Income dispersion and economic crises

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INCOME DISPERSION AND ECONOMIC CRISES

An Essay

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“Forecasting a crisis is not the problem;
the problem is managing to understand why a crisis happens at all.”

Foreword to the english version

The original text of this book was written in Italian. The bibliography lists the books in the author's personal library, often in translation, which he consulted to ensure compatibility between Say's Law and the concept of dispersion of income, as well as to verify that the ideas set out by the author are original. The author also consulted many other books in various libraries across Italy, but he is unable to provide the relative references.

The English translation was carried out with the help of Juliet Hammond Smith.

Slight changes compared to the original text and the following adaptations were agreed between her and the author.

Maurizio Pasquino

1

Introduction

There is a fool-proof method to find out whether the stranger with whom you are discussing the weather is an economist or not. If the person you are talking to is annoyed when weather forecasts are wrong, then that is a normal person, but if you are talking to someone who is downcast because the forecast is right, then that is an economist, or better, an economist who is never lucky enough to get a prediction spot on.

This and other mocking jokes about economists go around every time an economic crisis is severe enough to warrant front-page newspaper coverage.

In truth, economists are still somewhat bad at making forecasts, despite the great advances in economic science of the past two centuries.

If we consider the following three phases of a crisis – to forecast, to get a clear picture and to intervene – it is in the third phase where improvements in economic sciences have mostly taken place, and today we are much better at knowing how to intervene after the crisis has manifested itself.

Governments learnt from the Great Depression of 1929, and they then used that experience to take appropriate measures during the equally serious crisis of 2008 and worked to limit its negative impact.

While it is perfectly clear that economists do not excel in the first phase, that of forecasting, what is less well-known is that economists also come short in the second phase, that of identifying the causes and processes underpinning economic crises.

Economists are unable to predict economic crises or even see them when they emerge. My point is that the elements and processes that trigger economic crises have yet to be clearly identified, and their consequences are equally unclear.

Current economic science cannot come up with an explanation for the phenomenon of economic crisis and this is the starting point for the considerations set out in this book.

Following a lengthy thought process, my intention is to show how and why economic crises occur by introducing the new concept of income dispersion.

This involves looking at how the economic system works not only when everything is functioning normally, but also when the system is going through unhealthy phases.

Economists may be able to develop more effective forecasting models on the basis of my results, but my objective is somewhat different.

Seeing is more important than predicting.

It is easier to foresee an imminent crisis if you know what elements and processes cause it to happen.

If I achieve my objectives, there may be unexpected consequences, and these, in turn, will direct my gaze towards other even more ambitious goals.

2

Definition of economic crisis

The concept of economic crisis is easy to understand, but it should be explained clearly in order to make sure it is not confused with a commercial or financial crisis.

Three elements must be taken into consideration when determining whether an economic crisis is underway. These three elements are a population, the population's total income and a predetermined period of time.

The following definition applies.

An economic crisis occurs when a population's total disposable income decreases over a predetermined period of time compared to the previous period.

The consequence of an economic crisis is the impoverishment of the affected population, as the result of the reduction in average disposable income.

The average disposable income measures the well-being of a population, and the extent of an economic crisis can be measured by the ensuing decrease in disposable income.

The impact of a crisis can be more or less serious and be felt for a longer or shorter period of time.

Some crises can be resolved relatively quickly and easily, while others have dire consequences and require long-term structural intervention.

Commercial and financial crises differ from economic crises, as they usually only involve transfers of wealth from one section of a population to another, without lowering the average level of well-being.

It should be clear that none of the considerations contained in this book relate to crises of this kind. What is difficult to explain is how the overall prosperity of a population can actually decrease, and this is the issue that will be addressed in this book.

Conversely, the mechanisms that determine a shift in wealth within a population without affecting the average disposable income can be more readily understood.

Explaining the phenomena relating to commercial or financial crises is not among the objectives of this study.