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Policymakers should only proceed with more humility

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From Mr Daniel J. Aronoff.

Sir, Mohamed El-Erian and Richard Clarida (**Markets Insight**, August 3) observe that “wherever we look, the snapshot for ‘consensus expectations’ has shifted: from traditional bell-shaped curves – with a high likelihood mean and thin tails (indicating most economists have similar expectations) – to a much flatter distribution of outcomes with fatter tails (where opinion is divided and expectations vary considerably)”. They point to five implications of the spike in uncertainty; I would like to offer a sixth.

In a world of radical uncertainty, there is no “single point of view” about the future, and therefore no uniform, predictable reaction to economic policy. It is no longer possible (if it ever was possible) to anticipate a “market” reaction to fiscal stimulus – will it spur consumer and business spending, or will fear over future deficits cause businesses to pull back on investment? Will monetary expansion trigger an increase in nominal gross domestic product through lending and spending, or will cautious agents deleverage and hoard their cash, leading to deflation?

It is a very modernist predicament in which we each have our own subjective point of view. To presume the economy can be parcelled into sectors – consumers, businesses and so on – that can be described by Gaussian behavioural functions is to commit what FA Hayek labelled “the fallacy of misplaced concreteness”.

Policymakers should recognise the severe limitations to their knowledge and proceed with humility. One practical implication – I think – is that it would be foolhardy to “double down” now with another major fiscal stimulus that will place the public finances at risk if the programme fails.

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