2025: looking in the crystal ball
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The recent financial crisis is a powerful reminder of how bad we are at forecasting. I suspect that nearly every analyst falls into at least one of three camps: those who didn't see any crisis coming; those who were expecting a crisis, but either a different crisis from the one we got, or a particular aspect of that crisis, rather than the whole shocking package; or those who regularly forecast crises that have failed to materialise, but who got lucky this time. That leaves (maybe) a handful of honourable exceptions.

To borrow from John Kenneth Galbraith: sometimes it seems that the only function of economic forecasting is to make astrology look good. Forecasters trying to predict the growth and inflation rate in the United States in just one year's time, for example, do about as well as tossing a coin. So you're certainly not going to want to put too much weight on a forecast that covers the next 15 years. Still, there is a crumb or two of comfort to be found.

If we really want to use forecasts (and it turns out that we do, for a whole bunch of reasons but not least because we have to make a series of crucial decisions such as long-term investments that are conditional on our view of the future) then it seems that "consensus" or "median" forecasts are often the best way to go. We now have a pretty clear consensus view on what the world economy is going to look like over the next couple of decades. Moreover, this is a consensus forecast that has just come through a major shock the global financial crisis relatively unscathed. So what will this future look like?

Let's start with some of the basic building blocks the areas of greatest consensus. First up is population. Here, the clear consensus is that by 2025 we will have a larger global population which will be more urban and have a higher median age than at present. Most of this global population will (still) be found in what we call developing countries, whose share of the world total will be even higher than it is today. Of course, there is plenty of scope for disagreement about the precise numbers, which can vary quite significantly depending on the assumptions made about changes in fertility rates, but I would argue that the broad trends are not controversial.

So, for example, if we look at the United Nations Population Division's forecasts (I'll cite the median version), then the world's population will increase from about 6.9billion this year to about 8billion by 2025. By way of comparison, the US Census Bureau's International Data Base has the world's population rising from almost 6.9billion in 2010 to about 7.9billion by 2025. Nearly all of this increase in population is forecast to occur outside the developed world.

Meanwhile, the United Nations thinks that the median age of the world's population will rise from 29 to almost 33. The "old-age dependency ratio" the ratio of the population aged 65 years or over to the population aged between 15 and 64 will increase from 12 per cent to 16 per cent. Finally, while a slight majority of the world's population is urban today, that position is expected to consolidate by 2025, with about a 56 per cent urbanisation rate based on the UN forecast. Many of these people will be living in megacities (with a population of 10million people or more) and metacities (more than 20million). The United Nations identifies 21 megacities in 2010, including one city with more than 30 million people (Tokyo) and three with more than 20 million (Delhi, Sao Paulo and Mumbai). By 2025, it's forecast that there will be 29 megacities, and in terms of metacities, Dhaka, Ciudad de Mexico, New York-Newark, Kolkata and Shanghai will join the ranks of Delhi, Sao Paulo and Mumbai (Tokyo remains the only city projected to have a population of more than 30million).

Next up is economic growth. Once again, while there might well be rather large differences in growth projections for individual economies out there, sitting above this there exists a broad consensus on the big picture: economic growth in developing economies (or "emerging markets") will continue to outpace growth in developed economies.

This means that the consensus view is that gross domestic product per head of population will gradually converge across most economies, and levels of absolute GDP will converge rather more rapidly. The emerging markets known as the BRIC nations (Brazil, Russia, India and China) have been examined in studies and reports produced by a range of bodies, such as the OECD (Organisation for Economic Cooperation and Development), the World Bank, investment banks, accounting and consultancy firms, and think-tanks. All of their forecasts suggest a world in 2025 with three key characteristics: emerging markets will account for a significantly increased share of world GDP and a greater share of global growth; the gap in income per capita between these new economic powers and the established developed economies will have closed somewhat, but will remain substantial; and the world's largest economies will include a mix of high- and middle-income economies, with the number of representatives of the latter crowding out members of the former.

The aftermath of the GFC seems to have reinforced this consensus view, albeit with the more depressing feature that the convergence process is likely to be aided by a weaker economic performance in the developed world. According to this still-emerging element of our consensus future a view known as the "new normal" we now face a medium-term outlook for much of the developed world in which growth is limited by budgetary austerity in the face of heavier public debt, a more stringently regulated financial sector, and some chastened and hence more cautious central bankers.

Of course, this close connection between the present and the forecast future should be no surprise: as the fictional mystic Kehlog Albran says in The Profit, "I have seen the future and it is very much like the present, only longer" an idea that (as many analysts have pointed out) does a pretty good job of summarising both the process of forecasting and one of its major weaknesses.

Another and closely related building block for creating our forecast of the world in 2025 is global income distribution. Taking the consensus view about economic growth and making some basic assumptions about the distribution of national incomes gives us a forecast that is marked by a significantly lower rate of absolute poverty, as well as a larger global middle class increasingly comprised of people from middle-income economies. If we want to get a bit more ambitious, we can then take these three basic building blocks of our consensus future and pile some further assumptions on top of them.

Here are some examples that follow quite reasonably: Simple gravity-style models which propose that the volume of trade between two countries is an (increasing) function of the GDPs of the two economies, and a (decreasing) function of the distance between them would suggest that trade between developing and developed countries and between different developing countries will be much more important to total international trade. Applying a similar logic to cross-border financial flows delivers a similar outcome.

Likewise, the location of production will continue to be influenced by this evolving international economic geography. There are also going to be parallel shifts in the international currency system.

Despite the fact that the GFC has dealt a fairly severe blow to the euro, which had been considered the US dollar's major competitor for international reserve currency status, the more multi-polar world economy of 2025 is going to be one with a more multi-polar international currency system. These quantitative changes in trade and international shifts in the location of production will produce other transformations, including a shift in the relative competitiveness of international financial centres (China has ambitious plans for Shanghai, for example), changes in the demand for, and hence type of, "global" products, and adjustments in the relative importance of trade routes, trading partners and ports. A more populous, more urbanised and more middle-class (that is, richer) world has implications for the demand for commodities. The 2003-08 commodity price boom was longer and stronger than any 20th-century boom, and for many observers heralded a structural change in the price of commodities.

The other GFC the global food crisis also served to sound alarm bells about sustainability. The subsequent crash has reminded us that commodity prices are still susceptible to booms and slumps. Despite this correction, however, our consensus future is one where the price of commodities is higher relative to other goods. We can be more ambitious still, and pile a few more assumptions on top of our set of building blocks, albeit at the cost of a more rickety structure.

First, our more multi-polar world economy in 2025 will by definition be a world where economic leadership is more contested. This will have consequences for the provision of international public goods, including, for example, free trade. In contrast to its prediction of tectonic adjustments in the geography of economic power, our consensus future does not seem to assume any related seismic shifts in the structure of the current economic order when it comes to global markets. Nevertheless, the current institutional supports of that order (the WTO, the IMF and so on) are not going to retain their existing importance and roles, or at least not without radical changes in their nature. Similarly, it seems highly unlikely that existing ways of delivering international economic agreement (such as giant Doha Round-style trade negotiations) are still going to be with us in 2025.

Secondly, in this multi-polar world economy there will be a greater diversity of economic models among the "leading" economies. While talk of the death of the Washington Consensus and its replacement by a Beijing Consensus can often be overly simplistic, it nevertheless captures an important development: that the (very) rough agreement on economic policy and economic management that prevailed up until 2007 has departed, and by 2025 it seems quite unlikely that there will be a single dominant replacement. Instead, Chinese state capitalism will be brushing shoulders with US market capitalism, Indian capitalism and the several different European models. We might even have a Brazilian or an Indonesian competitor. Note, however, that this still assumes that markets will remain a central feature across all of these models, with no emergence of a radically new way of organising economic activity there's that "no seismic shifts in the current economic order" assumption, again.

Finally, it's worth thinking about what the discipline of economics the people who make these forecasts might look like in 2025. At present, economics continues to be US-dominated: the big debates tend to take place in US accents, at US universities, and using US concepts. I think that it follows from the previous two predictions that this is much less likely to be the case in the consensus future of 2025. Instead, we are likely to have a world where the cutting-edge professional debates will be more contested (more multi-polar, if you like) and will be conducted in a broader range of locations, and accents, than is the case today.

So that's a broad description of what the world economy might look like in 2025, based largely on the current consensus view, along with a couple of more adventurous guesses thrown in at the end. It's also not surprisingly a reasonably good description of what I would consider as my own base-case scenario. And, as implied back at the start, given the usual track record of forecasting, it's almost certainly going to be wrong in one way or another.

So why is it going to be wrong? Here are some possibilities to consider, grouped into two broad categories.

First, there is the risk of a shock that is large enough to shift the world economy onto a different trajectory. Perhaps the most obvious candidate here is another major financial accident. Despite the shift to greater financial regulation in the near term, my suspicion is that there is nothing in the consensus future that is likely to change the risk of an accident; we will still be (more or less) as prone to the financial sector running off the rails in 2025 as we are today. A big enough financial accident could yet derail our consensus future. Arguably, we have already come close. Alternatively, it's possible that a major technological innovation will go into production in time to usher in a new cycle of growth and investment that dramatically reinvigorates growth in the developed world within our forecast period. Then there are all the other kinds of shocks a pandemic, an international security crisis (think Iran or North Korea) or possibly even an extreme climate event which could also potentially push the world economy off course.

Second, the consensus forecast not only assumes quite big (and ongoing) shifts in the international distribution of economic power, but it then (usually implicitly) assumes that the world will manage that in a relatively orderly fashion. That second assumption could turn out to be wrong. Similarly, our consensus future not only assumes big structural shifts within the world's key emerging economies, but it also assumes that these shifts will be successfully accommodated without major destabilising consequences for the prevailing social and political arrangements. Once again, that assumption could well turn out to be incorrect. And there is also the risk that resource sustainability issues bite sooner (and with more severity) than assumed by the consensus projections. In other words, we have consensus on the one hand and uncertainties on the other.

It's a reminder of the words of Niels Bohr, the great physicist: "Prediction is very difficult, especially if it's about the future." It's also the only tool we have.

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