Tribute to George Goodman – To be or not to be a Forecasting Economist

Everyone needs a good joke once in a while. The late British politician, Winston Churchill, may spring to mind when one craves for a good laugh. Just the sound of his name, I would picture Churchill with a cigar in one hand, and a glass of champagne in the other, and telling a good joke in an absolutely straight face, of course. The messages behind his jokes were always as cunningly funny as they were seriously insightful and oftentimes, frightfully true. What greater way is there to lay down a timeless theory, while planting a smile, or even a belly laugh, on a reader's face?

While he might not have been remembered for his jokes like Winston Churchill would, George Goodman was certainly loved for his uncanny ability to present complex financial notions in a language that is comprehensible by people from all walks of life, whether on paper, in the form of screen play, TV series or even cartoon graphics. (Bloomberg news, 2014).

This piece is written as a tribute to George Goodman, who passed away on January 14, 2014. At the risk of repeating a well told joke that was made famous by Goodman, here is one of the shortened versions:

A physicist, a chemist and an economist are stranded on an island, with nothing to eat. A can of soup washes ashore. The physicist says, "… Let's smash the can open with a rock." The chemist says, "… Let's build a fire and heat the can first." The economist starts scrawling a series of equations in the sand, which eventually cover the entire beach… and triumphantly, he says, "Let's assume that we have a can-opener..."

The joke is believed to originate from a British economist in 1970, and first mentioned in a book named Economics as a Science (1970) by Kenneth E. Boulding. (Wikipedia 2014) "Assume a can opener" became an iconic catchphrase after George Goodman used it in his book, The Money Game, to make a mockery of economists' tendency to adopt various assumptions, often over-simplified ones, and ultimately arrived at economic forecasts that were wrong.

Economic forecasting only started in the early twentieth century when entrepreneurs and academics began to define patterns of periodic fluctuations in economic activities as the "business cycle." (Friedman, 2014 p. 3) In order to minimize loss and maximize gain from these cycles, people began to take great interest in trying to forecast when the next economic crisis would hit. It was during this period that a group of entrepreneurs identified this need as a business opportunity and professionalized 'fortune telling.' (Friedman, 2014, p. 3)

According to Walter Friedman's latest book, Fortune Tellers, this marked the birth of the first generation of economic forecasters and the methods they created to predict the future of the economy. Early forecasters often distributed their predictions along with charts and graphs to show how economic changes over time and pointed to the future. The practice of incorporating historical data and statistics quickly became the mainstream methodology for assessing the economic future, partly because the use of historical precedence and concrete data helped to quiet down accusations of economic forecasting as a practice of “occult arts” in fortune telling. (Friedman, 2014 p. 5)

Although the power and dominance of Economists continue to rise, as people thought they could predict the unpredictable, there was a catch in their research process. Before Economists can apply all their econometric modeling, in order to comprehend and assess the complexity of all the moving parts in the world of real economics, they often have to make certain assumptions, usually based on historical data, to anchor a starting point for their research thesis. I would argue that whether the resulting forecast is accurate, may or may not be rooted from the assumptions employed.

Cracking jokes about an Economist’s use of assumptions, particularly in this anecdote, where an Economist was depicted as so foolish as to assume that there was a can opener on a deserted island, is merely a manifestation of the broader and deeper level of ridicule of the vast inaccuracies of Economists’ predictions which, in spite of their elaborate modeling and history based assumptions, are often WRONG.

I believe there could be as many great theories and forecasts as there are flawed and inaccurate ones. As Friedman pointed out, Roger Babson predicted the 1929 crash, while Irving Fisher dismissed Babson with an ‘immortal line,’ that “stock prices have reached what looks like a permanently high plateau,” and became a permanent laughing stalk.

A handy explanation in an Economist’s defense is one from Oskar Morgenstern, a German Austrian Economist, who claimed that consistent accuracy in forecasting is impossible, because an unerring forecaster would soon attract a following large enough to change the course of events and invalidate the forecast. (Wall Street Journal, 2014) A good example would be to sell on warning of an impending stock market collapse thereby avoiding a crash that was predicted.

To forecast or not to forecast can be similar to a debate about whether case study is ‘better’ than primary research. Research is original and free spirited, while case study is more aftermath and ‘learn from mistake’ kind of approach, but no one is counting your mistakes. As a fellow University of Chicago trained economist, I surly take pride in being the former, regardless of the number of wrong ‘predictions’ or forecasts. I cannot sum it better than Friedman, who said Economists are indispensable, as they are academia who helped expand the frontiers of knowledge and enlarge the world of ideas, as scholarly exchanges are supposed to do. While I aspire to continue to follow the footsteps of those pioneers who undertook the impossible work of predicting our financial future and staying ahead of my curve in my work, the case study approach I learned at Harvard for my Sustainability study also helped me appreciate the merits of case studies, particularly the part of ‘learning from mistakes’.

In case there is excessive usage of vocabularies from my references, I feel obliged to conclude with a comment from Winston Churchill. “To copy from one is plagiarism; to copy from many is research.” I have done quite a bit of research here.

References

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Prepared by

Barbara Shaw
Chief Investment Officer
Imperial Capital Ltd.

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