

Early news of Wellington's victory at Waterloo allowed the Rothschild fortune to be extended by large purchases of

stock at prices pressed by the prospect of defeat. Such 'insider' knowledge affords many opportunities for gain. Similarly, value attaches to accurate forecasts of economic trends. Although economists rarely profit through trading on the basis of forecasts, high salaries are earned by their sale. Comments by former Chancellors suggest this money is not well spent.

Denis Healey cites inaccurate PSBR and international payments forecasts which sent him cap in hand to the IMF in 1976; he believes 'that most of the theories on which economics is based are bunkum'. Nigel Lawson contends that his advisers failed to anticipate the 'change in behaviour by both borrowers and lenders' after the 1979 abolition of exchange control and the 1983 collapse of the building society cartel. (Personal debt increased from around 50% to over 100% of annual income.)

Since their inception in 1968, Treasury growth forecasts have been wrong by 1% on average against a base figure of 2.5%! The explanation given is 'unprecedented changes in private-sector behaviour in response to institutional and structural changes'. In similar vein, economists at Morgan Grenfell complained that 'a unique housing market recession is defying established methods of prediction'.<sup>1</sup> Such claims are disingenuous. The poor record of economic forecasts extends over many decades. On 15 October 1929, Irving Fisher stated that he expected 'to see the stock market a good deal higher than it is to-day within a few months'. Nine days later, share prices tumbled.

If some forecasts show some accuracy, it is a consequence only of their number and diversity. Paul Samuelson's two rules for economics forecasters are (1) don't do it! and (2) if you must do it, do it often. Equally appropriate are the

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aphorism 'Give them the rates or give them the dates but do not give them both' and J.K. Galbraith's two-way classification of forecasters: those who don't know and those who don't know they don't know.

Forecasters assess actual states of the economy by comparison with theoretical equilibria. Such 'counter-factual' models incorporate no surprises, no mistakes and no readjustments. So, in order to compare actual events with their models, it is necessary to cheat – that is, the course of events is doctored to suppress the surprises, even though they are always historically relevant. By such use of empirical relationships, important details are always neglected. Together with an obvious inability to anticipate future surprises, this sets most detailed forecasts in the realm of fantasy.

The material of economics is relationships between *men and men*, and between *men and things*, which are generally too numerous, too diverse and too transient to quantify. This contrasts with the material of the physical sciences, where there are demonstrable and reliable relationships between *things and things*. In the physical sciences, statistical methods may be relevant to the analysis of categories of data obtained under exactly similar circumstances. Such conditions rarely apply to economics. Yet, when it comes to the functioning of economic systems, enormous weight is given to statistical correlations between large aggregations of data, even

though every component may be uniquely relevant to the course of events.

The application of econometric parameter estimates of (say) production functions for a whole industry can only mask essential differences. The success of an entrepreneur, in deciding upon a course of action, is determined by his *anticipation of change* and by his *alertness* to potential opportunities. Advance is the outcome of competition which ensures the demise of firms which take inappropriate decisions. No insight into the role of competition can result from the analysis of statistical aggregates, because competitiveness cannot exist without many diverse elements. For analogous reasons, there is little operational worth in statistical estimates of demand and supply elasticities, saving and import propensities, or of multiplier and accelerator relationships. The aggregations are too great and the relationships too fleeting. Yet economists continue to commit time and resources to such nonsensical calculations.

This criticism is particularly relevant to attempts to chart the course of the national economy, where macro-economic models often perform less well than atheoretical extrapolations of time-series trends, which do not pretend to provide any insight into the complexities of the economy. The extrapolations imply no belief in meaningful relationships between expenditure aggregates, nor in the relevance of *aggregate demand*. Their superior results must cast doubt upon the relevance of macro-economic theory.

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<sup>1</sup> *The Sunday Times*, 15 March 1995.