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MAIN ECONOMIC TENDENCIES IN THE CONTEMPORARY WORLD ECONOMY

The title of my address is very ambitious. In fact, I have not chosen it but it has been 'assigned' to me by the organizers of this ceremony, and since the Centro Einaudi had just decided to confer on me the honour of becoming a member of the scientific committee, I did not have the courage to refuse – or even suggest a different title.

I am an economist but I am not specialized in making predictions. And even if I was, the track record of economists is – perhaps – in the same league as meteorologists. So, why would you be interested in the ideas of yet another economist on what the main economic tendencies might be in the global economy today?

The brief answer to the question would be the one the then governor of the Bank of England gave to politicians who wanted to know what was going to happen after the crisis broke out; (now Lord) Mervyn King answered: "I don't know, I do not have a crystal ball". And that would be the end of my address.

But I have accepted to give this talk, so I cannot completely dodge my assignment. Later, I will mention some economic developments that I expect or hope will play an important role in the world. But the crux of what I will say will consist of considerations about whether or not economics is equipped to foresee these tendencies at all.

To me, the word 'tendencies' immediately conjures up the idea of trends, and I do not think that is only due to the fact that I am a student of the philosophy of Karl Popper. And now that I have mentioned Popper, particularly in the context of the Centro Einaudi it is only a small step to Friedrich von Hayek, his long-time friend and comrade-in-arms in the battle against illiberalism and obscurantism. Their friendship and mutual intellectual influence have not received the scholarly attention they deserve and one of the objectives I hope to achieve today is to arouse your curiosity.

Now, by yet another association of ideas, as Italians so beautifully say, the mentioning of Hayek leads me to the following anecdote. In 2004, at the end of a conference in Siena that was organized by my friend Carlo Zappia, I told a left-wing British fellow-economist, Ian Steedman, that the closest economics had come to conducting a macro-economic experiment was in Great Britain under Margaret Thatcher. After all, the country is clearly separated from the rest of the world by the sea and its leader boasted that her social and economic policies were guided by the theories of Hayek and Milton Friedman.

In so far as I meant this as a joke it was not very successful: Ian was not amused. Now, 17 years later, I have reasons to believe that perhaps there was more to my wisecrack than I could have suspected at the time. Let me explain.

During the last 14 years, economists have had two major occasions of putting their theories to the test in a laboratory that consists of the entire world. One is the financial and economic crisis that started in 2007, and the other the pandemic that started less than two years ago. And whereas the covid-19 pandemic was principally a health-care problem, both its effects and the ways in which it was dealt with make it compulsory study material for economists.

What do these two episodes have in common? (The list is not exhaustive.)

- Unprecedented – except for the two World Wars – fiscal and regulatory government intervention in the economy.
- One of whose consequences was a rapid and massive increase in public debt (I see with pleasure that one of the prize-winning essays is dedicated to the EU sovereign debt crisis).
- The fact that in both episodes exponential developments played a central role. That may explain the slow recognition that there was a large-scale problem with globally pervasive ramifications and consequences.
- In both cases, there is sufficient hindsight, "that most useful of all the instruments of the historian", to quote M.I. Findley, recognize that the problems could have been contained had they been recognized and understood in time instead of becoming very difficult to contain.
- In both emergencies, the fate of individual human beings, enterprises and countries depends on that of all others.

Neither had been predicted, not by economists nor by experts on public health. And by not predicted I mean not only that the *possibility* of these emergencies had not been foreseen – virologists had warned about the possible recurrence of epidemics like Ebola and Swine fever whereas economists, with very exceptions, had not even done anything of the kind for financial crises – but also *when* or *under what* conditions they would have materialized.

What makes these two emergencies particularly interesting for our topic is that they have provoked interruptions of tendencies that we had taken for granted: the crisis dramatically interrupted the trend of diminishing public deficits, and even more dramatically, the pandemic not only interrupted a demographic trend but even reversed it. Thus, the life expectancy in Italy, which has been gradually increasing for the last sixty years, dropped from 83.2 to 82.3 years in less than two years (ISTAT, 3 May 2021). That puts an abrupt end to what we considered the most stable regularity after the certainty that we will all die: demographic trends.

Perhaps these humiliating experiences ought to lead us to give up the pretense that we can (always) come up with 'real' predictions like those in the natural sciences and look for more modest and realistic alternatives instead. For that I suggest to get back to the classic text on the philosophy of social science, Popper's *The Poverty of Historicism* of 1957. The book contains a somewhat abbreviated version of three articles that were published in 1944-45. Popper's main object of criticism is the belief in the existence of historical laws ('historicism'). That does not mean he denies the existence of trends.

> [T]rends exist, or more precisely, the assumption of trends is often a useful statistical device. *But trends are not laws.* A statement asserting the existence of a trend is existential, not universal. … And a statement asserting the existence of a trend at a certain time and place would be a singular historical statement, not a universal law. The practical significance of this logical situation is considerable: while we may base scientific predictions on laws, we cannot (as every cautious statistician knows) base them merely on the existence of trends. A trend (we may again take population growth as an example) which has persisted for hundreds or even thousands of years may change within a decade, or even more rapidly than that.

Just how rapidly, we have discovered, as I have just mentioned.

Why is stating the existence of a trend – a prophecy in Popper's terminology – not enough? That is because if it is falsified we do not learn anything except that we were wrong. If, on the other hand, the prediction of a trend that is conditional – *i.e.* based on a theory – is falsified, we have an idea where to start looking for what is responsible for the falsification. By making predictions instead of prophecies we may learn from our mistakes. In order to be both scientific and practically useful we should formulate predictions instead of prophecies. That is the only way in which the study of past, present and future events allows us *to learn from our mistakes*.

Logically speaking, predictions and explanations are symmetrical. That does not mean, however, that a failure to correctly predict an event such as the crisis or the pandemic and its economic consequences makes economics and virology incapable of explaining them. That is because in conditions of indeterminism or complexity, the *logical* symmetry of explanations and predictions does not translate into a symmetry *in practice*: we may be able to explain events after they have happened even though it has not been possible to predict them. In other words, even if we know the relevant laws, we may not be able to ascertain or predict the presence of the pertinent initial conditions.

That problem partly coincides with the fact that in the social sciences the behaviour of individuals is guided by what they think and expect. Hayek puts it like this: "the truth is that in social evolution nothing is inevitable but thinking makes it so".

In this sense, the collective effects of individual actions are determined by ideas.

Fifty-five years later, the same Hayek writes: "Man is not and never will be the master of his fate; his very reason always progresses by leading him into the unknown and unforeseen where he learns new things".

On the face of it, this seems to be in stark contradiction with what he stated earlier. That conclusion, however, would be mistaken. That is because Hayek, like his friend Popper, emphasizes the fact that individual actions, including the policies of governments, almost always have consequences that are not only unintended but often also unpredictable. Here, Popper complements Hayek by observing that we cannot predict the content of future knowledge. For if we could, we would already have that future knowledge, which is absurd. (This is relevant for innovations, which is the topic of another prize-winning essay.)

The limited possibilities to produce scientific predictions in the social realm clashes with people's desire to dispose over reliable – preferably certain – knowledge about the future. Scientists are always under pressure from business and politics to provide it all the same. This pressure is hard to resist, particularly in times of cuts in university budgets. Few academics have the moral courage – or the financial independence – to give the reply of Mervin King which I quoted earlier. This is another reason for teaching future social scientists the limits to the possibility to predict in addition to advanced statistical techniques and sophisticated forecasting methods. This makes it indispensable to reintroduce courses in logic and the philosophy of science in social-science curricula, from which they have almost completely disappeared.

Here we bump into a problem that is perhaps even more fundamental. As we have rediscovered during the pandemic, scientific rationality is not the same as political rationality. That problem is not new. The relationship between a democratic government and the expertise that is required for solving economic and health problems have already been addressed by Plato and Socrates. Together with my friend Rob de Vries I am reading Plato's dialogues and it is surprising how relevant they are to the economic and health problems that we are facing today.

Both Popper and Hayek expose the link between obscurantism and authoritarianism and a pseudo-scientific approach to the realm of the social. Yet this common engagement of theirs hides some important differences. They hardly ever discuss these in public, but to the attentive reader of their work it is clear that they exist. They have different concepts of rationality.

Very briefly, and without going into details, their intellectual ways part from David Hume. The main elements of Hume's philosophy are empiricism, scepticism, conservatism and the logical criticism of induction. Popper adopts Hume's critique of induction and his scepticism, or a sceptical version of empiricism (observations serve only to test and not to justify theories), which are the corner stones of his critical rationalism. In Hayek's thought, on the other hand, an observationalist variant of Humean empiricism, that goes back to his early work in the philosophy of mind, is combined with conservatism.

For Hayek, individual human beings are irrational; Rationality (with a capital r) is a collective social phenomenon. Most social institutions have spontaneously evolved to solve particular problems and our limited human understanding can hardly if ever discover the mechanisms that make them successful. He draws the

conclusion from this that we had better not tinker with institutions that "contain the wisdom of ages". This conservative conclusion is part and parcel of Hayek's liberalism.

Popper, on the other hand, is convinced that individuals *are* capable of being rational. Their rationality consists in critically examining and discussing our ideas and theories, by which he means that we try to falsify them. This, together with his social-democratic political philosophy, leads Popper to a more optimistic idea about the possibility to change the social world. But he argues that it is best to adopt a cautious approach. Instead of large-scale and comprehensive interventions, which he condemns as holistic or utopian, we should follow the approach of piece-meal engineering. By making limited changes to social reality we reduce the risk that unintended consequences provoke major or irreversible damages or effects that may keep us from realizing our objectives. In addition, the implementation of small changes, preferably one at a time, makes it more likely that we can trace the origins of the unintended consequences of our interventions to their causes.

Now you will rightly object that the economic crisis and the pandemic made massive interventions on a global scale necessary. Does that invalidate Popper's approach? Not necessarily.

The common saying that "the crisis is too precious to waste" is a good summary of what according to Popper, is the main goal of science: to learn from our mistakes so that we may come up with better solutions to our problems in the future. (The third prize-winning essay is dedicated to this topic.) There are various instruments and ways for making this possible and piece-meal engineering is only one of them.

Another is the creation of the conditions for controlled laboratory experiments through simulations. Computers are powerful instruments that have become indispensable for this. When Popper wrote *Poverty* in the 1940's, he could not possibly have foreseen the role of computers. Nevertheless, in the third part of "The Poverty of Historicism" in *Economica*, he discusses what to all effects and purposes are simulations without using the name:

> Comparing various possible trends amounts to saying "let's suppose the following three (or whatever number of scenarios are compared) developments will take place during the coming A years (stating the duration

> is of central importance, given the use that is made of thinking in scenarios). How would we have to allocate the economic resources at the disposal of Government in order to adapt to any of them? Of course, the allocation of resources is only one of the many questions one may ask. Limiting ourselves to this example, thinking in scenarios may help to prevent committing resources irreversibly. It is a means for introducing prudence into policy.

And this is only one of the possible applications of simulations.

For reasons unknown (the absence of computers?), this passage was not included when *Poverty* was published as book.

A next step would be to try and transform the world itself into a laboratory. Of course, we cannot do this literally. But what we can do – and what is already happening, particularly during the pandemic – is to create the conditions for using the world as a laboratory. They include the homogenization and systematic collection of empirical data and creating the necessary institutional framework for doing this or reinforcing existing institutions such as the WHO and the OECD. That this is not unproblematic is illustrated by the discussions on the role of the WHO. They show, once again, that scientific and political rationality often pull in opposite directions, particularly on a world scale.

Now despite what I have just told you, let me conclude by mentioning some economic tendencies that in my personal and subjective opinion I find threatening and dangerous and some that give me hope.

Look at the following ranking of some of the richest people in the world with their net worth in $bn.

Bernard Arnault	187
Jeff Bezos	177
Elon Musk	152
Bill Gates	124
Mark Zuckerberg	97
Warren Buffett	96

Now, let's insert the GDPs of some countries:

		Kazakhstan	188
Bernard Arnault	187		
Jeff Bezos	177	Hungary	177
		Ucraine	165
Elon Musk	152		
		Algeria	151
Bill Gates	124	Morocco	124
		Ecuador	101
Mark Zuckerberg	97		
Warren Buffett	96		
		Ethiopia	94

Of course, these are estimates and they are in continuous movement (Arnaud has just surpassed Bezos). But the order of these magnitudes indicates some tendencies that I find very worrying.

They are an indication of the dramatic inequalities within and between countries that a market economy generates. The work of Thomas Piketty in particular has rightly drawn the attention to this.

This list also indicates the return of what almost everybody thought was a phenomenon of the past. The idea is not mine but was suggested to me by my friend Pietro Terna: it signals the return of centrally planned economies in a different – private – *form* from the socialist systems, but with some of the same *problems*. They include the concentration of economic and political power and influence and the perils to the freedom and property rights of the individual.

But not all of the tendencies I see are negative. I see some developments that give me hope.

One is that the cooperation by the major central banks of the world have reinforced the idea that a stable monetary system is a global public good. Or perhaps it is better to speak of a global common pool good. I can only express my hope that this perception will not succumb to the follies of influential politicians.

The pandemic, too, has the potential of convincing politicians that health is a global public or common pool good. If they succeed in translating this idea into practices that include the distribution of vaccines to all countries regardless of

whether they can afford them, this would be an additional miracle to that of the sensational speed with which academic laboratories and private pharmaceutical enterprises have developed and tested a range of vaccines.

As a last possible tendency, let me add the hope that the economic crisis but particularly the pandemic has convinced academics of the necessity to adopt an interdisciplinary approach to the solution of the important problems of the world.

Whether or not my (limited) optimism is justified, it all depends on the fact that, as Hayek wrote: "in social evolution nothing is inevitable but thinking makes it so".

The author will be happy to give the exact references to quotations on request.