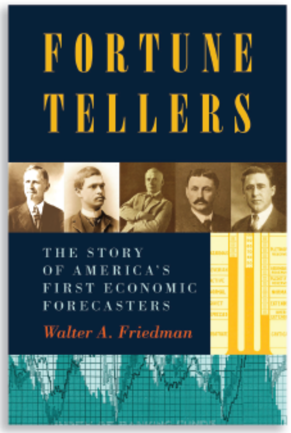

The Past of Forecasting

FORTUNE TELLERS: THE STORY OF AMERICA'S FIRST ECONOMIC FORECASTERS
BY WALTER A. FRIEDMAN
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REVIEWED BY DAVID A. PRICE

As a world financial crisis unfolded in November 2008, a London School of Economics professor spoke at a university event about the debacle's causes. Afterward, guest of honor Queen Elizabeth II demanded of him, with understandable peevishness, "If these things were so large, how come everybody missed them?"

Economic forecasting continued to be troublesome following the crisis. For instance, the economics department of the Organisation for Economic Co-operation and Development (OECD) released a report in February 2014 stating that its estimates of GDP growth during 2007-2012 were consistently too high across countries and time periods. The main difference between the OECD economists and those elsewhere may have been their willingness to admit their mistakes.

The high uncertainty surrounding economic forecasts has been well known for a long time. Indeed, the enterprise of prophecy has been associated with insanity at least since the Oracle at Delphi. Still, forecasts about the economy are central to business planning, investing, and, of course, economic policymaking. How the art and science of forecasting emerged is the subject of *Fortune Tellers*, a new history by Harvard Business School professor Walter Friedman.

If economic forecasting had an inventor, it was Roger Babson, son of a Gloucester, Mass., storekeeper. Babson became interested in business statistics at the dawn of the 20th century while working as a clerk at an investment firm. In 1904, at the age of 29, he founded the Babson Statistical Organization. Initially, he sold information on current stock and bond offerings, but the sudden onset of a financial crisis — the Panic of 1907 — led him to recognize a market for a different kind of information: analysis of what the latest statistics portended for the future.

Babson was an early believer in the existence of a business cycle that was distinct from the ups and downs of securities markets and was not caused simply by the weather and outside shocks. While others had proposed the existence of business cycles before — among them France's Clément Juglar and Russia's Nikolai Kondratiev — the concept had not been widely shared before Babson's work, Friedman notes. His prediction methods, though, were crude.

The work of infusing economic theory and higher mathematics into forecasting was done by others. Foremost among them was Yale economist Irving Fisher, who, in the early 20th century, gained fame for his work on the roles of changes in prices, credit, and interest rates as signs of changes to come in the real economy. "As a sign of his stature," Friedman recounts, "in 1924 the *Wall Street Journal* introduced John Maynard Keynes to its readership as 'England's Irving Fisher.'"

Another early contender in forecasting was the Harvard Economic Service, an arm of the university created in 1918 by economist Charles Bullock, who ran it with statistician Warren Persons. Their service, aimed at academics and business executives, brought more sophisticated statistics to bear on the subject and it gathered information on business conditions overseas as well as in America. Like Babson, however, Bullock and Persons were more interested in uncovering empirical relationships than in building theories to explain them.

Despite the greater sophistication of the academic forecasters compared with Babson, the Great Depression gave them their comeuppance. On Oct. 15, 1929, Fisher famously declared that stocks had reached "what looks like a permanently high plateau." The stock market crash began nine days later. Afterward, the *Weekly Letter* of the Harvard Economic Service advised that "serious and prolonged business depression, like that of 1920-21, is out of the question." Only Babson had warned that autumn of a crash, as he had been doing for the previous two years, contrary to the euphoria of the time. (On the other hand, although Fisher was wrong about the 1929 stock market, he was right in pointing out that the Depression was greatly worsened by the Fed's tightening of the money supply — a finding that only his more theory-based approach could have yielded.)

Another victim of the Depression was Herbert Hoover. Less well known than the turn in his political fortunes after the stock market crash is his role, documented by Friedman, in establishing government collection of business-cycle data. As secretary of commerce in the 1920s, he had enlisted Columbia University economist Wesley Mitchell to lead a committee on business cycles and to improve forecasting, believing that the private sector could use such information to avert future crises. Mitchell's work as the longtime director of research at the National Bureau of Economic Research would lay the foundations for modern business-cycle analysis.

Friedman provides a brisk, nontechnical view of crucial figures in American economic history — most of whom went through dramatic and wrenching swings of success and failure. In this, their lives resembled the business cycle to which they had given so much of their energies. **EF**