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Psychology and Macroeconomics


6.1 The problem of economic prognosis

So far as the empirical sciences are concerned, prognosis forms the touchstone of any new theory. Whenever certain phenomena – let them be called ‘causes’ – are observed to be regularly followed by certain other phenomena (‘effects’), any hypothesis purporting to establish a line of causality must be capable not only of explaining known past phenomena, but also of forecasting unknown phenomena in the future. Irrespective of the field of immediate concern – be it nature, medicine, the human soul, or the problems of human coexistence – the chief aim must always be prognosis, the final and decisive test of all discoveries in the fields of natural science, economics and sociology.

The concept of prognosis derives from the Greek προγνώσχεω (pre-recognition) as opposed to προφητεύω (prediction or prophecy), and comes to us from the field of medicine. There it refers to an assessment of the probable course and end of an illness. Its success depends heavily on a correct ‘diagnosis’ having been made.

In economics, prognosis is not confined to the forecasting of pathological phenomena such as inflations and business cycles, but comprises all the phenomena inherent in the total economic situation. It may refer to a limited sector such as a specific firm or branch of activity, or it may be concerned with overall economic forecasts of long-term phenomena,
such as the economic growth of a country, or of short-term phenomena, such as crises and booms.

To be considered scientific, a prognosis must be both oriented in reality and capable of objective description in the terminology of the science concerned. Furthermore, because a prognosis must be consistent with the hypotheses of the theory from which it springs, the assumptions underlying those hypotheses must obtain, and it must be possible to determine whether this is the case or not. On the other hand, it is hardly ever possible to determine in advance all the conditions required to bring about a future event, since they are frequently unknown, unrecognizable as such, or too numerous. As a rule, however, it will suffice to point out in the wording of a prognosis those conditions which are adequate to bring about the predicted event.

Every prognosis must include a specifically defined time dimension. The mere statement that a certain development, no matter how clearly delineated, will take place at some unspecified time in the future can, to be sure, never be disproved. But because of its lack of specificity it has no value as a prognosis.

The real problem faced by every prognosis is that one cannot know anything in the future. One can only assume or expect certain developments. Forecasts of future events are almost always based on data of the present and past. For example, future growth can be estimated by the method of ‘direct extrapolation’: if cement production has risen by 10 per cent annually during the last five or ten years, one can simply carry this figure over into the future and assume that cement production will continue to increase at the rate of 10 per cent per year – a very daring prognosis indeed!

The extrapolation method becomes somewhat more discriminating when it is applied indirectly, starting out from the factors which determine the variable to be predicted, in this case the future demand for cement. Such factors as housing starts, highway construction and industrial investment might serve as primary determinants. Necessary assumptions are that these determinants will in future continue to influence the variable to be forecast, and with the same effect as in the past. But the governing factors themselves are not isolated phenomena. They in turn depend on other influential factors, which themselves must be determined and ‘extrapolated’. Thus begins a chain of causality which of necessity must be broken off somewhere if a concrete result is to be obtained. Moreover, it is highly unlikely that all relevant governing factors can be evaluated. Instead, one must usually limit oneself to one or two of the most significant.