

# Macroeconomic Forecasting

A sociological appraisal

Robert Evans

Routledge Studies in the Modern World Economy



# MACRO- ECONOMIC FORECASTING

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London and New York

First published 1999  
by Routledge  
11 New Fetter Lane, London EC4P 4EE  
Simultaneously published in the USA and Canada  
by Routledge  
29 West 35th Street, New York, NY 10001  
*Routledge is an imprint of the Taylor & Francis Group*

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Typeset in Garamond by Curran Publishing Services  
Printed and bound in Great Britain by  
TJ International Ltd, Padstow, Cornwall

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*British Library Cataloguing in Publication Data*  
A catalogue record for this book is available from the  
British Library

*Library of Congress Cataloguing in Publication Data*  
Evans, Robert, 1968–  
Macroeconomic forecasting: a sociological appraisal  
256 p. 15.6 x 23.4 cm.  
(Routledge studies in the modern world economy)  
Contents

1. Economic forecasting  
2. Macroeconomics – econometric models  
HB 3730.E973 1999  
339'.01'12 12–dc21 98-53742  
CIP

ISBN 0-415-20694-4

# MACROECONOMIC FORECASTING

*Macroeconomic Forecasting* explores the gap between economic models and the economic world. Rather than removing the politics from economics, Robert Evans argues that economic models are precisely the place where politics are put in. The book provides a fresh and timely new perspective on the emerging debates about the roles and contributions of empirical models to policy making.

Robert Evans applies the theories and methods of the sociology of scientific knowledge to map out the intellectual world of macroeconomic modellers. In this way, the book illustrates not only the key issues in science studies but also several major debates within economics. From the normative commitments which shape decisions about the variables to include, to the interpretative flexibility of data and the eventual normalization of some accounts, the book shows how economic forecasts are the product of both econometric evidence and socially grounded judgements. Taking macroeconomic modelling and forecasting – a science which affects practically every citizen – as a case study, *Macroeconomic Forecasting* provides a coherent, sociologically informed view on the way in which computer models can be used to inform policy.

At a time when central banks are being given increased powers, the book provides a timely and critical perspective on the models used to take decisions about interest rates and taxes. *Macroeconomic Forecasting* will therefore be suitable for a wide range of readers including students in economics, sociology and management, and policy makers in fields where economic or other computer models play an important role.

**Robert Evans** is a lecturer in Sociology at Cardiff University. His research interests focus on the science and practice of computer modelling in policy making.

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# ACKNOWLEDGEMENTS

This book started life as a Ph.D. thesis in late 1992, and my debts of gratitude thus span six years, two jobs and three houses. Writing the book also gives me chance to atone for a very bad mistake made in 1997. When the thesis was finally submitted to the University of Bath, it did not include any acknowledgements. The dash from viva through corrections to formal submission was such that I selfishly focused on what had to be done and forgot about those who had helped along the way. Probably the most frequent victims of this way of working have been my family – Angela, Louise and Ben – who put up with an absent (or worse, tired and grumpy) partner and father on far more occasions than I care to remember. So to them my apologies, my thanks and my love.

Academic debts are part and parcel of a Ph.D., and in my case the biggest of these debts is to Harry Collins, whose ideas and enthusiasm have shaped much of what is written in the following pages. This influence and encouragement is gratefully acknowledged. However, the ideas were only part of the experience of what used to be known as ‘Bath-SSK’. The atmosphere and the company also helped to make it such a good three years, and for that I must thank David Gooding and others at the Science Studies Centre. In particular I thank Jo Hartland, for wise words and Welsh cakes; Judith Turbyne for being so colourful and Warren ‘No Relation’ Evans and Steve Travis for providing such excellent ‘competition’. Other people at Bath to whom I owe special thanks are Alan Lewis, whose course on Economic Psychology was the catalyst for everything which has happened since, and Adrian Winnett, who took on the task of supervising my thesis and without whom I would never have understood economics. Financial support for this Ph.D. research was provided by a joint SERC–ESRC studentship (J00429232006).

At the University of Newcastle upon Tyne, Simon Marvin and Simon Guy at the Centre for Urban Technology deserve special thanks, first for giving me a job and second for allowing me to finish writing up instead. At Cardiff, where I have been able to renew my acquaintance with Harry Collins, the return to a lively School of Social Sciences has provided just the stimulus needed to transform a long and rather wordy thesis into a much better book.

## ACKNOWLEDGEMENTS

I must also thank the Panel of Independent Forecasters for agreeing to be interviewed. Without them there would have been no project, and I am extremely grateful to them for their hospitality, good humour and patience in the face of what was, no doubt, some very naive questioning. Ken Wallis, Paul Ormerod and Alan Budd suffered a similar fate with grace and wit. In addition, I am grateful to Andrew Britton, Alan Budd, Tim Congdon, Wynne Godley, Paul Ormerod, Patrick Minford, Andrew Sentance and Ken Wallis for permission to quote from these interviews. David Currie refused, and no material from the interviews conducted with him is quoted directly. Of course, even though the others have given permission for me to use these interview quotes, it does not follow that they agree with the interpretation I put on them.

In addition, I must also thank the many referees and reviewers, some anonymous and some not, who have provided such excellent feedback on my work over the years. I am particularly grateful to Donald MacKenzie and Sheila Dow, my Ph.D. examiners, for their careful reading and constructive comments. I am also indebted to the anonymous reviewers who provided feedback on the manuscript submitted to Routledge: they were remarkable for both the care and attention they gave the task and the speed with which they discharged it. I hope I have done them justice. I also grateful to Mick Bloor, David Edge, Trevor Pinch, Mary Morgan, Simon Shackley, Sergio Sismundo, Adrienne van den Bogaard, Ken Wallis, Ian Welsh and Simon Wren-Lewis for various pieces of advice, encouragement and consolation along the way. Liz Brown at Routledge and Susan Curran of Curran Publishing Services also deserve my thanks for their support in turning a wordy manuscript into a publishable book.

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Finally, I would like to thank the participants at the following conferences their ideas and feedback: Annual Meeting of the Society for Social Studies of Sciences (New Orleans, October 1994); Science Policy Support Group (London, November 1994); Post Keynesian Study Group (University College London, February 1995); Workshop on 'Simulating Knowledge: Cultural Analysis of Computer Modelling in the Life Sciences' (University of Cornell, April 1996); 10th Anniversary Congress of the Tinbergen Institute



## ACKNOWLEDGEMENTS

(Amsterdam, May 1997); Annual Meeting of the Society for Social Studies of Sciences (Tucson, Arizona, October 1997); Department of Sociology (University of York, November 1997); Centre for Knowledge, Expertise and Science, (Cardiff University, July 1998). Despite all this help, I am the one who must take responsibility for any errors that remain.

Robert Evans  
November 1998

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# WHO KNOWS WHAT TOMORROW BRINGS?

Brief introductions to  
the sociology of scientific knowledge  
and to economic forecasting

Tuesday 3 November 1998.

The Chancellor, Gordon Brown, makes his Pre-Budget Speech to the House of Commons. He announces that because of the global economic downturn, which has seen world trade growth set to fall by two-thirds, world growth forecasts virtually halved and put one quarter of the world into recession, the UK government is reducing its economic growth forecast for 1999 by 3/4 per cent. The new forecast, of between 1 and 1½ per cent is above the average of recently published forecasts, but the Chancellor insists that it is based on 'cautious assumptions' and that spending targets can still be achieved.

Chancellor's Pre-Budget Statement  
as reported on HM Treasury web site  
<<http://www.hm.treasury.gov.uk/>>

## Introduction

Economic forecasting is a big business. Governments, banks, financial institutions and commercial organisations and corporations of every shape and size are involved in it. Every single minute of every single day the fortunes of individuals, companies, and sometimes it seems whole nations, are gambled on forecasts of the price of anything from coffee beans to money itself.<sup>1</sup> As the recent events in the world economy show, economic forecasting and its consequences have the potential to affect just about anyone and everyone.

It could be assumed, therefore, that the way in which these forecasts are produced would have been a topic of great interest for academic research. Strangely this is not the case, at least as far as sociology is concerned.<sup>2</sup> This

book begins to fill this gap by providing a sociological account of the models, methods and forecasts produced by one of the most important groups of economic forecasters: the forecasters who advise governments on matters of policy.

These forecasters are particularly interesting. First, the methods they use to produce their forecasts are quite distinctive, and because of their connections with formal economic theories they are particularly interesting to the sociology of scientific knowledge (SSK), my own academic discipline. Indeed one of the most obvious reasons for choosing to study these forecasters is that they actually use the techniques, theories and methods of economic science. In other words, these forecasters use data not just to make predictions but to test theories and to explain why the economy develops in the way it does. There is therefore a clear sense in which the economic analyses and forecasts produced in this way can be said to be 'scientific' and not just instrumental.

I would suggest that it is precisely the idea that the forecasts and models are scientific that underpins the belief that in conducting economic policy there are few, if any, alternatives. Other sorts of forecast – for example, those based on the reading of charts – are so obviously dependent on interpretation and judgement that an analysis of the ways in which their meaning is negotiated within a professional group would probably seem trivial. Some economists might even dispute whether this activity could be classed as economic forecasting.

In contrast, forecasts and policy recommendations based on theoretically informed and empirically validated understandings of the economy provide a much firmer basis for studying the role of scientific knowledge in policy making and the ways in which legitimacy is created. This is a second reason for writing this book. The role of these forecasts in providing information for policy makers makes them the legitimate concern of every citizen, but in my experience most publications by economists about economic forecasting are written mainly for other economists and are inappropriate for a general readership.<sup>3</sup> They tend to be formal, technical, and to emphasize the mathematics of the models rather than the practicalities of using them. They thus tend to portray economic forecasting as a technical activity and do not consider the social context that makes economic forecasting so important and interesting.

Although understanding the theoretical and mathematical rigour of the models is important, particularly for economic practitioners, economic forecasting also affects many areas of social life. As a result a more general and less technical account of how the models are used is also important. To address these issues, the meetings and recommendations of the Panel of Independent Forecasters, will be examined.

The Panel was a diverse group of seven economic forecasters appointed to advise the UK Government following the UK's exit from the Exchange Rate Mechanism (ERM) in September 1992. It met for the first time in February



1993 and was required to produce three reports a year. These contained policy recommendations for the Chancellor and were also made available to the public, a significant change from the previous practice in which the official sources of economic advice were restricted largely to economists in the Treasury, and recommendations were not published.

The seven members of the Panel reflected the broad spectrum of views, backgrounds and analyses that characterize economics in the UK. Theoretically they ranged from traditional Keynesianism, through (mainstream) neo-Keynesianism to New Classical economics and Friedman-influenced monetarism. They worked in organisations ranging from universities to merchant banks. Most had previously been involved in giving policy advice.<sup>4</sup> In practice, after the novelty of their appointment had worn off the Panel had a fairly low public profile. Its members devoted little time to it – each report was the product of two one-day meetings – and were free also to publish their own forecasts and analyses.<sup>5</sup>

The activities of the Panel raised several interesting issues for sociologists of science. First, they highlighted the interpretative flexibility of economic data. Given the theoretical differences that existed between the Panel members it was obvious that they would interpret the data differently. This should not necessarily be interpreted as a bad thing: one criticism made of the Treasury economists was that they did not consider all the alternatives. Nevertheless it posed an intriguing question: would the Panel agree on anything?

Second, the Panel of Independent Forecasters raised questions for sociologists regarding the use of science in policy making. Much literature on the sociology of scientific knowledge has focused on debates *between* scientists, but it is important to remember that claims of scientific knowledge often form the basis of policy interventions. Policy arenas and debates are frequently the place where scientific controversies spill out into the wider society. The interaction between scientists and policy makers is another long-standing concern in the sociology of science, and the Panel provided a new and interesting window on to this process.<sup>6</sup>

Finally there was the possibility of evaluating the Panel as an institutional mechanism for shaping economic policy and enhancing its legitimacy. Sociological theories of science and technology suggest that the successful translation of science into policy and vice versa depends critically on social agents accepting the roles specified for them. In economics, the roles are those of the economic agents specified in macroeconomic models and theories. If key groups, who may be policy makers, employers, workers, shoppers or the unemployed, do not behave as the 'intended agents' postulated by the modellers, then the analysis and recommendations will be difficult (if not impossible) to apply in practice.<sup>7</sup> In other words, for economic analysis to be effective as policy advice it will need to be credible not only as economics but also as a social and political strategy.

This book examines the range of theories and models that lay behind