

THE ART OF FORECASTING: A WAGER

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In his article "The Art of Forecasting: From Ancient to Modern Times" in the Spring/Summer 1992 issue of the *Cato Journal*, Donald M. McCloskey asserts that economists cannot make accurate forecasts. He likens forecasting to magic and divination, and he says it is dishonest to suggest that we can forecast better than the ancient readers of entrails.

For rhetorical purposes, Professor McCloskey says that if we could forecast, we would be putting our money where our mouths are. He takes the price of corn as his rethorical example.

Don McCloskey is not alone in thinking that economists cannot predict very well. The *Wall Street Journal's* Lindley H. Clark is typical: "Economists have a great deal of trouble predicting the future, and it's unlikely that this unhappy situation ever will change" (19 January 1990: A10.) And in the above-mentioned issue of the *Cato Journal*, Leland Yeager quotes with approval Irving Kristol's "The beginning of wisdom . . . is to know that the future is unknowable" (Yeager 1992: 53).

Yes, economists—and everyone else, too—cannot predict *short-run* trends of interest rates, exchange rates, and security prices. This incapacity is well-established scientifically. But it is possible to forecast *long-run* trends with great reliability. Of course this is contrary to all common sense and common belief. "If it's so hard to be right about a decade, imagine the howlers in store a century hence," says the *Wall Street Journal* (11 January 1990: 1). And the *WSJ* quotes Martin Gardner, the famous writer about mathematical puzzles and scientific fallacies, as saying that prediction "is like a chess game. You can predict a couple of moves ahead, but it's almost impossible to predict 30 moves ahead" (11 January 1990: 1). That may be true for some

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matters, such as the weather and politics. But it is not true for economics.

As with many other matters, I entirely agree with McCloskey about the dangers that arise from government forecasts as they are usually made. Regretfully, however, I find that I disagree sharply with him on the ability of economists to forecast *any* significant events. The source of the disagreement is that he focuses on the short run, whereas I focus on the long run.

Paradoxically, it is much easier to forecast many matters for the long run than for the short run. And to meet McCloskey's test of honesty, I am indeed prepared to put my money where my mouth is, and I have done so in the past; the real problem is to find people who will wager on these matters. For example, I forecast that the price of corn (his example) will be lower in the future than in the present. The forecast will be more accurate the longer the period in the future, but I am willing to offer the wager even for only a year, though the odds in my favor then become very slight. Can we set something up, Don?

I would make such wagers in securities markets if they existed. But, there are no futures markets to accommodate the long-run wager.

Exactly the same offer holds for all other raw materials. And I will even extend the offer to all measures of material human welfare, in any community, for any future year.

Indeed, it is almost a sure-thing prediction—subject only to the qualification that there be no global war or political upheaval—that people in the future will live longer lives than they do now, with higher incomes and better standards of living, and the costs of natural resources will be lower than at present. These predictions are so certain because the very same predictions, made at all earlier times in history have turned out so. And sound theory explains these benign trends (see Simon 1995 [1981]).

Check for yourself: Though the stock market gyrates from day to day and week to week, its course from decade to decade is almost always upward. The story is the same in reverse with natural resources. Copper, iron, wheat, rice, sugar, and every other natural resource have fallen in price, and therefore risen in availability, throughout the 200 years of U.S. history, and over the thousands of years of human history wherever records exist.

This makes sense. The history of civilization is a history of increasing knowledge of how to produce goods more efficiently and cheaply. This goes hand-in-hand with liberty becoming more widespread, and with increased mobility and communication. All this progress is reflected in the long-run trends of human welfare.

We could test Professor McCloskey's judgment against mine by asking if he will make a set of wagers with me for a variety of raw materials if I give him 51 to 49 odds for the period five years from now. (My suggesting an even-money wager would be no evidence for my confidence. If he pushes me very hard, he might even get better odds from me.) And an even longer-term wager is almost like shooting fish in a barrel—as I will bet Don McCloskey will agree after he thinks about the matter for two minutes.

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BOOK REVIEWS

The Privatization Process in Central Europe and The Privatization Process in Russia, Ukraine, and the Baltic States

Roman Frydman, Andrzej Rapaczynski, John S. Earle, et al.

Budapest, London, New York: Central European University Press, 1993, Vol. 1, 262 pp.; Vol. 2, 276 pp.

These two volumes are the first output of the Privatization Project of Central European University headed by Roman Frydman and Andrzej Rapaczynski and financed by the Soros Foundation. Project coordinators have been established in each of the countries discussed in these volumes; they oversee the compilation of detailed reports on the economic environment, the legal system, and the progress of privatization. Volume 1 examines the changes in Bulgaria, Czechoslovakia, Hungary, Poland, and Romania. Volume 2 focuses on Russia, Ukraine, Estonia, Latvia, and Lithuania. Without doubt these volumes represent the most important sources of data on the transformation process underway in East and Central Europe and the former Soviet Union yet published. Frydman, Rapaczynski, Earle, et al. should be congratulated for their tireless work in coordinating the Privatization Project and conveying their results in such an accessible manner to the scholarly and public policy community.

The importance of this work, however, does not lie just in the mountain of data provided. More important is the fact that the data provided is the *right* kind of data. Economists are notorious for their “thin” descriptions. Aggregate data, such as GDP or GNP, supposedly provide an accurate picture of the economic health of an economy without requiring an excursion through the details of everyday life. But such aggregate measures are woefully deficient.

This bias toward aggregate economics as opposed to detailed microeconomic analysis results in a general failure to examine the structure of economic interrelationships. “The consequence of [aggregate economics] is that in the statistical study of social phenomena,” F. A. Hayek wrote, “the structures with which the theoretical social sciences are concerned actually disappear. Statistics may supply us with material from which we have to reproduce these structures, but it can tell us nothing about these structures themselves. In some fields this is immediately obvious as soon