

Assessing uncertainty and its effects on the public sector: guest editors' introduction to the thematic issue of Public Sector Economics

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Guest editors' introduction
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“... As we know, there are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns – the ones we don’t know we don’t know. And if one looks throughout the history of our country and other free countries, it is the latter category that tends to be the difficult ones.”

Former U.S. Secretary of Defense Donald Rumsfeld (2002)

Economic uncertainty seems to be one of the most popular buzzwords lately. But what does the term uncertainty mean at all? As Knight (1921) defined it, uncertainty refers to the absence of quantifiable knowledge about future events or the probabilities of their occurrence. Uncertainty has been recognised as a determinant of economic behaviour even by classics such as Keynes (1937) and Hayek (1945). Economic uncertainty has also been one of the focal points of interest for central bankers. Suffice it to say that the former Chairman of the Federal Reserve Board Alan Greenspan (2003) and the current Chairman Jerome Powell (2018) labelled uncertainty one of the defining characteristics of today’s economic landscape. However, standing on the shoulders of Knight (1921), both practitioners and academics have mostly perceived it as a latent, unobservable theoretical construct.

The Great Financial Crisis somehow became the tipping point after which empirical work on the topic of uncertainty started to gain momentum. Baker, Bloom and Davis (2016) soon published their seminal work on the Economic Policy Uncertainty Index, and other empirical proxies of uncertainty started to emerge, all facilitated by rapid developments in computing power, growth of user-generated online data sources and social networks, and state-of-the-art analytical techniques. Some of these novel approaches to measuring uncertainty involve social media data (Ma et al., 2022), web scraping (Sorić and Lolić, 2017), forecasting disagreement (Bachmann, Elstner and Sims, 2013), and market volatility (Bloom, 2014). Soon enough, uncertainty came into the spotlight of empirical researchers’ attention.

Exact sciences like physics or chemistry rely on controlled experiments. Although there is a growing field of quasi-natural experiments in economics, the “dismal science” is often criticised by natural scientists as inexact because its objects are highly variable and random in nature, and as such incommensurable with those of natural sciences.

In that sense, we were intrigued by Haldane’s (2017) inspiring lecture that links macroeconomic stability to the first law of thermodynamics. In one of its variations, this physical law states that in an isolated system, energy cannot be destroyed, only transformed from one form to another.

A parallel with economic uncertainty is obvious. It too cannot be completely eliminated; its absence could in fact lead to a stale economy with negligible profit

margins (if any). So, what can prudent policymakers then do? Not being able to eliminate uncertainty completely, they can plan precautionary measures aimed at minimising the negative effects of uncertainty as it transforms itself and moves across the economic system. For example, it is hard to assess if and when a price bubble may develop in the housing market. Faced with that uncertainty, supervisory authorities can tighten the lending conditions for mortgage loans and require banks to strengthen their loss-absorbing capacity. With such prudential framework in place, there is some assurance for banks, households and construction firms that authorities will not let uncertainty about the housing bubble damage the economy. In that respect, we are pleased that this thematic issue has been able to consider several aspects of uncertainty relevant for the analysis of employment, macroprudential policy, foreign direct investment, and public budget management. This issue starts with two macroeconomic papers.

The first paper, “Traditional or social media: which capture employment better?” (by Marija Hruška and Mirjana Čižmešija) deals with the topic of measuring uncertainty *per se*. The authors evaluate the possibility of capturing the US economic uncertainty via big data. Their assessments capture two different data sources. The first is X (formerly Twitter) posts covering economic policy uncertainty, the second mines news media articles about the same topic, in the vein of Baker, Bloom and Davis (2016). Their econometric and machine learning models pinpoint the traditional media sources as the ones with higher predictive accuracy for the evolution of US employment.

In the second paper, “Macroprudential stance assessment: the case of Croatia”, Tihana Škrinjarić provides a framework for assessing the effectiveness of macroprudential policy in Croatia. Apart from providing a meticulous review of related studies, this paper acts as a methodological guide for constructing a macroprudential policy index by assessing different empirical challenges of building such an indicator in great detail. The empirical part of the paper focuses on Croatia as a country with an active macroprudential policy, with the aim of performing an innovative assessment of the costs and benefits of macroprudential instruments.

Marijana Andrijić, in her paper “Uncertainty, populism and foreign direct investment: the state of play in economic research” takes a bird’s-eye view of uncertainty and its wider socio-economic consequences. After a thorough theoretical examination of economic uncertainty and its empirical metrics, the author discusses the complex interplays among populism, foreign direct investment, and uncertainty. The literature review finds an important role for structural fiscal policies in moderating the discussed relationships.

Enkeleda Lulaj, on the other hand, focuses on the aspects of public budget management amidst uncertainty. In the paper “Thriving amidst uncertainty: a financial blueprint for the public budget”, Lulaj econometrically examines survey responses from selected municipalities in Kosovo, finding that several budget-related con-

structs are very important for efficient macroeconomic management. For example, as the respondents declared, budget preparedness significantly contributes to accurate budget management under uncertainty; budget empowerment feeds into employment opportunities and social stability; budget governance should reduce corruption and support sustainability; etc.

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