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Abstract

This essay argues that economics is a much overstretched scientific discipline nowadays. The global financial crisis that erupted in 2008, with many lingering consequences and dilemmas, has been followed by a global pandemic and an intensifying energy crisis on the backdrop of climate change as an existential threat. Water and food crises are spreading. The war in Ukraine has compounded a very bleak situation worldwide. Growing income inequality, a *winners take all* syndrome, finance that extracts massive rents, a resurgence of inflation and a debt trap in many countries, a growing geopolitical confrontation between the US and China, make up a picture that confounds policy-makers, governments and central banks alike. In addition, artificial intelligence has its bright, but also pretty dark sides. This cluster of crises, through their causes and implications, go beyond the ambit of economics, but the latter cannot find solace in its acknowledged cognitive and operational limits. Economics has to join forces with other sciences to help avert a perilous degradation of human life and dystopian scenarios come into being.

Is the *Dismal Science* back?**

I had qualms about using the expression *dismal science* to portray economics; this term goes back to the XIX century, in controversial, to say the least, writings by Thomas Carlyle and in Thomas Malthus' thoughts on the scarcity of natural resources facing population dynamics –which is a theme resuscitated by the Club of Rome about half a century ago and amply echoed by the Stern Review decades later (2007)[i]. My reservations originated in a fear that this "dark" qualification would be exceedingly pessimistic, that it is not appropriate to compare the current scientific-technological era, the advent of AI, with the age when a multifaceted industrial revolution was underway in Great Britain; that the society described by Charles Dickens' gloomy novels is not to be compared with the modern world, that brought hundreds of millions of people out of abject poverty outside Europe and North America.

On the other hand, feelings and aspirations, joys and apprehensions have roots in people's actual lives, in their social, economic and cultural ties, in the ways in which public authorities cater for basic public needs –with the latter originating in concrete situations. At the same time, up to date technologies do not enhance livelihoods of all individuals automatically. For instance, smart phones may open access to information to many citizens, but do not enable access to civilization, to equal chances for everybody. And such examples are plenty of in our world. Moreover, the Covid pandemic and climate change, the latter as an existential threat, bring to the fore the possibility of dystopian futures unless large scale human action takes place in due time.

Truth is also under threat as expertise is being questioned frequently and all kind of conspiracy theories take root. Hannah Arend stern warnings many decades ago are no less relevant in our times.

In what follows I refer to perceived limits of economics in influencing human action and policy tradeoffs and dilemmas, the huge challenges posed by extreme events, by climate change as an existential threat, why economic growth does not necessarily shows up in living standards.

Economics cannot be a factotum…

What has occurred in various domains, in recent decades, can easily induce the perception of economics as a *dismal science* –as an interpretation of the ways economies, societies evolve in analyses and in a normative sense, as to what a proper conduct of individuals and what public policies should be. It pays to remind in this respect the notorious Queen Elisabeth II's interrogation as to why economists were not capable to anticipate the last global financial debacle[ii].

Pieces of bad news keep bumping into us, although not a few individuals enjoy the use of products and services that define modernity and attempt to have normal lives in spite of bad events; cultural life is ever richer, sport events go on despite organizational blows (as was the case during the Pandemic), people travel worldwide even when restrictions are tightened, TV channels and other media outlets provide all kind of entertainment. And what matters most, big and small goodies are part and parcel of family lives, as are big and minor disappointments. At the same time, the current industrial revolution seems to have gone into a shady area in public debate and is not seen as an all-round problem solver.

But it is foolish to blame economics for all that is bad in our world, for natural calamities and ugly things that are not related to human beings' actions. Similarly wrong is to frown at economics when blatantly mistaken policies are undertaken, or when inter-ethnic and religious conflicts erupt, or military disputes cause havoc. It is also fair to admit however, that economics is not a hard science, be it seen by some as the queen of social sciences. In addition, since its very inception, economics was filled in with conflicting ideas, controversies.

Nonetheless, it is not difficult to point the finger at bad practices, which can be entailed, *inter alia*, by ignoring hard scientific data (rejectionists of Covid19 and of climate change are clear examples in this regard). And most of all, one-sided economic ideas, paradigms that prevail in certain periods of time, can undergird poorly defined policies and cause widespread pain. This did happen, for instance, with the *light touch regulation* of financial markets, a blind, driven by vested interests and misconceived ideas deregulation waves. That *boom and bust* cycles accompany the history of finance (as evidenced by Hyman Minsky, Charles Kindleberger and others) is no excuse for encouraging and amplifying financial crises via bad policies. The paradigm that extolled the virtues of unrestrained globalization, with no rear sight for ensued perils, is also an example of a simplistic and deleterious policy approach that influenced economic and social dynamics in recent decades. This globalization turned in what Yashka Mounk astutely remarked as “undemocratic liberalism”, as people lost increasingly the power to shape their lives, a view highlighted by Dani Rodrik as well.

An age of huge shocks, of tail events…

The global financial crisis (The Great Recession), the Pandemic, the energy price shock, climate change and, not least , the invasion of Ukraine have caused havoc in the global economy; these shocks have showed up in a persistent high inflation (with levels unseen in the past four decades[iii]), a fragile post-pandemic economic recovery, lasting supply side bottlenecks (that fuel inflation), regionalization of trade and economic flows that raise production costs, security and geopolitical motives that increasingly shape policy decisions and influence economies.

The globalization crisis started years ago, well before the eruption of the Covid-19 and the war in Ukraine. Thomas Friedman's "The world is flat" proved to be a naïve thought experiment, as were other hastened interpretations of the world –like Francis Fukuyama's End of History. China's economic rise in the past decades has made the world economy bipolar (some would say multipolar, if the EU is considered as a cohesive pole). The USA have seen their industrial and technological supremacy menaced by China's steady and fast industrial ascension. Likewise, during all these decades, fractures and divides have deepened, broadened, in the social and economic fabric of developed societies triggering a debate on what makes "democratic capitalism" fragile[iv]. And a confrontation between liberal democracy and illiberal/autocratic forms of political governance has gathered pace during the past decade[v]. The war in Ukraine has rallied democratic societies together in a confrontation that is ushering in, quite likely, a new Cold War in Europe and other regions of the world; the tendency to end up with several blocs in the global economy will probably accentuate. Janet Yellen, the US Treasury secretary, talked about a new Bretton Woods, that should be based on democratic, liberal values[vi]; this would drive further the global economy in the direction of a geopolitical divide, though, lately, for fear of collapsing trade world and of not being able to provide essential global public goods (deal with climate change and fight pandemics, etc.) there is talk more of de-risking instead of de-coupling.

Implications will be manifold and wide-ranging. There is already talk about the erosion of the *peace dividend* (the share of defense expenses in GDP), that was an outcome of the end of the second world war and, later on, of the fall of the Berlin Wall. The inference is that public budgets will assign more resources for defense expenditure and Europeans will no longer be free-riders (related to the USA), in this regard, within NATO.

Economies will get more of the traits of “war economies”, be these features more or less camouflaged. Not a few EU member states have already announced significant rises in defense expenditure and the NGEU (The European Plan) will quite likely be adapted in view of the new geopolitical and energy context.

Climate change and the spectre of “hydraulic civilization”

The war against the coronavirus is almost won, and it is only a matter of time before vaccine supplies will be available worldwide. Even if biological foes will “revisit’’ us, the lessons learned from this pandemic should help us to be more resilient in the future. To this end more has to be spent on public health, on R&D, on preparing people for dealing with similar events. Big pharma, with all their merits in developing vaccines (which, by the way, have been heavily subsidized by governments), should be less concerned about high profits and try to be better *corporate citizens*.

But while pandemics can be dealt with, be it at huge costs, climate change is a truly existential threat. Prehistoric beings disappeared because of a calamity that was brought about by a gigantic body that hit the earth, but the threat posed by climate change is man-made! Solid scientific reports[vii] indicate that carbon emissions have to be drastically reduced, that humankind needs to achieve carbon emission neutrality in a couple of decades in order to avoid extinction.

It is more than a pity that Club of Rome's and Jay W. Forrester's studies were disregarded by governments and a sort of technological optimism got the upper-hand. In 2007, a UK Treasury report (The Stern Review) noted that environmental issues and risks are the most blatant "market failure" in history, that public intervention is required to reverse a disastrous course of events.

This is why the emphasis put by the EU institutions and the Biden Administration (the US rejoined the Paris Accord), and, *nota bene*, by central banks and international financial institutions, on tackling climate change, on "greening"' economies, is a remarkable change of attitude. The response of industry, be it half hearted sometimes, is a good omen too. We need to get a breakthrough to this end by changing our policies, by reducing carbon emission; a ubiquitous carbon tax, changing lifestyles, changing production structures (eliminating fossil fuels, be it gradually) need to occur. Redefining the GDP (Gross Domestic Product), which includes negative externalities, is also needed –as a 2009 report by Amartya Sen, Joseph Stiglitz and Jean Paul Fitoussi asked for. As a matter of fact, GDP, the way it is computed now, could grow while Gross Domestic Wellbeing goes down. One needs to rethink economic growth in terms of human and ecological concerns and change its logic.

How we deal with climate change conditions the future of democracy. For people need basic food and water for their survival. Thousands of years, even hundreds of years ago, the struggle to have basic food available was the paramount worry of most people. Conflicts and wars, small and big, were waged in order to secure life essentials. This is reciprocated in modern times by conflicts and wars for the control of strategic resources as levers of power and economic wellbeing; geopolitics boils down to it ultimately. Among such resources, oil and gas are, ironically, at the roots of our existential conundrum nowadays.

The historian Karl Wittfogel wrote that those who controlled access to water held, in ancient societies, an unassailable sway over power; he talked of “hydraulic civilizations”. The public and private control on, and ownership of resources, is in the logic of market economies. And one could argue that it is hard to predicate a scenario of total concentration, control of such resources –as would be the case in a command/totalitarian system. But the issue at stake here is not primarily to fight monopolies/cartels so that absolute concentration of control be averted, though this issue is also critical. I make this assertion because climate change, unless properly tackled, could change the dynamic of social and economic relations were basic resources to become increasingly scarce and huge prices were assigned to them.

Illiberal tendencies have for years now been on the rise, in democracies as well. Analogies have been made with the interwar period in Europe in the wake of the financial crisis that erupted in 2008 –due to rising income inequality, anger, the bailout of the financial industry, mistrust of elites, etc. Climate change will likely augment illiberal propensities for a simple reason: action has to be taken and time is of the essence in dealing with climate change.

But a “return of the State” for the sake of dealing with climate change in a timely and effective manner is one thing, and the transformation of democratic governance into systemic authoritarian governance is another thing. This is why it is critical that governments act resolutely and timely for reversing a process that can cause a lot of suffering to people due to floods, wildfires, droughts, hurricanes, unbearable temperatures, etc. Action is critical for averting *tipping points* and dangerous non-linearities, which would cause water shortages and prices of basic food to skyrocket, and induce people to resort to all kind of means to secure them; this could cause widespread riots and conflicts, uncontrolled migration, wars.

We live, quite likely, on borrowed time when it comes to climate change. Decisive action can make the difference between salvaging democracy vs. societies repeating, more or less, the experience of “hydraulic civilizations”.

Capitalism has to be overhauled to make it fairer, inclusive, serve most citizens; this is the way to enlist wide support for dealing with climate change too. In the European Union, *the Green Deal*, the implementation of the Next Generation EU strategy as well as measures to reduce carbon emissions should be seen from this perspective.

Why GDP rises do not influence many ordinary citizens’ living standards positively?

There is a legitimate question: why so many ordinary citizens do not sense an improvement of their lives even when GDP goes up in real terms –as was the case before the Pandemic struck and when economic recovery started in 2021? For many individuals, economics appears as a discipline that comes constantly with pieces of bad news, as a *dismal science*, whose "sermons" are to be related to various policies and events. For instance, rising inflation, diminished real incomes, energy price shocks, etc., weaken the public discourse on economic recovery, or economic growth. There is here a "war effect" too, the multiple implications of the war in Ukraine and other military conflicts around the world. But the analysis has to go more deeply.

Several observations could help elucidate the question posed above; some of them predate 2008, the year when the financial crisis erupted:

- climate change shows up in a rising number of extreme events, that demand governments to step in in order to limit damage; this public intervention means that resources have to be diverted from other uses and, consequently, public budgets get strained;
- the global financial crisis has had lasting effects, among which higher public and private debts. This higher level of indebtedness has been further heightened by the fight against the Pandemic. And, currently, a tightening of monetary policies for containing high inflation points the finger at a looming "debt trap", that creates big headaches for central bankers and governments.
- for emerging economies that have large deficits and debts, their inherent fragility is more visible once big central banks tighten monetary conditions;

- distributional effects that relate to a thinning of the middle class in many advanced societies and to rising inequality;
- market abuse by big companies, tax evasion and tax avoidance that weaken public budgets and foster social resentment. Thence a rising public demand emerged for policies that should enhance *fairness* in society;
- The energy price shock means essentially a rise in the relative price of energy. This rise is, basically, a higher price of life essentials for most citizens –it is a crisis of the living standards. Societies are increasingly "winners take all" social conglomerates; and winners in the global economy in which access to critical resources is an economic and geopolitical priority are mostly countries that export energy massively, that are net exporters.
- The situation gets more complicated if key commodities, critical materials, (germanium, lithium, zirconium, etc) are factored in; the food crisis (epitomized by the surge of prices for grains) is very telling in this regard. Food as well as key industrial commodities can be, are, "weaponized".
- de-globalization itself sustains a rise in prices as a reflection of switching costs and higher productions costs.
- non-conventional systemic risks, among which cyber risks have prominence, proliferate; threats posed by shadow-banking and crypto assets should be highlighted.
- adverse shocks dent potential GDP, as well as potential economic growth. Climate change has to be mentioned in this respect for its major effects.

- in spite of its extolled virtues, artificial intelligence has deleterious effects too: it can "get out of control" unless properly monitored/used, and it can cause massive labor dislocation, that harms social stability.
- statistics, as a scientific method, is unclear when measuring welfare and income distribution. This explains why GDP is often seen as a misleading indicator unless other social and economic benchmarks are counted for.

Economic policy faces numerous trade-offs and choices can be quite painful --a specter of stagflation again?

Economic policies are increasingly overwhelmed by shocks and the complexity of conflicting goals, with hardly adequate, optimal, solutions in sight. It is not surprising, therefore, why politicians are reluctant to say it loudly, clearly. The reason is obvious: they are supposed to solve problems, not to look powerless. In addition, they have to inspire people, even under dire circumstances, they need to find ways out of difficulties and exude trust. It should be said that even when good things can be done these may be obscured by overall circumstances –as in the case of de facto "war economies", or prolonged states of acute emergency.

In deep crises policy choices are often of the sort bad vs. very bad. This is the context that explains quantitative easing (QE) programs adopted by not a few central banks. Likewise, reforms of finance, which was derailed by deregulation waves and a plethora of toxic products, neglect of systemic risks and excessive leverage, have to be judged from this perspective as well.

The Pandemic has led to a suspension of fiscal rules in the EU in order to avert a collapse of economies, but the flipside is a rise in public debts and budget deficits. And the rise in debts is quite worrisome in view of monetary policy tightening. Higher inflation (as "surprise inflation") can ease the impact of higher budget expenditure for a while, but is not a solution for the long haul.

Central banks are asked to defeat the resurrection of high inflation. But this is *mission impossible* as a short run endeavor. Those who ask for positive real policy rates by tomorrow sound out of touch with reality. Imagine what would be the effect of the Fed and the ECB having raised their key rates to over 8-9% abruptly. As sensible voices say, policy rates need to reach levels above longer term inflation expectations, above neutral rates –though one can argue that the latter are hard to fathom out since they are unobservable. Moreover, the ECB is entitled to fear a new fragmentation shock were its policy rates go up brutally.

It should be said, however, that major central banks seem to have been behind the curve for quite a while; they have underestimated the impact of supply side ruptures that were entailed by the Pandemic and the energy crisis. The transience of high inflation has proved more of a wishful thinking exercise, although central bankers had motives to fear squeezing economies at a time when the recovery is still fragile. And the war in Ukraine has caused additional big damage.

The current inflation shock is very much due to supply side ruptures. If a simplistic monetarist thinking would be applied, inflation would have had to be much higher than current numbers indicate; just think that base money in the US rose from cca. 840 billion USD in June 2008 to above trillion USD in early 2022[viii]. Even now, when high inflation has returned as a major concern, the massive increase of base money (cash and reserves of commercial banks held at the Fed) is accompanied by a high liquidity preference --which means that money velocity went down dramatically, one cause being *sudden stops* in various segments of financial markets, which turned the Fed and other central banks into *market makers*. It may be, however, that the Fed could have been more cautious in view of substantial fiscal stimuli. Big rises in base money can be noticed in the balance-sheets of the BoE, ECB and other central banks.

In economics one meets a *misery index*, that brings together inflation and unemployment. This index can be used to estimate pain thresholds (trade-offs) when, for example, defeating inflation would cause recession, a *hard landing* --as it did happen in the US following the oil price shocks several decades ago.

A tandem of high inflation and economic stagnation/recession is a big headache for central banks and governments. Real world is made up of multiple equilibria, and some of them can be pretty precarious. Magic solutions do not exist as the causes of the current very serious situation are, apart from the impact of the Ukraine war, more or less structural. These causes have accumulated over time and originate in an asymmetry between market entry and exit, with a suboptimal allocation of resources, pro-cyclical policies, neglect of structural policies in the belief that markets always know best and their functioning is smooth, the overlooking of climate change, unmanaged globalization, etc. The war in Ukraine and its widespread implications exacerbate dilemmas and policy trade-offs.

An unprecedented global situation

The sequence of major shocks (crises) is unprecedented after the second world war, and it is going to test social and economic stability in many countries very severely for many years to come. Where inclusion, fairness, solidarity, transparency, sound public finance and the rule of law are better entrenched, where market abuse is less frequent, odds are higher that this period of time (that may be long lasting) would cause less damage.

The energy transition and climate change can have devastating effects worldwide unless large scale human action is put into motion; de-carbonization of activities and changes in lifestyles are a must. Rich countries have to help poor countries deal with extreme events and the international financial institutions need to play a greater role in this respect. Public budgets need higher fiscal revenues to fend off effects of extreme events, of various crises.

As public policy choices are concerned, it is reasonable to posit that extremist policy approaches are not adequate: an individualist focus in which society does not matter, as Margaret Thatcher once remarked vs. a centralizing/administrative approach that opts for an overriding, omnipresent state presence in the economy. It is true that during very hard times (like in the Pandemic) more public intervention is asked for in order to secure key public goods and avoid social disintegration, chaos. However, no less important is the need to protect values that define a democratic society and rules that enable a market economy to function, that stimulate innovation and foster entrepreneurship. But it is not easy to optimize and calibrate policies during very hard times.

Concrete measures must fit concrete situations, even when lessons are spread around and governments learn from each other. These measures hinge on the functioning of societies, and in democracies, they cannot be introduced discretionarily on a permanent basis. Wherever societies are more divided, deep tensions develop and have nasty political implications.

Final remarks

Economics helps public policy by rationality algorithms/rules and procedures provided it does not succumb to fundamentalism and oversimplifications. *Learning by doing* also helps to this end. But economics is not a hard science and it is also plagued by colliding ideas and paradigms; economists frequently meet policy dilemmas and tradeoffs.

We are going through a very difficult period of time and crises have become almost a constant parameter in our lives; this means that public governance will likely be an exercise of crisis management of long duration, with a derived objective of increasing systems' robustness and resilience.

Miracles are not possible and economists need more than ever to be humble and intellectually honest in their prescriptions. Economics cannot be alchemy.

Economics and economic practice have their own cycles, they do/can learn from new data and failed policies, interrelate with ideas that percolate throughout our societies; these cycles depend on and influence social and economic dynamics, while pessimism can coexist, or alternate with optimism in the social and cultural ethos, and define a Zeitgeist.

The bottom line is that economists need to join forces with other intellectuals and help mitigate the consequences of the “poly-crisis” that has engulfed the world, avert climate change as an existential threat as well as the bad sides of AI.

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[i] The Club of Rome report “Limits to Growth” (1972) relied on research done by the Meadows group and systems models created by Jay Forrester at MIT

[ii] See also Rupert Neatie, “Queen Elisabeth II finally finds out why economists did not anticipate it”, The Guardian, 13 December 2012

[iii] Inflation has come down considerably from the peaks registered in 2022, but is still much above target levels.

[iv] After the eruption of financial crisis Robert Reich lamented a functioning of economy that does not work for most citizens. Thomas Piketty and others highlighted increasing income inequality that is threatening social stability in advanced economies. Martin Wolf talks about the “Crisis of democratic capitalism”’ (2023), This is a theme that is to be found earlier in Paul Mason (2015) as well. See also Daianu (2009).

[v] I did refer to roots of authoritarian tendencies in the world, both in advanced and poor economies in “ Overhaul capitalism to save democracy”(2021).

[vi] She said it just before the Spring meetings of the IMF and World Bank of April 2022

[vii] Reports of the Intergovernmental Commission on Climate Change of the UN are most authoritative in this regard

[viii] Data from Fred (Saint Louis Fed)

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