

LEARNING FROM DEPRESSION

ESKO PROKKOLA

ABSTRACT

The world-wide economic depression is exceptionally long and deep. It could not generally be predicted although the symptoms were already visible. Those who got the forecasts right say that they relied on intuition. It is, for instance, possible to see the normal situation intuitively. Any deviations in one direction or the other may be a sign of future problems. It is easier to provide for difficulties to come if you work out scenarios. Observing the signs of future development requires an open mind and means following the situation from different angles. Interfering with the trend is probably only possible by contributing to the debate conducted at various levels of society.

Wake up, you actuaries, and see the signs of a depression. Never within living memory have we witnessed anything like this.

It is not important whether you know the correct definition of depression. Economists agree that the present, practically world-wide slump is exceptionally long and deep. We are witnessing a strange situation that has not occurred in living memory. Let us call this slump a depression. Its rareness is an essential quality in terms of this paper. It is also hard to predict. Nobody wants to admit the seriousness of the situation. People are trying to use witchcraft to make it disappear. Credibility is the key magic word.

The signs of the present situation were in sight for a long time but there were few who knew how to interpret them correctly. Cities spoilt by money, packed with temples dedicated to Mammon, shunned by ordinary people; excessive automation; insane share appreciation. These are just a few of the symptoms of a frenzy that had to pass over.

It is true that it is sometimes difficult to see a bubble because there are so many who are making profits all the time. In any case, seeing it may call for some childish courage. In the fairy tale by the Danish poet

and dramatist Hans Christian Andersen, only the innocent child had the courage to say that the emperor had no clothes. Even after the bubbles have started to burst the obscure illusion of maintained affluence and adequacy of resources makes it difficult to see the depression.

Do not trust too much those who are trained to make forecasts. They may not remember any longer than you. Their theories may be false and have no foundation in reality. Maybe they just do not want to see the depression.

Many of the computerised models made by the economists failed to predict the depression. When the depression came in spite of all the predictions to the contrary and turned out to be deeper and longer than had been foretold, it prompted a rapid revision of methods. Better results were achieved when the models were abandoned and intuition relied on. The world is not as simple as the best models always seem to make it.

The scientific truth of the economists is a bit like losing your vision. It may have been good insight at the time. When the vision is lost and the theory remains, the blurred and somewhat distorting reflection of the theory prevents us from seeing reality.

It seems as if the first to misunderstand the work of Keynes were his own students, who were even more keynesian than Keynes himself. The root of the misunderstanding lies in the fact that the words of the great teacher were perhaps intended to be solutions of a certain kind to the situation prevailing at the time. They were, however, adopted as if they were eternal truths.

In the financial world, there are no perpetual laws. It is like a game of queen's croquet where the rules are constantly changing. A cheater hears the cry: "Off with his head."

The current working generation has no personal memory of the depression of the thirties. The traumatic experiences of the generation that lived through that depression took the form of economic theories and economic rules, which were then stored in the long-term memory of society. There are contradictory interpretations of the developments. So, we do not know whether the depression was overcome thanks to Roosevelt's New Deal or because of the teachings of Keynes, or whether the economic upswing began in spite of politics.

We could also ask whether the thirties made people accustomed to cures for depression. There have also been later attempts to control

the economy using means that are mainly detrimental in times of normal trade cycles.

Both the United States and the Soviet Union have been looked upon as great social experiments. One has been called the experimental field of free enterprise; the other experimented with a planned economy. In neither have the original ideas remained unchanged. Thus they do not meet the requirements of a scientific experiment. So we will be getting contradictory explanations in the future, as well.

When you're looking for the symptoms of a depression, act creatively like the hero of a detective story! Take an interest in all suspicious phenomena! See what the others don't! Use original research methods! Try to understand the background of events and have an eye for psychology!

Someone analyzing threatening trends these days could ask what it is that drives banks into difficulties. Why do some do better than others? What are the reasons for the difficulties facing international reinsurance? What are the internal reasons, what the external? Where do the numerous economic scandals originate? Why can different countries and even different US states be affected by different economic cycles? How does the fluctuation between freedom of trade and protectionism arise?

The present economic situation easily gives rise to a whole lot of interesting questions. Economic fads, huge money-consuming projects that are changing our environment and, more generally, changes in that environment could very well be worth taking a closer look at. One could also ask if there are structural flaws in the foreign exchange market or in the economy at large.

When analyzing issues like these, many different sources of information have to be resorted to. First, we come across the mass media, with all that they include. Second, there are reports from various research institutes. As the work proceeds, new questions arise, leading us on to new sources of information. There is no shortage of material. In fact, there is so much material of various kinds that the question of valid research methodology emerges. In practice, however, the course the study takes depends on the employer of the researcher. From his point of view, it is not necessary to examine every possible thing. The employer has set some objective for the study.

The financial institutions operating in the international market conduct market surveys like these. Their angle is to look for good opportunities, such as good objects for investment.

When we are charting exceptional risks, the angle changes. This is where the computerized models of the economists failed. It seems that the chance of success is bigger when intuition is relied on. Maybe it means something like knowing intuitively what the normal situation should be like and establishing that the situation is not normal at present. Then you ask yourself what could cause the situation to cease to be normal and where this could lead. This kind of reasoning includes elements of the problem analysis employed by industry. According to this, we also have to work out scenarios of future threats and make provision for them at as early a stage as possible.

These exceptional times give us an opportunity to get to know an exceptional situation. No economic system has succeeded in eliminating the possibility of depression, not to mention deep depression. It is obvious that the exponential growth of the global population or of productivity, for instance, cannot go on forever. If you ask whether joining the EC is good for us, an expert on economic history might reply that it is good for the contemporary generation if it survives 200 years.

Twenty years ago it was still a quite common belief that trade cycles had been alleviated. The explanation offered was that the measures for economic policy control had been wisely used. Now this belief seems unfounded. Study of the phenomena of depression takes researchers back, closer to reality. It is here and now.

In the economy, competition is quite natural. And where there is competition, there are rules. There may be something wrong with the present rules. Perhaps currency speculation should be prevented by some means. It may also be that changes in the environment will force us to change the rules.

Intellectual growth can best be achieved through co-operation. Luckily enough, it is impossible to make a model for intuition. When looking for signs of danger, intuition makes us free to think about something other than objectives that are material, in a narrow sense, and to view them from different angles. The pros and cons of the economic rules depend on the angle, and therefore cooperation and debate are necessary. The possibility of the lonely actuary making scenarios of threats interfering with development seems nonexistent. He should therefore contribute to this debate.