

CFM QUARTERLY

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PART A : ARTICLE

NARRATIVE ECONOMICS

In his presidential address to the American Economic Association in January 2017, Robert Shiller dwelt on the theme of narrative economics. He considers the epidemiology of narratives relevant to economic fluctuations.

The key points of his address are:

1. The human brain has a penchant for narratives.
2. Narratives have a huge economic impact and quantitative analysis may help us in gaining a better understanding of the epidemiology of narratives.

Penchant for Narratives

While there have been controlled experiments showing that people respond strongly to narratives in the fields of marketing, education, philanthropy, and journalism, there have been no controlled experiments to prove the importance of changing narratives in causing economic fluctuations.

Shiller defines a narrative as “as simple story or easily expressed explanation of events that many people want to bring up in conversation or on news or social media.” It is not generally a researched story and can be based on varying degrees of truth, with glaring holes in it.

Narratives can be used to stimulate the concerns or emotions of others and/ or advance self- interest. It usually has some human interest, explicit or implicit.

The relatively recent advent of modern information technology and social media may increase the impact of non- factual narratives in today’s world than in decades past.

It appears that stories distinguish us most from animals. Our species may be called Homo narratives (storytelling man) rather than Homo sapiens (wise man). The human mind strives to reach enduring understanding of events through a narrative that is embedded in social interactions.

Psychologist Jerome Bruner stressed the importance of narratives which are mixtures of facts and emotion and human interest. As he said, "I do not believe that facts ever quite stare anybody in the face. From a psychologist's point of view, that is not how facts behave as we well know from our studies of perception, memory, and thinking. Our factual worlds are more like cabinetry carefully carpentered than like a virgin forest inadvertently stumbled upon."

It appears that certain basic structures of stories recur, though the names and circumstances may vary from one story to another, suggesting that the human brain has receptors for certain built-in stories. According to Ronald B. Tobias, in all of fiction there are only twenty master plots: "quest, adventure, pursuit, rescue, escape, revenge, the riddle, rivalry, underdog, temptation, metamorphosis, transformation, maturation, love, forbidden love, sacrifice, discovery, wretched excess, ascension and descension." Going a step further, Christopher Booker argues that there are only seven basic plots: "overcoming the monster, rags to riches, voyage and return, comedy, tragedy, and rebirth."

Narratives in Economics

There is a profusion of scholarly literature about narratives in several academic disciplines and associated concepts of norms, social epidemics, and contagion of ideas. Economists can learn from this. As Shiller says, "We economists should not throw up our hands and decide to ignore this vast literature. We need to understand the narrative basis for macroeconomic fluctuations, and to think about how narrative economics ought to be more informing of policy actions now and in the future."

Indeed there have been narrative epidemics of economic theory. Consider the narrative epidemic associated with the Laffer Curve. Proposed by Arthur Laffer, an economist, the Laffer Curve is an inverted U curve relating tax revenues to tax rates. The Laffer Curve narrative exploded into public attention in 1978 focusing on a 1974 event in which Laffer drew his curve on a napkin at a restaurant table. Much of the Laffer Curve contagion is due to the fact that it was seen as justifying major tax acts. Its contagion was related to the political changes associated with the ascendance of Ronald Reagan in the U.S. and Margaret Thatcher in the U.K. and their commitment to tax cuts.

The global financial crisis of 2007- 2009 was first referred to as the "Great Recession of 2007" in late 2006 by Nouriel Roubini, a year before the recession had started. The

very nomenclature “Great Recession” could be interpreted as evidence of a narrative epidemic. It took few years, until 2009, for the term to catch on and go viral.

Representativeness heuristic says that people judge current events by their similarity to memories of representative events. The Great Depression is a model that is etched in people’s mind because of its legendary status. To justify their requests to apply stimulus, presidents and prime ministers have invoked it.

However, narrative economics, to the extent it has been practised by scholars, does not have a good reputation. Why? Shiller’s answer is: “In part, it may be due to the fact that the relation between narratives and economic outcomes is likely to be complex and time varying. The impact of narratives on the economy is regularly mentioned in journalistic circles, but without the demands of academic rigor.”

The advent of big data and better algorithms of semantic research might bring greater rigour to the field. As Shiller says, “Research in economics is already on its way to finding better quantitative methods to understand the impact of narratives on the economy. Textual search is a small but expanding area in economic research.”

PART B : SNIPPETS

Debiasing the Corporation

Here are some suggestions by Richard Thaler for debiasing the corporation.

1. **Write the Stuff Down** People suffer from hindsight bias – after the fact people think they knew it along. So when a decision is taken write what is expected of it. As someone quipped, “If you don’t write it down, it never happened.”
2. **Nudge the corporation** The manner in which options are framed has an influence on the choices people we make.
3. **Build diversity** It is important to have diversity in how people think.

Features of the Neoclassical Framework

The neoclassical framework is inspired by physics. Humans in neoclassical framework are like idealised particles in physics. They may be called ECONS. ECONS display the following characteristics:

- Consistent expected utility
- Bayes’s rule for updating probabilities
- Self- regarding preferences

- Emotionless deliberation
- Exponential discounting
- Unlimited abilities
- Unlimited attention
- Unlimited willpower
- Frame- independent preferences

Neoclassical economics is typically underpinned by optimization based solutions and an equilibrium approach.

The Becker Proportion

According to the Becker proposition, the most efficient way to deter crime is to impose the “severest possible penalty, F , with the lowest possible probability of detection and conviction, p .” By reducing p , society can reduce enforcement costs (such as policing and trial costs). But by increasing F , which does not cost much, the deterrence effect of the punishment is maintained.

PART C : WIT AND WISDOM

HUMOUR

Relative- Fool

A to B “C says that he is closely related to you.”

B “C is a fool !”

A “Then he must be related to you “

Crossword Puzzles

The manager asked a young job applicant “What special qualifications or unusual talents do you have?”

Job applicant, “Yes, I have won several prizes for solving crossword puzzles and slogan writing.”

Manager, “That sounds good, but we need people who are smart during the office hours.”

Job applicant “Oh yes, all that was during the office hours.”

WISDOM

1. Youth is when you're allowed to stay up late on New Year's Eve.
Middle age is when you're forced to. : Bill Vaughan.
2. Decision is a sharp knife that cuts clean and straight. Indecision is a dull one that hacks and tears and leaves ragged edges behind.