Canadian Economic Forecasting in a World Where All's Unsure
by Mervin Daub.
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This well-written and interesting book provides an overview of Canadian economic forecasting in the post-war period. Like many of its genre, the book suffers from the wide scope of its coverage. While it deals with almost all topics of interest, in many cases it does so in a once-over-lightly fashion that only whets the reader's appetite for more information. This is perhaps inevitable as the book is the first of its kind and puts the Canadian forecasting industry one-up even on its bigger brother to the south which still lacks its own Boswell.

On balance, the book must be highly recommended to participants and observers of the Canadian economic forecasting scene. The book will be particularly useful if it encourages further research into the Canadian economic forecasting industry and if it is picked up as a model for comparable studies in other countries, particularly the United States, the spawning ground of the industry.

The book is replete with interesting anecdotes on the history of the industry. Examples include: the "Diefenbaker Affair" where the incoming Diefenbaker government in 1957 discovered a forecast of an economic downturn made by the outgoing Liberal government and used it to blame the Liberals for the recession, allegedly discouraging subsequent governments from making publicly available forecasts well into the 1970s; and the pioneering attempt by William C. Hood and his associates at the University of Toronto to establish an econometric forecasting firm named the The Canadian Economic Consulting Association.

Missing in the book from my own parochial point of view is a discussion of the evolution of forecasting in the Department of Finance. This is an especially egregious omission given the role of the Department as the government's official economic forecaster and the central role of its forecast in the preparation of the budget and the fiscal plan.

Daub does emphasize, however, the importance of the public sector in carrying out the developmental work on forecasting in Canada. Daub characterized this as the "Canadian way in the face of a technological onslaught" from south of the border. The efforts of Industry, Trade and Commerce in the late 1940s and early 1950s, and the Bank of Canada and the Economic Council starting in the mid-1960s, are all adequately chronicled.

The supply and demand for forecasting services are examined in the book. An interesting approach pursued in the book, which provides some insights, is the application of the industrial organization model of structure, conduct and performance to the forecasting industry.

A key element of market structure largely ignored by Daub is the close relationship between the development of the industry and the evolution of computing. The econometric model-building that is the industry's stock and trade was only made possible by the advent of affordable computational capacity. The industry benefitted much from the dramatic declines in computer costs and came to be dependent on time sharing for a large proportion of its revenues. A major challenge facing the industry is the loss or time sharing revenues as clients switch to microcomputers. The industry has been responding by introducing PC-based products, including databases, econometric modeling software, and forecasting models.

Another criticism of the book is that Daub had very little data on the forecasting industry. To a certain extent this was because three of the so-called oligopoly of four forecasting firms (Conference Board, Informetrica, DRI, and Wharton) are private corporations, two of which are wholly owned subsidiaries of U.S. forecasting firms. However, in the process of interviewing 200 organizations or individuals, many of whom either worked for the forecasting firms or were clients, Daub could have gathered more intelligence on clients and fees.
Using this information he could have made rough estimates of revenues. This additional information would have contributed to a better understanding of the industry.

The lack of financial data leads Daub to the, in my view, erroneous conclusion that the "industry makes abnormally high profits in relation to business in general" (p.103). This is based on comparing the pre-tax return on equity of the Conference Board (36 per cent) and of one of the three private firms that provided him with financial information on a confidential basis (22 per cent) with that of all businesses (13 per cent).

There are at least two reasons why Daub's figures on rate of return on equity might overstate the industry's true profitability. First, it is not clear what equity is for a non-profit organization such as the Conference Board and the pre-tax rate of return on assets is a much more modest 8 per cent. Second, the pre-tax rate of return on equity is not a very meaningful concept for a private firm where the owners are free to take their compensation either in the form of wages or dividends depending on which is the most advantageous from a tax point of view.

There are also two reasons why I would not expect industry profitability to be high. First, profitability has been squeezed by declining time sharing revenue. Second, a factor that would suggest that the pure forecasting activities of the industry would be relatively unprofitable and that is downplayed by Daub in his analysis of industry profitability is the public good aspect of forecasting. Once a forecast has been prepared it can be provided to additional users at almost a zero marginal cost.

As any of the forecasting firms can attest, the widespread availability of forecasts from financial institutions as well as the government and the frequent reporting of surveys of forecasters in the financial press satisfies the needs of many potential clients for forecast information. The forecast firms are thus forced to make their money from supplying proprietary forecasting information, related services such as consulting and products such as software rather than from simply providing clients with forecasts of the big aggregates such as real GDP, inflation, the unemployment rate, interest rates and the exchange rate.

The provision of forecasts by banks and brokerage houses is such an important part of the industry that it swamps the output of the "big" four forecasting firms. Interesting questions that are not addressed in the book are why there is such a high degree of complementarity between the provision of economic forecasts and financial services and what is the public relations and marketing value of an economic forecast to a financial institution.

Daub's view that the industry is "abnormally profitable" leads him to fret a bit about what the appropriate public policy response should be before arriving at a laissez-faire conclusion. The two methods of recourse considered are the law and competition from public forecasting sources. His examination of the case law in the United States and Canada on the issue of liability relating to forecasting is interesting and informative.

The book also examines the accuracy of forecasting both in Canada and abroad by surveying earlier work by Daub and others. The conclusions are: there are no significant differences in accuracy among forecasters; forecasters tend to underestimate actua1s for nominal GNP; everyone makes the same errors at the same time; and there is no difference over time in the relative accuracy of any given forecaster in any given country. These agnostic conclusions accord with Daub's view that there is an "efficient-like market" in forecasting technology, but must come as a disappointment to many aspirant forecasters out to make their name.

Perhaps though these conclusions are too agnostic. Analysis of forecasting performance in Canada over a shorter period of time such as the 1980s based on surveys done by the Department of Finance and the the Conference Board shows that there are significant differences in performance among forecasters with some forecasters doing consistently better than average and others worse.

There are a few errors of fact or interpretation in the material with which I am familiar that raise questions in my mind about the accuracy of some of the other material with which I am not. For instance, Daub writes: that "today CANDIDE continues to be the cornerstone of the Council's modelling efforts" when the CANDIDE model was dropped by the Council in 1986 (p.57)j that the Bank of Canada sometimes releases forecasts when it does not (p.68 and 174)j and that Informetrica has close links to the Economic Council when the Council does not even subscribe to Informetrica's forecasting services (p.99).

To conclude on a less caviling note, Daub has produced a very readable and interesting (at least for forecasters) book whose strengths much outweigh its weaknesses and that fills an important gap in our knowledge of economic forecasting in Canada, giving economists and policy makers a better understanding of the issues facing the industry.

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