industrialized nations moving forward.

Bitcoin was created through the same process of breeding through society and the economy. It was thought to be a replacement for traditional money because it was a digital asset. It encompasses all roles, including those of value keeper, exchange medium, and accounting unit. After all, it has evolved into a valuable investment. But as inflation in 2022 started to manifest from several angles, brought on by both monetary and fiscal theories of inflation, the price of bitcoin fell. The historical evolution of the key four macroeconomic concepts is similar to that of the COVID epidemic in shorter time periods, and the larger time volumes of bitcoin. Some people experienced very high costs as a result of the described inventions, whereas for others, these costs turned into profits.

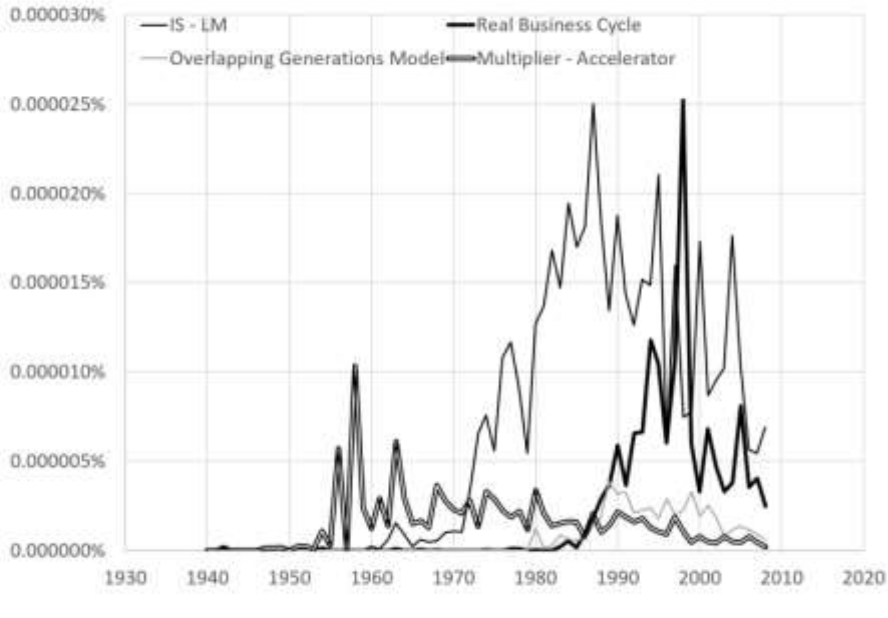
Once more, the interconnecting ideas between narrative economics and mainstream economics are the multiplier-accelerator model (Samuelson, 1939), the overlapping generations model (Samuelson, 1958), the real business cycle model of Kydland and Prescott (1982), and the IS-LM approach (Hicks, 1937). Although they were first announced extremely late in the period, these theoretical concepts have subsequently grown into every significant aspect of the economy and society. As well as the development of the COVID Pandemic and Bitcoin.

Ten years after their initial publication, three of the four listed methodologies have fully reflected in economic theory and practice. This situation is analogous to an epidemic that spreads gradually in tiny steps.

Only when there are more than a certain number of occurrences does a new phenomena become perceptible. The aforementioned economic theorems were initially seen as provocative outliers, but after 10 years they entered the mainstream and were accepted as certain truths. According to Shiller (2020), academics lay the groundwork for a new paradigm during the aforementioned startup phase through their presentations at conferences and written papers. The theorem is presented by the media in the second step, and in the third phase, the general public adopts the theorem as the only one that can be true in order to demonstrate the value of their general education.

Young (2010) asserts that rather than being wholly novel and having an impact on economics and economic policy, the IS-LM model appeared appealing because of the way two intersecting functions based on the supply and demand notion were developed. It was simple, and something promising caught people's interest. The IS-LM model primarily represented Keynes' theories' incorporation into a theoretical framework. Keynes was a gifted writer and something of a celebrity. Celebrities must create societal narratives because, as we all know, people like them. Contrarily, Hicks was a dry academic who needed to use stories from Keynes's life to draw readers to his writings (World War II, which was discussed as early as 1919 in "Economic Consequences of Peace"; most recently published as Keynes, 2017); bisexuality; marriage to a fashion icon; and becoming wealthy through the financial markets. Due to the fact that modern narratives have hijacked the aforementioned economic narratives, they can endure for a longer period of time. However, the consequences of economic narratives only last a short time. Narratives have the ability to change and reappear. Google Ngrams counts for four economic theories: IS-LM (Hicks 1937), Multiplier-Accelerator (Samuelson 1939), Overlapping Generations Model (Samuelson 1958) and Real Business Cycle model (Kydland and Prescott, 1982).

Fig. 2: Four most famous economic theories at Google Ngrams



Source: Schiller (2017)

The National Bureau of Economic Research (NBER) lists the following as the most important economic events that influenced narratives in the US:

- The deadliest conflict in which the nation was engaged took place after the economic downturn (1857–59), the secession of the southern states of the USA, and the ensuing Civil War (1861–65).
- The best-selling economic book in the US, "Progress and Poverty" (Henry George), which attributed persistent disparity to the idea of an unrestrained free market, was published as a result of the Depression of 1873–1879.
- The US entered the Spanish-American War and the Philippine War as a result of the Depression of 1873–1879 and two following contractions in 1893–94 and 1895–97.
- The establishment of the FED and the United States' subsequent participation in World War I were prompted by a string of economic downturns that occurred between 1907 and 1914.
- The greatest deflation in the history of the nation occurred during the country's brief but severe downturn in 1920–21.
- Following the stock market crash, the Great Depression of 1929 led to a global economic downturn.
- It was preceded by the Second World War and the American economy's recession in 1937–1938.
- The wars in Iraq and Iran started before the US recession of 1980–1982.
- Even today, the Great Recession of 2009 is still spreading a "virus" of stories.

The overwhelming majority of economic narratives are repeated and frequently resurface in new forms, but they always take the same basic shape: The gold standard versus bimetallism, thrift versus extravagant consumption, the destruction of all jobs by automation and artificial intelligence, real estate booms and busts, crashes on financial asset exchanges, boycotts, profiteers, and unfair business, the wage-price spiral, and the negative effects of unions are just a few of the topics covered.

The Laffer curve, the Rubik's cube, Bitcoin, supply-side economics, the narrative of narratives in the form of fake news, the American dream (including the right to have own house), the Trumpian narrative about unheard Americans, technological bubbles, and many others are among the most well-known economic narratives of recent decades. The aforementioned storylines can be found in the original, earlier editions from the list above by careful readers.

3 First case of narratives – economics case: Laffer Curve

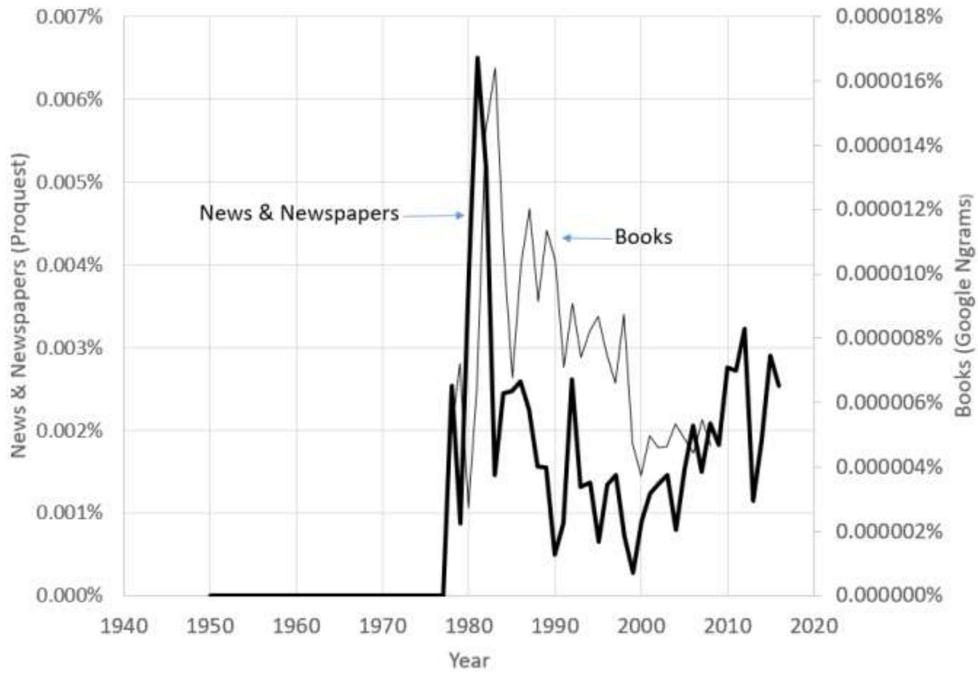
The Laffer curve seeks to reduce taxes without reducing spending. It initially emerged at the dinner where Arthur Laffer introduced the aforementioned concept in 1974. Since then, the Laffer curve story has come up twice. In relation to the phrase and concept of so-called modern monetary theory, it first occurred in the 1980s and then again after the year 2000. In both instances, it led to a drop in taxes, which led to issues with public sector finances. The Laffer diagram resembles other diagrams from introductory economic theory courses quite a bit. The Laffer curve diagram is particularly well-liked by the general population, which is the distinction. The major takeaway is that extremely high income taxes discourage people from working more, which lowers national income. In the 1980s, the Laffer curve expanded rapidly in the USA and the UK. It also created a very strong contagion in France, despite the socialist presidency of Francois Mitterand at the time.

It is known as the beginning story more so than the idea itself. Two distinct income tax rates are supposed to achieve the same level of tax revenues under the Laffer curve. As a result, Jude Wanninski, the Wall Street Journal's editorial director, and Donald Rumsfeld were all given the concept by Artur Laffer. Wanniski (1978) illustrated the concept's colorful side in the international best-seller "The Way the World Works." The Laffer graphic was written on a napkin that Wanniski's wife discovered in his late files after his death. The napkin has been on exhibit at the National Museum of American History ever since. However, Artur Laffer turned down the napkin, claiming that his mother had taught him not to throw away lovely things like cotton napkins. It appears that the thought itself is less the cause of the spread than the tale of how the idea first came to be. Contagion appears to be caused, at least in part, by effective storytelling. Scientific research has also shown that unexpected visual cues can assist people remember events and help a story become legendary. Without any supporting evidence, Wanninski asserted that the economy is located on the Laffer curve's inefficient side. Long-term memory was formed from an economic anecdote in the story. The visual sight of the napkin lowers the rate at which people forget the idea over time. The occurrence rate of the "Laffer Curve" by year. It is the proportion of articles with this term among all articles for news and newspapers published between 1950 and 2016 (ProQuest). For books (1950–2008, according to Google Ngrams), it is the proportion of "Laffer Curve" occurrences to all the words in the database for that year.

Fig. 3: Laffer Curve Counts

a) News and Newspapers (ProQuest)

b) Books (Google Ngrams)



Source: Schiller (2017)

4 Second case of narratives – scientific case: Rubic´s Cube

The Rubic´s cube is an additional illustration of narrative. Erno Rubik, a Hungarian sculptor and architect, created a cube-shaped logic game in 1974. It is made up of the littler, striped cubes. It rose to fame as a result of the perception by many that it adheres to novel, innovative mathematical principles. The Rubic's cube was introduced as a profound scientific idea by Douglas R. Hofstader in 1984. For example, quarks and quantum physics are both related to the Rubic's cube according to Hofstader (1984). Nowadays, a lot of people still recall the rejected principle.

Conclusion

The behavioral economics approach, which is quite real in terms of the impact of pandemics 2020 - 2022, was briefly discussed. The narrative grew in significance as the social network did. Additionally, we discussed the full repercussions and degrees of the two narratives—the Laffer curve (economic theory narrative case) and the Rubik's cube (scientific narrative case). These two erroneous, data-based conclusions were not verified. However, they have made advancements in the domains of science and economics. The four most popular macroeconomic notions showed the same evolution and impact.

The COVID Pandemics explanation, the IS-LM-BP strategy, and all the other theoretical and practice principles, for example, resulted in numerous economic impacts and costs, despite the fact that decision-making was primarily based on impressions rather than evidence. Additionally, we discussed how crucial public relations perceptions are to the empirical realization of theoretical concepts.

The compelling Laffer curve narrative influenced macroeconomic theory and policy and also made an appearance in the preference for supply-side economics. It also had an impact on microeconomic reality by favoring leveraged buyouts, corporate raiders, and increasing shareholder value principle against other goals. These cause businesses to be deeply in debt and to disregard their implicit agreements with stakeholders and employees.

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