



Evaluation of Forecasting Services of the Directorate General Economic and Financial Affairs

Final Report

December 2007



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This report has been prepared by ADE and DIW at the request of the European Commission.

The views expressed are those of the Consultant and do not represent the official views of the European Commission.

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List of Acronyms

AMECO	Annual Macro Economic Database of the Commission
ARIMA	Autoregressive Integrated Moving Average
BEPG	Broad Economic Policy Guidelines
CLI	Composite Leading Indicators
COR	Committee of Regions
DFM	Dynamic Factor Model
DG	Directorate General
DG ECFIN	Directorate General for Economic and Financial Affairs
DSGE	Dynamic Stochastic General Equilibrium model
EC	European Commission
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
ECON	Committee on Economic and Monetary Affairs (European Parliament)
EESC	European Economic and Social Committee
EFC	Economic and Financial Committee
EG	Employment Guidelines
EIB	European Investment Bank
EMU	Economic and Monetary Union
EO	Economic Outlook (OECD)
EP	European Parliament
EPC	Economic Policy Committee
ERM II	European Exchange Rate Mechanism (Post 1999)
EU	European Union
GDP	Gross Domestic Product
GEM	Global Economy Model
GFCF	Gross fixed Capital Formation
HICP	Harmonised Index of Consumer Price
IEPG	Integrated Economic Policy Guidelines
IGP	Integrated Guidelines Package
IMF	International Monetary Fund
JC	Judgement Criterion
MS	Member States
MP	Macroeconomic Projections
NAIRU	Non-Accelerating Inflation Rate of Unemployment
NCB	National Central Banks
NRP	National Reform Plans
OECD	Organisation for Economic Co-operation and Development
PEP	Pre-accession Economic Programme
RMSE	Root Mean Square Error
SGP	Stability and Growth Pact
SNA	System of National Accounts
SVAR	Structural Vector Auto-Regression model
VA	Value-added
WOE	World Economic Outlook (IMF)

Executive Summary

Evaluation Objectives

This evaluation of the DG ECFIN's forecasting services was commissioned by the Directorate-General for Economic and Financial Affairs within the framework of the DG's Evaluation Plan for 2006. As stated in the Terms of Reference, the general objective of the evaluation is to promote understanding and lesson-learning leading, where demonstrated as necessary, to changes in the forecasting activities of the DG and their resulting outputs, with consequent benefits for the user communities, both internal and external to the Commission¹.

The evaluation addresses the following issues:

- the extent to which DG ECFIN's forecasting outputs are used by various institutions and match their actual and future needs;
- the capacity of the forecasting process to meet DG ECFIN's goals and deliver high quality output;
- the capacity of the forecasting process to maintain and enhance the internal knowledge and skill base of DG ECFIN;
- the contribution of DG ECFIN's forecasts to policy formulation and implementation;
- the quality of the communication strategy for forecasts.

Evaluation Context

The production of macroeconomic forecasts is one of a number of major activities of DG

ECFIN, in the framework of its mission statement: "*DG ECFIN's main role is to foster the success of Economic and Monetary Union both inside and outside the European Union, by conducting economic and budgetary surveillance, providing policy assessment and advice, promoting appropriate policy action and advancing economic policy coordination*"²". Hence, the evaluation addresses DG ECFIN's forecasting activities in the broader context of the other activities of the DG.

The evaluation also takes into account the fact that macroeconomic forecasts are also made available by numerous other institutions outside the Commission, notably the OECD, IMF, ECB, the Member States, private businesses and scientific organisations.

Methodology and organisation

The Evaluation Questions were imposed by the Terms of Reference and the methodological approach concentrated on how to answer them. The evaluation methodology included the following sequence of activities:

- Structuring the evaluation: i) elaborating the intervention logic; ii) formulating judgement criteria for each Evaluation Question; and iii) developing methods and instruments for collection of the necessary information.
- Collecting the information through the following: i) conduct of open and semi-structured interviews with strategic informants; ii) elaboration of two questionnaire surveys; iii) analysis of DG ECFIN's forecasting results and

¹ The terms of reference are reproduced in Annex 1.

² Source : DG ECFIN's website : Mission Statement 2007.

comparison of the results with actual outcomes; and iv) documentary analysis of other institutions' practices.

- Analysing the information with a view to validating the judgement criteria and answering the Evaluation Questions.
- Deriving the conclusions of the evaluation from the findings for the Evaluation Questions.
- Formulating recommendations in liaison with the Steering Group.

The evaluation started in December 2006 and has been conducted in three successive phases. An inception phase was devoted to structuring the whole evaluation. An intermediate note³ served as a basis for launching a dialogue on the interpretation of the intermediate results, on the main thrust of the conclusions and on the main points requiring further analysis. This final phase completes of the findings and draws out the conclusions of the evaluation and a corresponding set of recommendations.

The evaluation was monitored by a Steering Group comprising members of DG ECFIN and a representative of the Member States.

Principal findings of the Evaluation

The principal findings on the forecasting services of DG-ECFIN are presented below:

1. DG ECFIN's macroeconomic forecasts are used by a wide range of professionals and institutions. Most users of macroeconomic forecasts use those of DG ECFIN, although not exclusively. The main products are the fully-fledged Spring and Autumn forecasts. They are taken by users as inputs or a framework for their own work, or for economic policy formulation. In the Commission DG ECFIN is easily the main consumer of macroeconomic forecasts. The

preference of users for the ECFIN forecasts stems from their comprehensive coverage of all EU countries and their focus on fiscal variables. (Evaluation Question 1a)

2. Overall the forecasting products of DG ECFIN meet current user needs. The consistency of the accompanying commentary is considered satisfactory, and its quality as good, by a large majority of users. The forecasting activities include a variety of products (fully-fledged forecasts, intermediate forecasts, short-term forecasts and indicators) that cover more than the needs of most users. Some users may therefore consider that the range of products, and in some cases the level of detail, exceeds their own requirements. The issue is therefore more one of presentation of the results than of an inadequate range. (Evaluation Question 1b)

3. The future needs of users, identified in the Report of the Council of the Improvement of the Stability and Growth Pact, imply greater continuity and interaction between short-term economic forecasts and longer-term analysis centred on identification of necessary structural reforms and their impact on economic development. The greater involvement of the country desks in analytical work is a step in the right direction, but there is so far no formal strategy of reorganisation aimed explicitly at these objectives. (Evaluation Question 1c)

4. Overall, the forecasting activities support the achievement of the designated goals of the forecasting process. But current practices do not seem to be optimally designed. As the goals are also related to medium- and long- run perspectives, greater focus on medium- and long-term forecasts and alternative scenarios is indispensable for support of discussion of structural issues. (Evaluation Question 2a).

5. The forecasting processes are adequate for sustaining forecasting output of high quality. Nevertheless, accuracy can be further improved by regular analysis of

³ Evaluation of Forecasting Services of the Directorate General Economic and Financial Affairs, Intermediate Report, 4th June 2007.

forecasting errors and application of forecasting intervals. The arithmetical consistency of forecasts is guaranteed by the trade consistency exercise but it is not comparable with the theoretical consistency provided by the use of a consistent multi-country model. (Evaluation Question 2b)

6. There is abundant evidence that considerable freedom is exercised by the Commission Services in the elaboration of their forecasts and in the choice of methods they adopt. (Evaluation Question 2c)

7. The forecasting approaches of other international institutions are broadly comparable. Nevertheless, DG ECFIN's forecasts could advantageously adopt some of these approaches in several respects. In particular, the weight of econometric methods in the forecasting portfolio should be increased to improve the medium- and long-term analysis required for the designated goals. In contrast with other institutions, a DSGE model is only at an experimental stage in DG ECFIN but it is definitely needed to facilitate discussion of medium- and long-term issues in a framework which provides a more robust response to the Lucas critique. (Evaluation Question 2d)

8. The missions of DG ECFIN, in particular in the context of macroeconomic surveillance of the MS economies, necessitate a credible in-house capacity to provide a consistent commentary with forecasts and a deep understanding of Member States' and other countries' economies. Moreover, its mandate requires DG ECFIN to provide forecasts on different economic indicators. The conduct of forecasts within DG ECFIN appears to be a major element in the maintenance and development of the knowledge and credibility required for its mission statement. Outsourcing of forecasting activities would therefore not completely eliminate the need for substantial in-house processing of forecast results obtained from external sources. It is not guaranteed that such an

option would significantly lead to an increase in the resources available for analysing the economic situation and preparing policy decisions, although the contribution of forecasting activities to the knowledge-building process seems less pronounced for aspects more specifically related to the Lisbon agenda. On the other hand, from the point of view of the majority of actual users, stopping in-house production of forecasts would imply the loss of a useful source of information for which there is no comparable alternative. (Evaluation Questions 3a and 3b)

9. The influence of DG ECFIN's forecast products and outputs on Commission activities and on the design and formulation of EU policies varies substantially from one policy to another. Policies related to the SGP and to coordination of economic policies are without doubt influenced by DG ECFIN's forecasts. But their influence is much more limited for policies falling within the scope of medium- to long-term perspectives. Indeed, beyond the legal requirements DG ECFIN forecasts are mainly used by the EU institutions as another source of background information in their decision-making process. (Evaluation Questions 4a and 4b)

10. The availability and quality of the information provided by the Commission on the results of its forecasts is assessed very positively by a majority of users and the indications are that it compares favourably with communications provided by other international institutions. However, the effectiveness of the communications strategy in feeding into the economic policy debate suffers from a deliberate strategy of separating the presentation of forecasting results, in a format as neutral and factual as possible, from the analysis of their policy implications. (Evaluation Question 5a)

11. A departure from the current "neutral" communication strategy and a move towards publication of the forecasts combined with analysis of specific policy issues would need to be more effective, particularly in targeting

audiences concerned with the policy issues investigated. The evaluation also indicates that there is a demand for additional targeting to facilitate access to subsets of the forecasts. (Evaluation Question 5b)

Principal Conclusions of the Evaluation

Conclusions on the products, the process and the methods

- The portfolio of products is characterised by its short-term horizon and its diversity. The fully-fledged forecasts are the main output; this product is unique on the market and generally appreciated by users
- Although there remains major demand for elaboration of country forecasts, the trend in the responsibilities and mandate of the Commission increasingly necessitates additional types of forecast.
- The process is designed to maximise the credibility of the forecasts *vis-à-vis* the Member States and to provide a platform of discussion with the MS and other EU institutions (EFC), mainly on fiscal issues. This objective is also relevant to theoretical aspects of the choice of process and methods.
- The production of forecasts is an essential part of the activities of DG ECFIN and could not be entirely externalised.
- DG ECFIN forecasts are of good scientific standard but the methods adopted limit their theoretical consistency and their use for further medium-term and structural analysis.

Conclusions on the contribution of the forecasting activities to their specific and intermediate objectives

- DG ECFIN's forecasts are used by a wide range of actors and institutions but the purposes for which they are used vary strongly from one type of user to another. Whereas they serve as background information for most users,

their use in policy-making, while effective, is restricted to coordination of fiscal and budgetary policies.

- DG ECFIN's forecasts are resource-consuming but (i) they are also central to the working of particular EU institutions, and (ii) their production generates important spill-over.
- The organisation and production of DG ECFIN's short-term forecasts are not conducive to achievement of all designated goals, some of which are more related to medium-to-long-run issues.

Conclusions on the communication strategy

- The way in which the forecasts are communicated is aimed at providing the general community of potential users with a public good, and it succeeds in doing so.
- However communications policy is not the object of a clear Commission common strategy on objectives (other than those mentioned under Conclusion 3.1) agreed between DG ECFIN, the Cabinet of the Commissioner and DG COMM.
- The communications policy is deliberately neutral and not targeted on specific users; this limits the extent of its usefulness and its impact on the decision-making process.
- Communication of the forecasts is too technocratic for certain user categories.

Principal recommendations of the Evaluation

Based on the previous conclusions and analysis, three groups of recommendations are formulated.

The **first** group includes three recommendations designed to **improve the efficiency of forecasting activities**:

R1.1 Strengthen the theoretical consistency of the forecasts by making more use of the

consistency and theoretical characteristics of econometric models, and reorganise the production process for DG ECFIN's forecasts so as to foster deeper intertwining of short-, medium- and long-run analysis.

R1.2 Pursue and deepen the effort already being made to conduct systematic analysis of past forecast revisions.

R1.3 Without going to the lengths of outsourcing forecasting activities, develop a system for making use of external cooperation for developing models and methods, and improve external cooperation in such a way as to facilitate discussion of forecasting results and their policy implications, and to link the forecasts to medium-term projections and scenarios.

The **second** group comprises two recommendations meant to **increase the contribution of the forecasts to improvements in policy making**:

R2.1 Reinforce the involvement of country desks in the monitoring and analysis of medium- and long-run national policies and structural reforms, in particular those related to the Lisbon Agenda, by fostering their involvement in the production of model-based long-term forecasts.

R2.2 Further develop dialogue with MS and other EU institutions on the policy implications of forecasting results, in particular on aspects beyond public finances

And, finally, the **third** group comprises two recommendations aimed at **making better use of the communication strategy to ensure that the policy messages of the forecasting exercises are understood and taken into account by decision-makers**.

R3.1 Develop a goal-orientated communications strategy involving DG ECFIN, the Commissioner and DG COMM and aimed at conveying not only the results but also the policy message of the forecasts.

R3.2 Improve accessibility of the forecasting results to users interested only in selected aspects or who are interested more in broad results than in technical detail.

1. Introduction

1.1 Objective and scope of the evaluation

The evaluation of the DG ECFIN's forecasting services was commissioned by the Directorate-General for Economic and Financial Affairs in the framework of the DG's Evaluation Plan for 2006. As stated in the Terms of Reference, the general objective of this evaluation is to support learning and understanding, leading - where demonstrated as necessary - to changes in the forecasting activities of the DG and their resulting outputs, with consequent benefits to user groups, whether internal or external to the Commission⁴.

The production of macroeconomic forecasts is one of a number of major activities of DG ECFIN, in the framework of its mission statement: *"DG ECFIN's main role is to foster the success of Economic and Monetary Union both inside and outside the European Union, by conducting economic and budgetary surveillance, providing policy assessment and advice, promoting appropriate policy action and advancing economic policy coordination"*⁵.

High quality macroeconomic forecasts improve the basis of the decision-making process of public authorities, private households and firms, that is to say the wider community which potentially uses DG ECFIN's forecasts.

The evaluation deals with the following issues:

- the extent to which DG ECFIN's forecasting outputs are used by various institutions and match their actual and future needs;
- the capacity of the forecasting process to meet DG ECFIN's goals and produce high quality output;
- the capacity of the forecasting process to maintain and enhance the internal knowledge and skills base of DG ECFIN;
- the contribution of DG ECFIN's forecasts to policy formulation and implementation;
- the quality of the forecasting communication strategy.

The evaluation examines the planning, implementation, outputs, and effects of DG ECFIN's forecasting activities and can be considered a cost-benefit analysis of these activities. It takes as its starting point the internal study on the track record of the Commission Services' forecasts, published in 1999. The evaluation considers DG ECFIN's forecasting activities in the broader context of the other activities of the DG. It also takes into account the fact that other macroeconomic forecasts are made available by numerous institutions outside the Commission, notably the OECD, IMF, ECB, Member States, private businesses and scientific organisations.

⁴ The terms of reference are reproduced in Annex 1.

⁵ Source : DG ECFIN's website : Mission Statement 2007.

1.2 Methodological approach and organisation

1.2.1 Methodological approach

The Evaluation Questions were prescribed by the Terms of Reference and the methodological approach focused on how to answer them. This approach involved the following activities:

- **Structuring the evaluation**

- 1° Based on the review of the forecasting activities of DG ECFIN, their institutional and legal framework, the mandate of the DG and the analysis of related documents, an Intervention Logic was elaborated. It identified the hierarchy of objectives pursued by the various forecasting activities and their expected results. The linkage of the Evaluation Questions to that intervention logic was made explicit.
- 2° For each Evaluation Question judgement criteria were formulated accompanied with an explanation of how they would be validated.
- 3° Identification and development of methods and instruments for collecting the information necessary to substantiate the judgement criteria:

- **Collecting the information**

This activity consisted in

- identification of strategic informants;
 - conduct of open and semi-structured interviews of these informants in Brussels, MS and other institutions;
 - elaboration of two questionnaire surveys, one of them sent to six different target groups;
 - analysis of DG ECFIN forecasting results and comparison with actual outcomes;
 - documentary analysis of other institutions' practices and of outsourcing experience.
- Analysis of the information with a view to validating the judgement criteria and answering the Evaluation Questions.
 - Derivation of the Conclusions of the evaluation from the findings and answers to the Evaluation Questions.
 - Formulation of Recommendations in liaison with the Steering Group.

1.2.2 Organisation

The evaluation started in December 2006 and has been conducted in three successive phases, monitored by a Steering Group comprising members of DG ECFIN and a representative of the Member States.

An Inception Phase was devoted to structuring the whole evaluation, i.e. to analysing the overall framework of the forecasting activities of DG ECFIN; to deriving the intervention logic underlying these activities; and to developing the methodological approach to be applied in subsequent steps with a view to answering the Evaluation Questions prescribed

by the Terms of Reference. This phase was concluded with an Inception Note⁶.

An Intermediate Note⁷ was prepared as a report to the Steering Group on the results of the analysis conducted at the intermediary stage of the evaluation and to serve as a basis for engaging in a dialogue on their interpretation, on the main direction of the Conclusions and on the main points requiring further analysis.

The present draft final report pursues this work and provides the final findings and their interpretation by the evaluation team, that is the answers to the Evaluation Questions based on the judgement criteria defined in the inception stage. On this basis Conclusions have been elaborated by the evaluators and presented in this report. A first indication of the Recommendations that can be derived from these conclusions has been outlined and will be further elaborated in a workshop with the Steering Group and other representatives of DG ECFIN.

1.3 Structure of the Draft Final Report

The draft final report is structured as follows: Sections 2 and 3 present respectively the overall framework of the forecasting activities of DG ECFIN and the intervention logic underlying these activities. These sections reflect the previous reports and incorporate all comments made at the earlier stages of the evaluation.

Section 4 presents the findings of the evaluation and analyses whether they do or do not validate the judgement criteria. This section has been revised and filled out since the intermediate phase, strengthening the information basis and taking into account comments and suggestions made by the Steering Group during presentation of the intermediate report. The questionnaire survey on the users and uses of DG ECFIN's forecasts had elicited a satisfactory rate of response from three groups of targeted institutions: the Member States, non-member States, and DG ECFIN itself; the rate of response was disappointingly low for the other three groups: other Commission DGs, EU institutions other than the Commission, and other international agencies producing competing macro-economic forecasts. To improve the information basis from these sources the survey was resubmitted, but this elicited only a very marginal increase in the rate of response, and a round of interviews with representatives of these groups, most of whom had not previously been met, was conducted. In parallel, the quantitative analysis on the reliability and accuracy of the forecasts has been further elaborated. These additional interviews and analyses permitted completion and strengthening of the information already accumulated and has provided a more solid basis for the validation of the judgement criteria.

This section is supported by several technical Annexes presenting a synthesis of the results of the questionnaire surveys (Annexes 5 and 6), the technical methodology adopted for

⁶ Evaluation of Forecasting Services of the Directorate General Economic and Financial Affairs, Inception Note, 19th February 2007

⁷ Evaluation of Forecasting Services of the Directorate General Economic and Financial Affairs, Intermediate Report, 4th June 2007.

analysing the forecasts (Annex 7) and the results of the quantitative analysis of the accuracy and reliability of the forecasts (Annex 8).

Section 5 presents and elaborates the Conclusions of the evaluators derived from the study and Section 6 outlines, for further discussion with the Steering Group, the main Recommendations.

2. Overall framework of the forecasting activities of DG ECFIN

2.1 The Commission Services' forecasting in EU budgetary surveillance and economic policy coordination

2.1.1 The Stability and Growth Pact

The Stability and Growth Pact (SGP) is the main institution through which budgetary discipline is implemented within the framework of Economic and Monetary Union (EMU). It was adopted in 1997 to strengthen the Treaty provisions on fiscal discipline in EMU provided for in articles 99 (multilateral surveillance) and 104 (excessive deficit procedure), and entered into force when the Euro was launched on 1 January 1999.

The SGP has three main components:

1. *A political commitment* by all parties involved (Commission, Member States, Council) to full and timely implementation of the budget surveillance process set out in the Council Resolution of 17 June 1997. This political commitment ensures that effective peer pressure is exerted on a Member State failing to live up to its commitments.
2. *Preventive elements* which through regular surveillance aim at preventing budget deficits going above the 3% reference value. To this end, Council Regulation 1466/97 reinforces multilateral surveillance of budget positions and co-ordination of economic policies. Importantly for this evaluation, it envisages submission by all Member States of stability programmes (for countries of the Euro zone) and convergence programmes (for countries participating in ERM II) which are examined by the Commission and the Council. The Regulation also provides for the possibility of triggering the early warning mechanism in the event of significant slippage in the budgetary position of a Member State being identified.
3. *Dissuasive elements* which, in the event of the 3% reference value being breached, require Member States to take immediate corrective action and, if necessary, allow imposition of sanctions. These elements are contained in Council Regulation 1467/97 on speeding up and clarifying implementation of the excessive deficit procedure. Implementation modalities, including the numerical values of the deficit and debt criteria, are detailed in a Protocol according to which the statistical data used for the application of the excessive deficit procedure, which involves a number of *forward-looking elements*, shall be provided by the Commission.

In addition, the broad economic policy guidelines (BEPGs), which the Council addresses to the Member States, are intended to help them frame their economic policies effectively (Cf. section 2.1.2).

Within this framework, art. 104 of the Treaty requires the Commission to monitor public finance developments in the Member States with a view to identifying gross errors. The

monitoring process is based on annually updated stability or convergence programmes prepared by the Member States⁸ and submitted to the Commission and the Council. Stability. Convergence programmes must present:

- a medium-term objective for the budgetary position (close-to-balance or surplus), for the adjustment path and for the expected path of the general government debt ratio;
- the main assumptions about expected economic developments (growth, employment, inflation and other important economic variables);
- a description of budgetary and other economic policy measures being taken or proposed to help achieve the objectives of the programme; and
- an analysis of how changes in the main economic assumptions would affect the budgetary and debt position.

In addition, convergence programmes must present the medium-term monetary policy objectives and the relationship of those objectives to price and exchange rate stability.

The information included in stability and convergence programmes must cover the preceding and current years and at least the following three years. Moreover Member States need to specify their medium-term objective for the budgetary position and set out the policy measures designed to achieve and maintain it, including the accompanying economic assumptions. Following the reform of the SGP, the medium-term objective is now differentiated for individual Member States in the light of the economic and budgetary heterogeneity within the Union, including the fiscal risk to sustainability. Other elements of the reform are the aim of a more symmetrical approach to fiscal policy over the cycle through enhanced budgetary discipline during good economic times, while “major structural reforms” with verifiable impact on long-term sustainability are taken into account in a temporary deviation from the medium-term objective or from the adjustment path taken towards it.

In accordance with the rules governing the SGP, the Council examines the annual programme updates at the start of each year. This examination is based on assessments by the Commission and the Economic and Financial Committee of *inter alia* whether:

- the medium-term budget objective in the programme provides a safety margin to ensure avoidance of an excessive deficit;
- the economic assumptions on which the programme is based are realistic;
- the measures being taken or proposed are sufficient to achieve the medium-term budgetary objective (and, for convergence programmes, to achieve sustained convergence);
- the content of the programme facilitates closer co-ordination of economic policies; *and*
- the economic policies of the Member State concerned are consistent with the broad economic policy guidelines.

⁸ The new Code of Conduct on the content and format of the stability and convergence programmes, endorsed by the ECOFIN Council on 11 October 2005, incorporates the essential elements of Council Regulation 1466/97 into guidelines to assist the Member States in drawing up their programmes. It also aims at facilitating the examination of the programmes by the Commission, the Economic and Financial Committee and the Council.

The assessment takes into account the Commission Services' forecast, code of conduct (since its introduction in 2005), the commonly-agreed methodology for estimation of potential output and cyclically-adjusted balances and the broad economic policy guidelines. Based on its assessment, the Commission adopts a recommendation on which, after consulting the Economic and Financial Committee, the Council delivers an opinion⁹. The Council can thereby invite the Member States concerned to strengthen their programme and, if necessary, can recommend a Member State to take adjustment measures in order to prevent an excessive deficit. If subsequent monitoring suggests worsening budgetary divergence, the Council can recommend that prompt corrective measures be taken.

Council Regulation (EC) 1467/97 of July 1997 on speeding up the implementation of the excessive deficit procedure as amended by Council Regulation (EC) No 1055/2005 of 27 June 2005 specifies that “[...] *the excess of the reference value shall be considered temporary if budgetary forecasts as provided by the Commission indicate that the deficit will fall below the reference value following the end of the unusual event or the severe economic downturn.*” (Art. 2) and that “[...] *The Council shall assess the existence of unexpected adverse economic events with major unfavourable consequences for government finances against the economic forecast in its recommendation*” (Art. 3 (5)) or “[...] *in its notice*”(Art. 5 (2)). Traditionally the forecast in the notice is the Commission's.

Moreover, in the 20 March 2005 ECOFIN Report (section 1.6), the Council recognises “*the important contribution that Commission forecasts can provide for the coordination of economic and fiscal policies.*” It further notes that “*In their macroeconomic and budgetary projections, Member States, in particular euro area Member States and Member States participating in ERM II, should use the "common external assumptions" if provided by the Commission in due time. Member States are free to base their stability/convergence programmes on their own projections. However, divergences between the national and the Commission forecasts should be explained in some detail. This explanation will serve as a reference when assessing a posteriori forecast errors*”. In addition, the Report specifies that the Commission forecast serves as a benchmark when assessing a posteriori forecast errors.

Finally, specifications for the implementation of the SGP and the new Code of Conduct on the content and format of the stability and convergence programmes stipulate that “*The excess over the reference value shall be considered as temporary if the forecasts provided by the Commission indicate that the deficit will fall below the reference value following the end of the unusual event or the severe economic downturn*” (Section I, Part B.1) and “*The occurrence of unexpected adverse economic events with major unfavourable budgetary effects shall be assessed against the economic forecast underlying the Council recommendation or notice*” (Section I, Part B.4). It is also noted that “*Stability and Convergence programmes should be based on realistic and cautious macroeconomic forecasts. The Commission forecasts can provide an important contribution for the coordination of economic and fiscal policies. Member States are free to base their Stability/Convergence Programmes on their own projections. However, significant divergences between the national and the Commission Services' forecasts should be explained in some detail. This explanation will serve as a reference when forecast errors are assessed ex post*” (Section II.2).

⁹ As a general rule the Commission can issue in the direction of the other EU institutions (in particular the Council) proposals, recommendations and opinions. A proposal can only be rejected with the unanimity of the Council, and a recommendation by the majority. The Council can issue in direction of the member States recommendations, opinions and « avis conformes »

2.1.2 Economic Policy Coordination

Besides the Stability and Growth Pact, the Treaty also provides for policy cooperation through coordination of economic policies in the context of the BEPGs and the European employment strategy (the Luxembourg process). Other processes that apply in the area of economic policy coordination are the economic reform process (the Cardiff process), the macroeconomic dialogue involving the social partners in the European employment pact (the Cologne process) and the open method of coordination established by the Lisbon European Council (the Lisbon process).

The European Council Resolution of 13 December 1997 on economic policy coordination in stage 3 of economic and monetary union and on Articles 111 and 113 of the EC Treaty indeed introduces enhanced surveillance and coordination in the following areas:

- macroeconomic developments in Member States and development of the exchange rate for the Euro;
- budgetary positions and policies;
- structural policies in labour, product and service markets, as well as cost and price trends.

In that context the BEPGs were established to provide more concrete and country-specific guidelines and focus more on measures to improve growth potential and create jobs. Accordingly, Member States committed themselves to a comprehensive and speedy exchange of information on economic developments and policy intentions with a cross-border impact, even if there is no threat of a deterioration in the budgetary situation.

The Barcelona Council urged rationalisation of the different coordination processes, and in 2002 the Communication from the Commission on streamlining the annual economic and employment policy coordination cycles (COM(2002) 487) proposed a streamlining of the various policy coordination cycles. Moreover, it also suggested strengthening of the focus of the various coordination processes in the medium term and giving greater prominence to implementation of recommendations and evaluation of their impact.

In March 2005 the Heads of State and Government of the EU endorsed the revision of the Lisbon Strategy as proposed by the Commission and the following Spring European Council approved the simplified governance arrangements with a single set of Integrated Guidelines dealing with macro-economic, micro-economic and employment issues. To this end a new simplified and integrated guideline package (IGP) was established that brought together two existing sets of guidelines: the Broad Economic Policy Guidelines (BEPGs, Treaty art. 128) and the Employment Guidelines (EGs; Treaty art. 99). The Integrated Guidelines are the central policy-making instrument for the development and implementation of the Lisbon strategy and apply over a three-year period, i.e. 2005-2008.

DG ECFIN is involved in monitoring and implementation of these coordination processes. In particular it assesses Member States' progress in implementing the previous year's BEPGs recommendations relating to structural policy and formulates policy recommendations for the Member States in respect of product, capital and labour markets. DG ECFIN also co-ordinates the Commission's work on structural indicators designed to

analyse progress in the areas identified by the Lisbon and Gothenburg European Councils, namely employment, innovation, economic reform, social cohesion and sustainable development. In the context of the Cardiff process, DG ECFIN is closely involved in the Economic Policy Committee's multilateral review of structural reforms by Member States in product, capital and labour markets, while providing inputs into DG Internal Market's annual Cardiff report. In the context of the Luxembourg process, DG ECFIN contributes to assessment of Member States' National Action Plans for employment and to the Commission's draft of the Joint Employment Report, while participating in and providing technical input for the macroeconomic dialogue, or Cologne process.

Finally, DG ECFIN prepares economic analyses on several Community policies and provides evaluations of relevant proposals by the other Commission Services to ensure that economic criteria are taken into account. This role covers the Internal Market and taxation, the information society, competition policy, labour market and social policy, the Common Agricultural Policy, regional policy, and policies on the environment, transport and energy.

These activities substantially enlarge the role of DG ECFIN beyond the sole surveillance of the Member States' budgetary position and require widening of the scope of forecasting indicators to cover a wide variety of macroeconomic aspects, including those related to the international environment.

2.1.3 Convergence report

Art. 121 of the Treaty requires the Commission and the European Central Bank (ECB) to produce regular reports on the "*progress made in the fulfilment by the Member States of their obligations regarding the achievement of economic and monetary union. [...] The reports shall also examine the achievement of high degree of sustainable convergence [...]*". The Commission's convergence reports examine in detail whether the Member States satisfy the necessary conditions for adoption of the single currency, namely the convergence criteria and the legal requirements. Convergence reports are produced at least once every two years, or at the request of a Member State with derogation.

The reference to *sustainable convergence* (i.e. also forward-looking), coupled with the provisions of the Protocol on the convergence criteria according to which "*the statistical data used for the application of the Protocol shall be provided by the Commission*", introduces scope for using the Commission's forecasts.

2.1.4 Economic aspects of enlargement

DG ECFIN is involved in the production of regular (annual) reports assessing progress made by candidate countries in the EU accession process. In particular, it is responsible for evaluating the economic Copenhagen criteria as well as the Community *acquis* in the areas of EMU and capital movements. This assessment is completed by the pre-accession fiscal surveillance procedure, which aims to develop technical expertise and administrative capacity in candidate countries to enable them to participate in EU multilateral fiscal surveillance procedures. Within this framework, DG ECFIN makes an assessment of and annually reports on each candidate country's submission of its Pre-accession Economic

Programme (PEP)¹⁰ and notification of public deficits, debt levels and associated data (since April 2001).

Also since 2001 DG ECFIN has conducted annual assessments of macroeconomic and financial stability risks in the candidate countries, with the objective of contributing to the successful economic integration of candidate countries, as well as to evaluating their "macro-preparedness". Finally, in the framework of accession negotiations DG ECFIN is responsible for the content of negotiations on EMU as well as on freedom of capital movements, and for the subsequent monitoring of commitments.

These mandates are supported by the forecasting products of the DG and, in the spring and autumn of each year DG ECFIN makes and publishes an economic forecast for each candidate country, parallel to the forecasts for the EU.

2.2 The forecasting activities

Economic forecasts establish a common basis for policy discussions. DG ECFIN applies different forecasting methods to predicting the business cycles at the respective levels of the EU, the euro area, the Member States and the candidate countries. One of the main objectives of the evaluation is to discuss the appropriateness of the forecasting portfolio, and the composition of the individual tools therein.

Four categories of forecasts and projections are produced by DG ECFIN, making use of different techniques and instruments. They are explained in the following sections¹¹.

2.2.1 The fully-fledged biannual forecasts

Production of the biannual fully-fledged forecasts is the most comprehensive and most important forecasting activity of DG ECFIN. They are produced twice a year (spring and autumn) and provide a comprehensive macroeconomic series for all the Member States (27 since Spring 2007), the euro area (by aggregation), the candidate countries and the large non-EU economies. The variables comprise the components of aggregate demand, the evolution of the labour market, wages and prices, the current account, and the government budget balance. The forecasting horizon is up to two years

The forecasts are not officially endorsed by the European Commission but the Commissioner in charge of economic and financial affairs informs his colleagues of their outcomes and releases them during a press conference; and they are simultaneously the object of a comprehensive publication.

¹⁰ The Pre-Accession Economic Programmes are part of the Pre-Accession Fiscal Surveillance Procedure and aim at outlining the appropriate medium-term policy framework, including public finance objectives and structural reform priorities, needed for EU accession. Implementation of the measures in the document aims at covering the Copenhagen criteria. All EU candidate and acceding countries elaborate and update annually their PEPs as an element of the multilateral fiscal surveillance procedure. The PEP is therefore the forerunner of convergence and stability programmes.

¹¹ Annex 4 presents the organisation chart of DG ECFIN. The reader is invited to refer to it for the full names of the various directorates and units; in this text only the general acronyms are used (ECFIN A_1, F_4 etc.).

The *production process* of the biannual fully-fledged forecasts can be best described using the workflow diagram of figure 1. The production process starts with the preparation of external assumptions, such as oil and other raw material prices, exchange rates, interest rates and other variables considered as necessary external information for the forecasting process. To facilitate discussion of the assumptions there is a kick-off seminar with external experts. The external assumptions are summarized in a position paper, circulated among forecasters and used as a fundamental input into individual country deskwork. Based on the method of "iterative-analytical" forecasts, each country desk produces a first individual country forecast. Different statistical and judgemental methods are employed by the country desks at this stage, where selection may also depend on data availability. In addition some variables can be better forecasted on the basis of direct information than of behavioural equations. For example, the increase in the standard wage rate might be determined by long-term contracts. EU and euro area variables are obtained by aggregating country-specific variables, that is to say using a bottom-up approach.

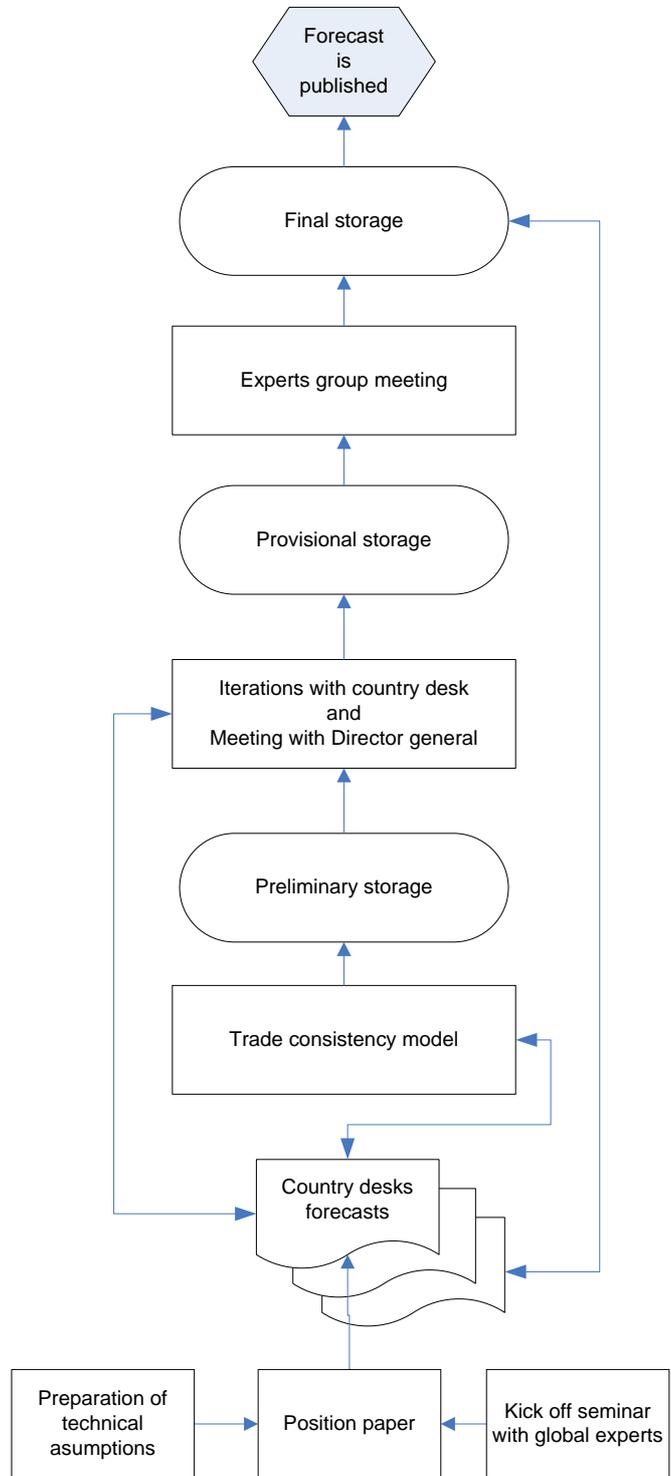
The forecasts for individual countries are subjected to a trade consistency exercise (TCE) to check and ensure their consistency. The TCE is initiated at a very early stage of the forecasting process, before the first storage. It consists of comparing (i) the volume of exports of goods and services forecast for a given country by its country desk with the weighted forecast volume of imports from the trading partners, and (ii) import prices for that country with the weighted forecast export prices for its trading partners. Nominal weights are used owing to the lack of availability of bilateral trade flows in real terms. The exercise is conducted at the level of all countries or regions subject to fully-fledged forecasts but focused on consistency at EU level (both Euro area and EU-25). Trade flows are disaggregated into merchandise and services. For EU Member States the forecast distinguishes intra-EU and extra-EU flows. Comparison 'i' permits identification of changes in market shares, whereas comparison 'ii' highlights possible inconsistencies between export and import prices. These two comparisons constitute the main elements of the consistency check. Observed deviations that cannot be interpreted by changes in competitiveness or other obvious factors are discussed with the country desks which are then required either to provide a justification (which might entail a correction in another country) or adapt their own figures. After a few iterations significant discrepancies are eliminated. The process ensures the arithmetic consistency of the forecasts but does not guarantee their theoretical consistency (for instance, long-run consistency of price and quantity elasticities) as the number of degrees of freedom is very large allowing a multiplicity of adjustments. However in practice, since the TCE is engaged at a very early stage of the forecasting and is repeated several times during the process, and given the adoption of common technical assumptions, it seems that discrepancies are not dramatic. This type of TCE offers the advantage of imposing consistency in a way that is not purely mechanical but requires inclusion in an economic analysis of the main observed anomalies; it nevertheless does not offer the same degree of coherence that would be provided by the theoretical foundations of a multiregional trade model.

After the TCE, the results are presented to the Director General and possible iteration rounds follow. Policy simulations using the QUEST model and the newly developed DSGE model come into play and can lead to possible re-adjustments and iteration rounds

starting with country desk re-adjustments and finally leading to trade consistency model checks.

In the next stage, the resulting provisional storage is presented at a meeting with Member States experts. This appears to be the final stage where re-adjustments are possible. A final storage precedes the finalisation of the forecasts and their publication.

Figure 1: The production process of DG ECFIN's (full fledged) forecasts



Several **tools** have been developed by DG ECFIN and are used in the production of the fully-fledged forecasts:

- *Iterative-analytical forecasts:* The "country-desk work" is based on basically a two-fold method: a spreadsheet-based forecast containing mainly the demand and production side of the economy and serving as a tool for consistency checking in the framework of System of National Accounts (SNA), combined with "expert knowledge" on budgetary developments and government statistics (general government transactions and balances). The technique used to prepare the forecast is explained as an iterative-analytical framework: based on intensive knowledge of the actual state of the business cycle and with "stylized facts" in mind, a typical pattern for future development is projected and again cross-checked in the light of the "stylized facts". The iterative-analytical forecast method is the main workhorse for the biannual forecast.
- *Trade consistency model:* The trade matrix serves as a consistency-checking tool to check the consistency of country-based forecasts within the aggregate levels (crosschecking of foreign sector consistency).
- *QUEST II:* The traditional structural macro-econometric model, based on forward-looking expectations and a fully developed supply side (production function and NAIRU) is still in use. The main purpose of its usage is for policy and scenario simulations (oil price shocks, exchange rate shocks...) within the process of making the fully-fledged biannual forecast

To produce the forecasts, the following **sources of information** are used:

- The AMECO database
- EUROSTAT, ECB, National Statistics, IMF trade statistics.
- National Sources (Ministries, Central Banks, Member States sources (Institutes etc.).
- Forecasting Network (EUROFRAME) reports (twice a year within the timeframe of the fully-fledged forecast).

The Annual Macro Economic Database of the Commission (AMECO) deserves special mention as it is both a resource and an essential output of the forecasting activity of DG ECFIN. This annual macro-economic database contains data for the EU-27, the euro area, the EU Member States, the candidate countries and other OECD countries (United States, Japan, Canada, Switzerland, Norway, Iceland, Mexico, Korea, Australia and New Zealand). It covers the period from 1960 to the horizon of the latest available fully-fledged forecast (currently 2008) and provides DG ECFIN and other Commission Services with a valuable set of consistent data. It provides a common basis for the analytical work of DG ECFIN and for the simulation models and exercises. It is made available to the public via the website of DG ECFIN.

The **human resources** involved are important. For each of the large Member States there are two economists working for the respective country desks, whereas for each of the small Member States there is only one economist per country desk.

Furthermore, obviously all units in ECFIN Directorate A are somehow involved in

forecasts. Keereman (1999) cites about 40 persons as being involved in forecasting exercises. This number refers to the situation prior to the last accession round, and therefore the number of persons involved is nowadays significantly higher and maybe 60-70 are now involved. The production time for a full round of forecasting (autumn, spring) is about a month

2.2.2 The interim forecasts

In between these fully-fledged forecasts, one-year projections for GDP growth and consumer price inflation are carried out twice a year by country desks. The main objective is to provide regular updates for the spring and autumn forecasts and to verify on the basis of available short-term indications that the fully-fledged forecasts remain on track. The outlook is only carried out for the euro area, the EU and the large Member States (Germany, France, Italy, Spain, UK and Poland). The updates are prepared using indicator methods and bridge equations. The forecasts are revised after reasoned argument. The horizon of the bridge equations is two or three quarters ahead.

Like the fully-fledged macro-economic forecasts, the interim forecasts are not endorsed by the European Commission but their outcome is the object of a press conference and they are made available to the public on the website of DG ECFIN.

The main *tools* are *Bridge equation models* to link available leading indicators with actual GDP growth and growth for the 2-3 quarters ahead. Short-term forecasting of euro area GDP started with Grassmann and Keereman (2001) using a bridge equation. The interim forecasts take into account the most recent information on external factors and on all Member States.

The *resources* involved in the production of the interim forecasts are less intensive than for the fully-fledged forecasts and involve about 15 staff members for 2 weeks.

2.2.3 Other short-term forecasts

Various short-term forecasting (monthly and quarterly) activities are conducted by DG ECFIN. Their purpose is to follow up and anticipate short-term trends in a series of economic indicators with a view to providing needed information in the context of the analytical work of the DG and to verify whether the other, heavier forecasts require adjustment. This work also provides information for the desks in charge of the preparation of the fully-fledged forecasts. The monthly forecasts are not the object of a formal presentation by the Commission but their results are made available to the public on the DG's website .

The main *tools* are

- *Dynamic factor model(s)*: Recently, dynamic factor models (DFM) became more and more a standard tool in forecasting. DG ECFIN developed a dynamic factor model for the aggregate euro area (Grenouilleau, 2004). The model is updated monthly and the results,

along with forecasts for three quarters ahead, are published without comment on DG ECFIN's homepage. Further DFMs are under construction for "large" Member States.

The approach delivers short-term projections for the current quarter and for the two quarters ahead. Currently the model is not integrated into the official forecasts; nevertheless it provides alternative predictions that can strengthen the credibility of the official forecasts as long as there is no divergence, and a case for further investigation in case of discrepancies. The model is therefore mainly a cross-checking instrument used for credibility and plausibility.

- *Turning point models:* turning point indicator models have been developed in DG ECFIN (Bengoechea and Quirós, 2004).
- *Business and Consumer Surveys.* Business and consumer surveys are mainly used for prediction of turning points in the business cycle (EU Commission, 2006). Confidence indicators are obtained as aggregated balances for industry, services, consumers, construction and the retail trade sector. The measures are available on a monthly basis and rely on questionnaires which have been harmonized across countries. Because of the harmonisation process the state of the business cycles in different regions of the Internal Market can be compared. For each question, balances of positive and negative answers are calculated. Confidence indicators are averages of the normalized and seasonal adjusted balances of opinions given in response to the respective questions. To track the overall activity, an economic sentiment indicator is derived as a weighted average from the standardised series of the individual surveys, where the largest weight (40 percent) is assigned to the industrial sector. Based on the first principal component of a balance of opinion derived from the industrial survey, an indicator for the business climate in the euro area is reported on. However it does not provide additional information as it is almost perfectly correlated with the industrial confidence indicator.

Indicator models and DFM forecasts are regularly updated and produced. Owing to their pure technical nature these forecasts are not time-consuming.

2.2.4 The technical forecasts and projections

The fully-fledged forecasts are used as a basis for mid-term projections and model simulations. The main tools for these extensions and technical projections are:

- *SVAR:* a structural vector auto-regression model using ARIMA procedures permits extrapolation of the outcomes of the fully-fledged forecasts three years beyond their horizon. This is done for the main aggregates and permits calculation of the cyclically-adjusted budget balances and the assessment of stability and convergence
- *DSGE model:* A dynamic stochastic general equilibrium (DSGE) model has been developed in recent years and was presented in 2005 (Ratto, Röger, in't Veld, Girardi (2005). At present the main purpose is policy analysis (as QUEST II), but on an experimental base ECFIN Unit A-1 uses the model for forecasting purposes.

2.2.5 Summary

The overall architecture of forecast products is presented on figure 2. The figure illustrates the well-known trade-off between timeliness and availability on the one hand, which calls for more “technical” methods, and on the other hand coverage, plurality of methods and flexibility, which calls for “resource-intensive” iterative procedures

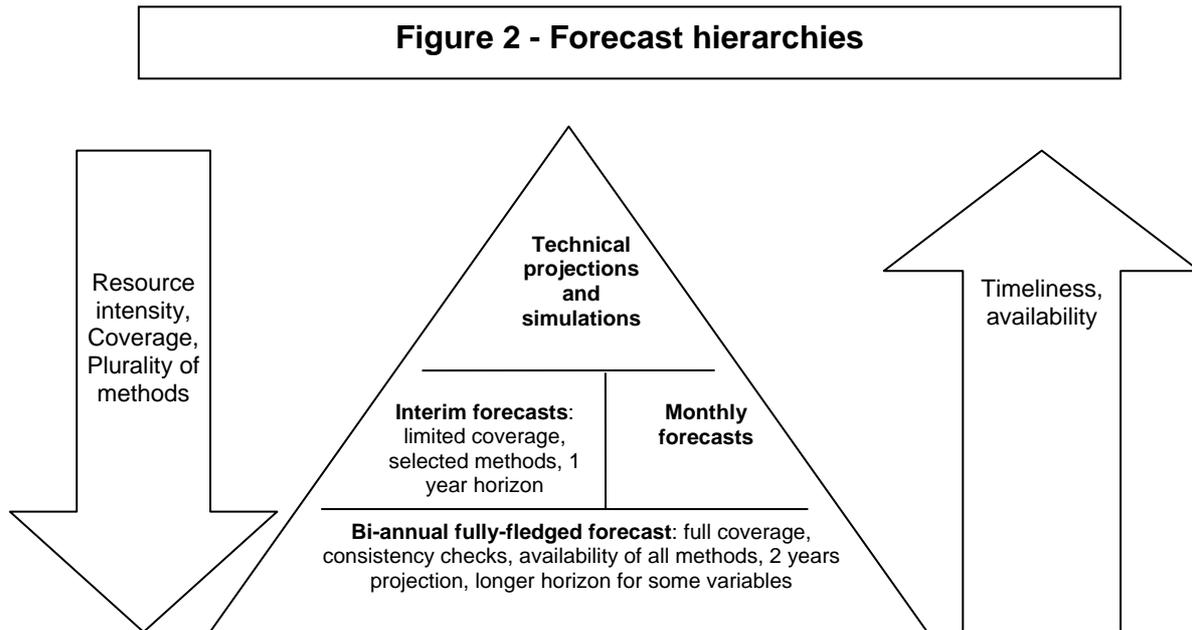


Table 1 provides a summary of the main forecasts and their characteristics.

Table 1 - Main categories of forecasts, resources and purposes

Type of forecasts	Techniques/ tools used	Time and resources involved	Publication Communication	Main purposes
Autumn/spring full fledged forecasts	Iterative-analytical, models and expert judgement assumptions (interest rate currently based on export approach but soon on market based approach; random walk for exchange rate)	1 month DGECEFIN: Country Desks of the Directorate F and G as well as the Units A2, A3, A4, C3 C4, D1, D2, D3 and R4 ¹² . EUROFRAME and expert group on occasions	The Commissioner informs his colleagues of the outcome of the forecasts, then releases the forecasts during a press conference. Simultaneously a comprehensive document with detailed table and explanation of the forecast is made available on the website of the Commission and published in "European Economy"	To follow up and understand the EU and world economic developments, to prepare the Convergence Report and to serve as a benchmark for the enforcement of GSP,
Interim forecasts	Iterative-analytical, process (for large countries mainly), technical forecast models (bridge equations, SVAR, DGSE).	1-2 weeks DG ECFIN: Country Desks from the Directorate F and G as well as the Units A2, A3, A4, C3 C4, D1, D2, D3 and R4. EUROFRAME and expert group on occasions	Press conference and publication on the website of the DG.	To check to what extent the fully-fledged forecasts are on track and to improve forecasting methodologies
Other short term forecasts	DFM Turning point model	1-2 weeks Unit A1 DGECEFIN: Econometric models and medium-term studies	No formal presentation to the press Commission but publication on the website of the DG of the monthly Euro area GDP growth projections.	To check to what extent the fully-fledged forecasts are on track and to improve forecasting methodologies
Technical forecasts	ARIMA, turning point models based on business and	Depending on the purpose of the projections and	Mid term extensions of the fully-fledged forecasts are published	To serve as a basis for analysis and simulation exercises

12 As regards Directorate A, unit A4 is in charge of the technical coordination of the forecasting activity. It also drafts most parts of the horizontal part of the forecasting document. Unit A1 is in charge of models providing alternative simulation and model-based outlooks for the Euro area and the EU as a whole. In addition Unit A1 calculates potential growth and the output gap. Unit A2 is in charge of the databases and is instrumental in the preparations of the statistical annexes and the calculations of some of the variables (cyclically adjusted balances etc). Unit A3 also provides inputs to the position paper (as A1 and Dir. C and D) by analysing the information in their business and consumer surveys while Unit A5 used to provide practical support for the publications (this function was transferred to R4 in the reorganisation).

Dir. C provides the external assumptions for interest-rates and exchange-rates and a horizontal expertise in general on financial markets, financial conditions and inflation (Units C3 and C4).

Dir. D prepares the other part of the external assumptions in terms of oil prices and other commodities as well as the global outlook (US, Japan, China etc.) and other non-EU countries whose economies we predict, being the candidate countries (units D1, D2 and D3, where D2 performs a coordinating function for these external assumptions from Dir. D).

The expertise in Directorate E, particularly regarding the functioning of the internal market, is also sometimes used.

	consumer surveys	simulations		
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2.3 The users and the usages of DG ECFIN forecasts

The DG ECFIN forecasts are primarily intended to allow the DG to fulfil its mission statement: “*DG ECFIN's main role is to foster the success of Economic and Monetary Union both inside and outside the European Union, by conducting economic and budgetary surveillance, providing policy assessment and advice, promoting appropriate policy action and advancing economic policy coordination*”¹³.

Within Economic Monetary Union economic policy is a common concern but the responsibility of each Member State. The main instruments of DG ECFIN to assist the Member States in ensuring that their policies meet the common objectives are:

- the Integrated Guidelines (encompassing the Broad Economic Policy Guidelines);
- the Excessive Deficit Procedure;
- the Stability and Growth Pact;
- assessments of the Stability and Convergence Programmes and the National Reform Programmes for growth and employment submitted by the Member States in the context of the Lisbon Strategy;
- the Convergence Reports.

The spring and autumn Economic forecasts, as well as the Interim forecasts, are published by DG ECFIN but not adopted by the Commission¹⁴. They are accompanied by an analysis of the economic situation and are meant to provide a common basis for discussion with the Member States of their economic situation and policies. They constitute key elements to allow DG ECFIN to formulate its recommendations to the Council.

Aside from their official forecasting DG ECFIN produces and makes available internally and to the general public the results of specific forecasting exercises, models and surveys, more specifically:

- monthly forecasts based on a Dynamic Factor Model;
- regular business and household confidence surveys.

These additional forecasts and short-term data are intended to provide technical verification of the plausibility of the main official forecasts in the intervals between successive publications. They are a source of general information and are also an occasion for discussing how to improve forecasting methodologies

In addition to providing a platform for discussion on macro-economic policy surveillance issues in the broad sense, the forecasts are also used by DG ECFIN as technical inputs for other exercises. For instance they serve to calibrate the first periods of the Quest simulation model, and are used as inputs for various analytical and technical studies.

13 Source : DG ECFIN's website : Mission Statement 2007.

14 Meaning that these forecasts are not the object of a vote of the College of the Commissioners but presented to this College by the Commissioner in charge of DG ECFIN.

DG ECFIN's forecasts are publicised and used by a variety of institutions as technical inputs or sources of information for their own work. There is no legal provision obliging the Commission to prepare forecasts for any of these institutions.

Beyond DG ECFIN itself, its forecasts are used by the EU institutions, namely:

- The European Parliament. Traditionally a press conference marks the official public launch of each new forecast. It is followed by an informal presentation by the Commissioner of DG ECFIN to the representatives of the political groups participating in the ECON Committee of the Parliament.
- The Council uses the forecasts to base its decisions on the SGP and other surveillance and economic issues
- The other general Directorates of the Commission, namely DG Admin, DG Budget, DG Regio, DG Empl, DG Enlarg, DG Relex, use the forecasts as technical or information inputs for specific aspects of their work.
- The Economic and Social Committee
- The Committee of Regions
- The ECB
- The EIB

All these institutions are possible users of DG ECFIN's forecasts to a variable extent but there is no obligation to do so or give preference to the Commission's forecasts *vis-à-vis* others.

Besides the EU institutions, a wider community of forecasting users also comprises:

- The Member States
- International Organisations: OECD, IMF
- The academic community
- Civil Society
- Consensus Forecasts

This larger community has access to these forecasts, which are a public good, and can use them as technical inputs into their own work or as informative sources in support of negotiations or policy decisions.

2.4 Overview of competitive forecasts

The OECD, IMF and ECB prepare macroeconomic forecasts for a two-year horizon and the medium term. The OECD and IMF forecasts refer variously to the world economy, particular regions and individual countries. The ECB projections focus on the euro area, where the outlook is obtained through aggregation across the Member States. The forecasts cover a wide range of variables such as GDP growth, demand components and inflation. The OECD and IMF projections also cover labour market variables, and trends in wages, costs and fiscal balances. The path of some variables (usually nominal exchange rates, commodity prices, but also short- and long-term interest rates) is specified as exogenous,

where the impacts of different settings are explored through simulation methods. The accuracy of the forecasts is regularly reviewed.

OECD: Twice a year the OECD publishes projections for the world economy in its Economic Outlook (EO). The main focus is on framing the policy debate in member countries. The OECD's projections are based on a mixture of information from a number of economic and statistical models, as well as expert judgement.

Each forecasting exercise starts with a broad exchange of views between OECD country experts and topic specialists. This provides a starting point for the global outlook and its potential interactions with individual country projections through trade and financial linkages. Consistency is ensured via an iteration process feeding through the OECD's multi-country INTERLINK macro-econometric model, and through discussions between the country and international trade experts. There is a built-in reality check as OECD staff meet with government economic forecasters to test their conclusions against their expertise and knowledge of local conditions. However, comments and suggestions are not automatically reflected in the final version of the EO. The published projections and analysis reflect the independent assessment of economic conditions by the OECD staff economists.

The starting point of each forecasting round is to review new developments since the last projections were produced: changes in commodity prices, exchange rates and interest rates, fiscal trends and whether economic activity has evolved differently from what had been expected. With this new information INTERLINK provides preliminary estimates. This analysis is extended by means of several indicator models.

The country desk forecasts are compared with the INTERLINK predictions based on historical relationships, the difference being due to residuals or additional factors. Large deviations in the equation projections point to the need to discuss further why historical relationships may have broken down and whether a breakdown is temporary or permanent. Judgements on whether and how quickly relationships reassert themselves can have significant implications for the story behind the projections. The results of econometric modelling influence country desk thinking. In preparation of the projections the estimates are combined with local knowledge and judgement, but not in a rigid or mechanical way.

The OECD assembles the short-term EO projection alongside a set of medium-term projections covering a five-year horizon. These scenarios indicate the requirements necessary to bring the economies back to overall balance over the medium term, in terms of closing the gaps between actual and potential output and between actual and structural unemployment. Furthermore, the medium term projections act as baseline scenarios for macroeconomic simulations of the effects of various alternative assumptions on economic policy or other forces (see Downes, Drew and Ollivaud [2003]). The baseline scenario is also intended to provide insights into the possible build-up or resolution of specific imbalances and tensions in the world economy over the medium term, and into the scope for policies to assist the adjustment process.

Since 2003 the OECD has presented an interim assessment of short-term prospects between each issue of the EO. These interim reports rest on a limited information set, are limited to a biannual forecasting horizon and a smaller number of variables and countries. They help to evaluate to what extent the latest EO projections for the larger economies are still on track. The main tool is a suite of indicator models that serve to forecast GDP for each of the economies considered. The indicators make use of a country-specific selection of monthly series, for example industrial production, retail sales, and business confidence.

In particular, Composite Leading Indicators (CLIs) are designed to provide early signals of turning points (peaks and troughs) between economic expansions and slowdowns. CLIs are compiled for 29 countries, 6 non-member States and 7 regions. They are constructed using sets of 5-10 variables (components) per country that are closely related to past turning points in a reference series such as for GDP or industrial production. The selection of components is based on judgement criteria such as economic reasoning, cyclical behaviour, timeliness, absence of data revisions and others (OECD, 2001). As their focus is on the detection of turning points, the main message is the increase or decrease in economic activity rather than the amplitude of the change. To distinguish between the trend and cyclical development, CLIs are reported in both ratio-to-trend and trend-restored versions. The former eliminates the long-run trend, which is restricted to the latter alternative.

IMF: The World Economic Outlook (WEO) presents the IMF staff analyses and projections of economic developments at global level, in major country groupings (classified by region, stage of development, etc.) and in many individual countries. It focuses on economic policy issues as well as on analysis of economic developments and prospects. It is prepared twice a year as documentation for meetings of the International Monetary and Financial Committee, and is the main instrument of the IMF's global surveillance activities. In addition, regional economic outlook reports explore recent developments and prospects for countries in various regions. These reports also address economic policy developments that have affected economic performance in the respective regions and discuss key challenges faced by policymakers.

The WEO forecasts are based on econometric methods as well as on expert judgement. On the modelling side the IMF staff has been developing a new multi-country macro-econometric model, the Global Economy Model (GEM); see Bayoumi et al (2004). It is based on DSGE principles, that is to say built on a microeconomic framework in which consumers maximise utility and producers maximise profits. The model is especially suited to discussion of the medium- and long-run impacts of structural reforms (Everaert and Schule, 2006).

ECB: Twice a year the ECB issues Macroeconomic Projections (MPs) produced by experts from the ECB and from the national central banks (NCBs) of the EMU Member States. The projections are accompanied by descriptions of their main features. The MPs show the expected macroeconomic conditions over a short-term horizon and provide inputs into the second pillar of the ECB monetary strategy.

A set of initial assumptions is agreed at the beginning of the forecasting round, covering interest rates, exchange rates, the international economy and fiscal variables. These

assumptions can be changed during the course of the forecasting exercise, taking consistency into account. The ECB and NCB staffs separately prepare initial projections, and describe the underlying economic rationale and assumptions regarding, for example, institutional settings at national level such as labour market developments and wage prospects. Each NCB prepares an initial projection for its own country, whereas ECB staff prepares sets of projections for individual countries as well as for the euro area as a whole, the latter being consistent with the aggregation of the individual ECB country projections. The initial NCB country projections and their aggregation are discussed at working group level, along with the initial country and area-wide projections by ECB staff. At the end of this process the final forecasts are produced.

The MPs are based on a combination of econometric models and expert knowledge. A variety of structural macro-econometric models are employed to provide analytical support for the projections. The models used in the forecasting exercise include the area-wide model of the ECB (Fagan, Henry and Mestre, 2001) and country models developed by the ECB and NCBs, including multi-country models. The structural models are accompanied by alternative econometric tools such as reduced form equation systems and time series models. The ECB and NCB staff also use leading and coincident indicators, bridge equations and judgemental methods. In addition, both knowledge of the institutional context and other specific information are integrated into the projections, and a number of consistency tools are used. As a result the projections embody both structural econometric model-based and judgemental methods. Consensus building among experts (modellers and non-modellers) is facilitated by quantifying and analysing the extent to which the MPs may depart from a prediction based on past behaviour, as derived from structural macro-econometric models.

To reflect the uncertainty surrounding the projections, intervals are reported for each variable. They are based on the differences between actual outcomes and previous projections carried out over a number of years. The width of the interval is twice the absolute range of these differences. In general the ranges differ depending on the variables and time horizons involved. They tend to be larger for variables with higher volatility, such as the growth rate of gross fixed capital formation. To further quantify the impact of various sources of uncertainty, various scenarios are presented. They are performed at aggregate euro area level both using the area-wide model and by examining the aggregate of country effects. Currently the ECB is developing a new area-wide model built on DSGE principles (Coenen, McAdam and Straub, 2006). This model is primarily used to study the effects of structural reforms.

3. Intervention logic

The purpose of the intervention logic is to provide the hierarchy of objectives pursued by the forecasting activities of DG ECFIN and the link between the activities and the objectives.

Figure 3 illustrates the intervention logic for DG ECFIN's forecasting activities. It is derived from the main documents used to determine the legal basis (cf. section 2.1), the Terms of Reference (cf. annex 1), data from DG ECFIN's website and a preliminary intervention logic diagram elaborated by DG ECFIN during preparation of the Terms of Reference of the present evaluation.

Its construction follows the "mirror" logic of DG Budget's Evaluation Guidelines¹⁵ in which the following chain:

Activities → Operational objectives → Specific objectives → Intermediate objective → Overall objective

representing the intended hierarchy of objectives and resources to achieve them, is matched by the chain:

Inputs → Outputs → Results → Intermediate impact (or outcomes) → Overall impact

representing the resources mobilised and activities effectively undertaken, and the successive achievements that the evaluation has to verify at each level.

The figure 3 diagram represents the intervention logic of the forecasting activities of DG ECFIN; it therefore does not cover the overall research and analysis activities of the DG. Reading the diagram from the bottom up:

1) The activities (inputs)

These are the activities and resources mobilised to produce the forecasting services. They consist of the combination of the activities linked to the process of producing the forecasts as described in Table 1 and Figures 1 and 2 of Section 2, and the analytical and support work (data, development and maintenance of models, etc) associated with them.

2) The operational objectives (outputs of forecasting services)

Two categories of the outputs of forecasting activities may be distinguished:

- outputs the production of which is deemed necessary for the conduct of the analytical and economic surveillance activities of DG ECFIN; these are mainly the fully-fledged forecasts, completed by the interim forecasts;
- the other forecasting exercises (monthly forecasts, technical forecasts) and resources mobilised around them are not directly prescribed by the legal mandate of DG ECFIN

¹⁵ See in particular annex B of European Commission : Evaluating EU Activities. A practical guide for the Commission Services. July 2004.

but usefully complement them and also serve other objectives of DG ECFIN or other users.

3) The specific objectives (results)

Activities generate outputs and outputs are meant to serve specific purposes. These have been derived from the analysis of the legal basis presented in section 2 and from the website of DG ECFIN: http://ec.europa.eu/economy_finance/about/activities_en.htm . They are broken down into two large categories according to the main users and uses:

- i. The specific objectives that correspond to the designated goals of DG ECFIN.

The forecasting activities of DG ECFIN were initiated in the early 1970s to prepare the Community's macroeconomic framework (economic budget) and to serve as a basis for policy discussions in the Economic Policy Committee and the Monetary Committee (later Economic and Financial Committee). When the Stability and Growth Pact was enacted it made explicit reference to the Commission forecasts, thereby giving a legal basis for this activity. However, the designated goals of DG ECFIN's forecasting activities are broader than this legal mandate and encompass provision of the information (as well as maintenance of in-house analytical capacity) needed for macro-economic surveillance with a view to anticipating future economic developments and preparing macro-economic policy orientations. They have been disaggregated into sub-groups represented on the diagram:

 - economic coordination of the euro area and the EU MS;
 - economic policy coordination (BEPG)
 - monitoring of budgetary policy and public finance
 - analysis of EU economies (including convergence reports)
 - support and preparation for enlargement
 - analysis and support for third country economies
- ii. The second group of specific objectives is to provide other users, in particular other EU Institutions and Member States, with useful information for their own work and decision-making.

It should be noted that this last category of specific objectives are "by products" in the sense that the forecasting activities of DG ECFIN are primarily not developed to serve these purposes and might even not be developed or be developed differently if these objectives were binding on DG ECFIN. They are offered as a public good and insofar as they are used by others they might contribute, through the activities of these other actors, to the achievement of the overall objectives.

The first category is the main justification of the reason why DG ECFIN entered into the production of certain types of forecasts. To highlight this difference in the diagram, the boxes representing the activities and subsequent hierarchy of objectives that are needed by DG ECFIN to fulfil its designated goals, are shaded.

4) Intermediate objectives (intermediate impacts).

These objectives are partly derived from an intervention logic diagram elaborated by DG ECFIN during preparation for this evaluation, and they take account of intermediate

impacts linked to the use of DG ECFIN's forecasting activities by other DGs and the wider community.

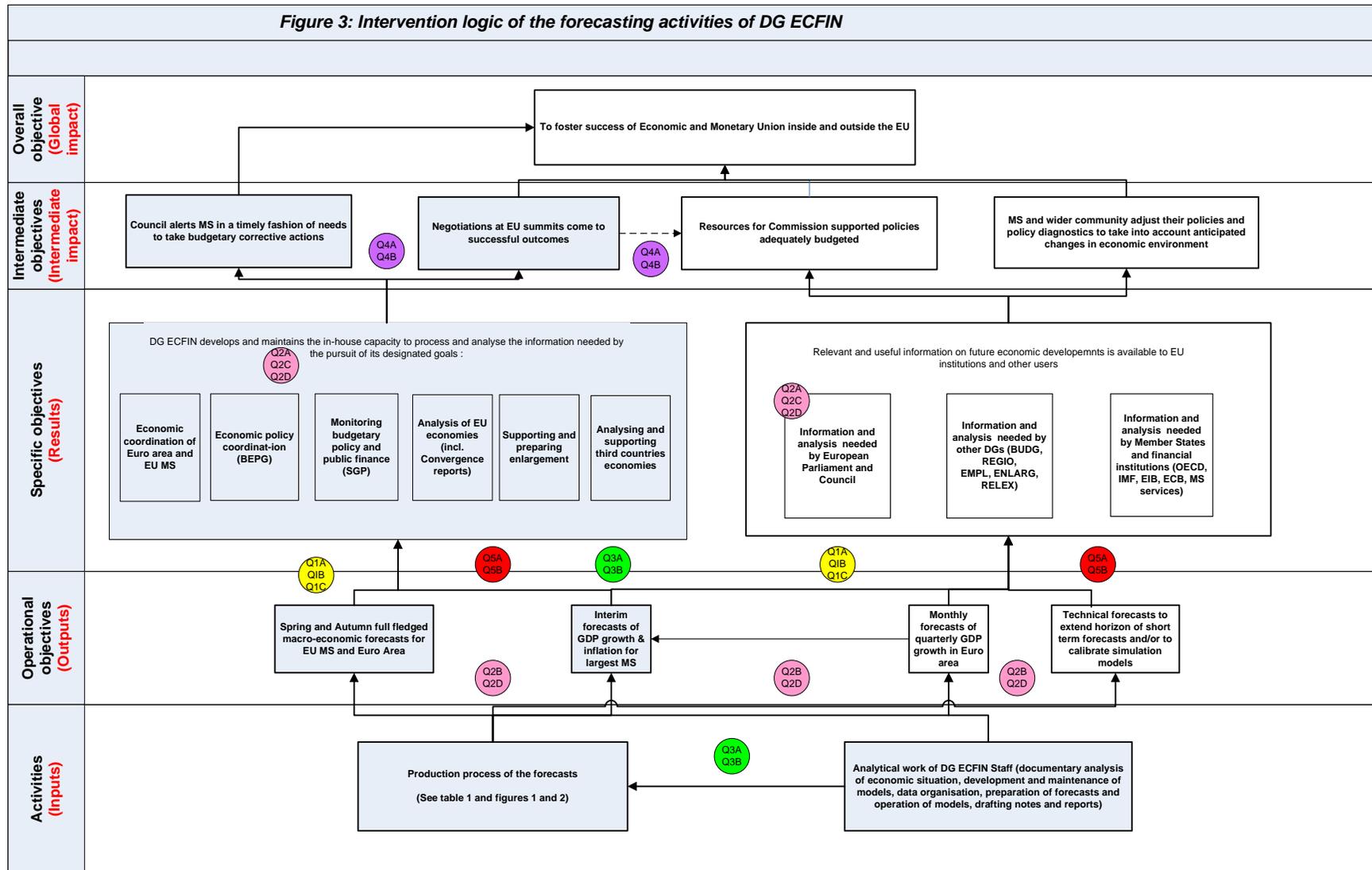
5) Overall objective:

This objective is derived from DG ECFIN's "Mission Statement" as presented at:

http://ec.europa.eu/dgs/economy_finance/organisation/mission_en.pdf

It was derived from the legal mandate (see section 2) and from the analysis process described in various documents¹⁶, and drew on a preliminary intervention logic diagram designed by DG ECFIN to help prepare the Terms of Reference of this evaluation.

¹⁶ Among which, Keereman, Filip : The track record of Commission Forecasts, Economic Papers n° 137, October 1999, the terms of reference of this evaluation, the mission statement of DG ECFIN.



4 Answers to the Evaluation Questions¹⁷

For each Evaluation Question a first sub-section briefly recalls the rationale behind the question and its coverage, a second subsection presents the findings of the evaluation so far and verifies whether they lead to validation of the judgement criteria on the basis of which the Evaluation Questions are answered.

4.1 Evaluation Question Q1a

To what extent are the forecasting outputs used by EU institutions:

- *European Commission*
- *European Parliament*
- *Council and the supporting EFC and EPC Committees*
- *European Economic and Social Committee, Committee of Regions and international organisations? Where EU institutions and international organisations are not users of the forecasting outputs, do they use alternative sources and, if so, why?*

4.1.1 Explanation and coverage

This question aims at verifying whether the EU institutions that one would expect to use macro-economic forecasts do so in reality. If the answer is in the affirmative the question then attempts to address the extent to which the forecasts prepared by DG ECFIN are vital for their work, or just one alternative among others.

4.1.2 Judgement criteria and validation

JC1a.1 The institutions/actors considered in the evaluation use forecasting outputs

The basis for the validation of this JC is the questionnaire survey (cf Annex 5) and interviews. Four categories of recipients of the questionnaire are concerned by this JC:

- G3: DG ECFIN
- G4: Other DGs
- G5: Representatives of EU institutions other than the Commission
- G6: Representatives of the international institutions producing alternative forecasts (ECB, OECD, IMF).

¹⁷ Annex 4 provides the list of the five groups of evaluation questions.

Table 1 reveals a disappointing rate of response for Groups 4, 5 and 6. It is not clear whether this should be interpreted as a lack of interest in the forecasts of DG ECFIN and hence in this evaluation, or as reflecting the small absolute number of recipients targeted. For these groups additional semi-structured interviews of selected informants were conducted with a view to strengthening the information basis.

	G3	G4	G5	G6	Total G3-G6	G3	G4	G5	G6	Total G3-G6
	<i>Nr of answers</i>					<i>% of respondents of the group</i>				
Adjusted number of questionnaires	35	17	7	10	69	50.7%	24.6%	10.1%	14.5%	100.0%
Number of responses	15	5	2	1	23	65.2%	21.7%	8.7%	4.3%	100.0%
Rate of responses per group						42.9%	29.4%	28.6%	10.0%	33.3%
Q8 Do you use forecasts of macroeconomic variables?										
Yes	12	2	2	1	17	80.0%	40.0%	100.0%	100.0%	73.9%
No	3	2			5	20.0%	40.0%			21.7%
No answ.		1			1		20.0%			4.3%

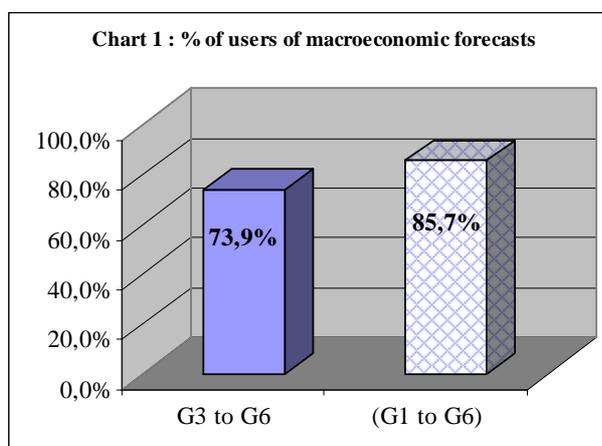
For the third group, DG ECFIN staff, there is a clear and unsurprising indication that macro-economic forecasts are used. Respondents in Group 4 are distributed equally between users and non-users of forecasts, whereas respondents in Groups 5 and 6 are all users. Overall a vast majority (76%) of respondents from the four groups which answered this question are using macro-economic forecasts in their work.

It is worth mentioning (see chart 1) that the proportion of users of macro-economic variables is higher when including Groups 1 (MS) and 2 (representatives of non-MS). The response rate was above 50% in these groups, respectively 89% and 100% being users of macro-economic forecasts (cf. annex 5).

Interviews with representatives of the third group (DG ECFIN) confirm the major points of the survey. DG ECFIN staff, by the very nature of their job, are regular users of macro-economic forecasts, as also are the staff of international institutions dealing with macro-economic questions.

Representatives of Group 4 (other DGs) confirm their regular use of macro-economic forecasts to complete their information on the current situation of the sector or area they are dealing with or to confirm or refute their own views of the short-term macro-economic outlook in these areas, and more generally as important background information

The situation in EU institutions other than the Commission (Economic Policy Committee, Economic and Financial Committee, Committee of the Regions, European Economic and Social Committee, European Parliament, European Investment Bank) is variable. Whereas



the EFC and to a lesser extent the EPC are major users of macro-economic forecasts, the use of such information is much more limited, even cursory, in the other institutions (EP, EESC, COR). In these cases macro-economic forecasts are part of the general information and overall economic background on which the institutions need to keep themselves permanently informed but they do not constitute an essential technical input into their work. For the EIB, following the economic situation of the countries in which it operates is part of its routine work and involves compilation of available macroeconomic data and forecasts, mostly as background information.

The last group comprises institutions that are themselves producers of macro-economic forecasts and are therefore natural users of the main available forecast.

This JC can therefore be considered as generally validated. Most groups considered in this evaluation are regular users of macro-economic forecasts. At the very least these forecasts are part of the background information needed for the main tasks of the institutions concerned.

JC1a.2 The institutions/actors considered in the evaluation and using forecasting outputs use those provided by DG ECFIN

Table 2 summarises the answers to the questionnaire survey relevant to this JC.

		G3	G4	G5	G6	Total G3-G6	<i>(Total G1-G6)</i>
	Number of questionnaires sent (memorandum item)						
	Adjusted number of questionnaires sent	50.7%	24.6%	10.1%	14.5%	100.0%	
	Number of responses	65.2%	21.7%	8.7%	4.3%	100.0%	
	Rate of responses per group	42.9%	29.4%	28.6%	10.0%	33.3%	
Q9(a)	Do you use forecasts of macroeconomic variables provided by DG ECFIN?						
	Yes	80.0%	80.0%	100.0%	100.0%	82.6%	92.2%
	No	20.0%	20.0%			17.4%	7.8%
	No answ.						
Q9(b)	If YES, which forecasting products of DG ECFIN do you use?						
	Spring and autumn economic forecasts	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
	Interim economic forecasts	83.3%	50.0%		100.0%	68.4%	66.2%
	Monthly economic forecasts	33.3%	25.0%		100.0%	31.6%	28.2%
	No answ.						
Q15(a)	Are there potential alternatives to DG ECFIN's forecasts as an input of your work ?						
	Yes	33.3%		100.0%	100.0%	34.8%	70.1%
	No	66.7%	100.0%			65.2%	28.6%
	No answ.						1.3%
Q15(b)	If YES, specify.						
	Open Q. ⁽²⁾			2	3		
	⁽¹⁾ Percentages of respondents of the group or of those who responded yes to the main question.						
	⁽²⁾ Number of open responses						

The majority of users of macro-economist forecasts are using those produced by DG ECFIN. Again, it may be noted here that the proportion of users of DG ECFIN forecasts is even higher among respondents from the Member States (G1), who are not addressed by this question. The last column in italics provides, for additional information, the results for all the groups (i.e. including G1 and G2). It shows that the usage of DG ECFIN forecasts is widespread among all groups and that the relative use of fully-fledged and monthly forecasts is similar across the different categories of user, whereas interim forecasts seem to be used mainly by G3 (and also G1). However, for a proportion of non-EU institutional users (G1 and G2) there are alternatives, which is not the case for the majority of respondents from G3.

Respondents who identified alternatives inputs for their work mentioned by order of importance the IMF (World Economic Outlook), the Consensus Forecasts, the OECD and ECB products.

Documentary analysis and interviews with DGs other than DG ECFIN and representatives of the EU Institutions indicate that the main reasons why the ECFIN forecasts are used are as follows:

- Their “European official stamp”. In some cases this is binding. For instance, DG Budget has an obligation to use the macro-economic forecasts of DG ECFIN as the macro-financial framework for the preparation of the Community budget. In most cases the European Institutions consider that the DG ECFIN forecasts should be favoured over the alternatives because of their European characteristics.
- Their geographical coverage (EU individual countries).
- Their focus on fiscal data.

However, the forecasts are viewed as too complicated by some interviewees who use them only as cursory background information. The issue seems to be more one of communication strategy¹⁸ (according to these informants the forecasts should be presented in a more popular and simple format) than of substance but it encourages some users to favour other sources.

Interviewees in international institutions (Group 6) exhibit strong differences. The ECB does not seem to make much use of DG ECFIN’s forecasts because they have developed their own and focus on monetary issues and the euro area. The OECD uses DG ECFIN’s forecasts as a source, together with ECB and IMF forecasts, relating to the EU Member States. They compare their own forecasts and projections with the results of DG ECFIN’s forecasts and use information provided by the latter to feed their own country analyses and related projections. In their forecast production process, OECD staff regularly meet representatives of the EU Member States and Commission to exchange views and information.

There is enough evidence to conclude that this JC is validated

JC1a.3 For those institutions/actors using DG ECFIN’s forecasting outputs, these outputs are a major element of their work

For this judgement criterion questionnaires and interviews again form the basis of the findings. Table 3, based on questions 10 and 12 of the questionnaire (annex 5) summarises the use of DG ECFIN’s forecasts.

	Regularly	On occasion	Never/no
As inputs for work	60.9% (63,8%)	21.7% (23.4%)	17.4% (7.8%)
In decision making	47.8% (48.1%)	39.1% (39.0%)	13.0% (13.0%)

¹⁸ To be covered when analysing evaluation question 5.

The frequency of use of DG ECFIN's forecasts as inputs into their work is very similar whether only G3-G6 or all groups are considered. Nearly two-thirds of them use these forecasts on a regular basis, and about five-sixths on a regular or occasional basis. This is confirmed by interviews conducted during the evaluation, most interviewees confirming that they need a macro-economic reference framework for many of their activities. They consider that the fully-fledged forecasts provide this adequately.

The proportion of respondents who use regularly or occasionally DG ECFIN's forecasts to support decision-making is equally high but with a different distribution between those who do so regularly and those who do occasionally. Whereas 61% of respondents use ECFIN forecasts regularly as an input into their work, less than 50% use them regularly in support for decision-making.

An open question was proposed to respondents who replied that they never used DG ECFIN forecasts. The main arguments advanced by respondents from G3-G6 is that their work did not justify the use of these forecasts (e.g. because they are dealing with legal issues); the arguments advanced by G1-G2 respondents is that they use their own forecasts.

A large majority of respondents (73% for G3, 80% for G4, and all respondents in the other groups; see table 3a) considers that the outcomes of the decision-making processes of their respective institutions have been influenced by the forecasts (mainly the fully-fledged forecasts). On the other hand, 60% of Group 3 (question Q14(a), table 3a), and with one exception all respondents of the other groups, stated that forecast results do not trigger their decisions. While it is important to remember here that the weak rate of response for the last three groups undermines the significance of these answers, the information retrieved from the interviews clearly indicates that DG ECFIN forecasts are mainly used by Groups 3-6 as part of the information they need, and which therefore influences their policy recommendations and decision-making processes. The interviews also confirm that it is only in the context of macro-economic surveillance that DG ECFIN's forecasts are used as triggers for decision-making.

Table 3a: Use of DG ECFIN forecasts in decision making						
<i>% of respondents of the group or of those who responded yes to the main question</i>						
		G3	G4	G5	G6	Total (G3-G6)
Q13(a)	Are some outcomes in the decision making process of your institution influenced by DG ECFIN's forecasts ?					
	Yes	73.3%	80.0%	100.0%	100.0%	78.3%
	No	26.7%	20.0%			21.7%
	No answ.					
Q13(b)	If YES, which forecasting products influence the decision making process of your institution?					
	Spring and autumn economic	90.9%	100.0%	100.0%	100.0%	94.4%
	Interim economic forecasts	72.7%	50.0%		100.0%	61.1%
	Monthly economic forecasts	36.4%	25.0%		100.0%	33.3%
	No answ.					
Q14(a)	Are there some outcomes in the decision making process of your institution for which forecasts of DG ECFIN are used as triggers (i.e. determining the nature of the decision on the basis of preset critical values)?					
	Yes	40.0%		50.0%		30.4%
	No	60.0%	100.0%	50.0%	100.0%	69.6%
	No answ.					
Q14(b)	If YES, which DG ECFIN forecasts do you use as triggers?					
	Spring and autumn economic	100.0%		100.0%		100.0%
	Interim economic forecasts	33.3%				28.6%
	Monthly economic forecasts					
	No answ.					

Interviews with representatives of Groups 4 and 5, whose rates of response to the questionnaire were very low, yielded the following information on this judgement criterion:

- ECFIN forecasts are evidently a major input for those who have an obligation to use them (e.g. DG Budget).
- They are essential inputs into the work of the EFC both in terms of background information and as a basis for decision-making. and they are important for the EPC as background information.
- As background information they are important for and regularly used by several other Commission Services and European Parliament Working Groups.
- Some EU Institutions make little or no use of them (EESC for instance) either because the information is not in a suitable form (too technical; not immediately understandable by uninformed receivers) or because the information is not precisely tailored to their needs (too much information provided, cf. infra JC1b1 and JC1b2).
- Several Services of other DGs and EU Institutions would require longer-term forecasts accompanied by more structural analysis.

In the light of the evidence collected this JC can be considered as partially validated as the use made of DG ECFIN forecasts differs widely among Commission DGs and other EU Institutions.

DG ECFIN's forecasts are major inputs for the DGs and institutions that have an obligation to refer to them in their own work (DG Budget, EFC) and for all activities connected with macro-economic surveillance of the European economy. In these cases DG ECFIN's forecasts are a major technical input and are taken into account in preparing policy decisions.

DG ECFIN's forecasts are used mostly as background information by several Commission Services (DG Employment, DG Regio) and by some EU Institutions (EPC) that generally find them more suitable than other forecasts because of their coverage of European countries, their comprehensiveness and their focus on fiscal issues.

For other users these forecasts are part of the available information but are not used in preference to other sources; in some cases they are viewed as insufficiently user-friendly.

Answer to Evaluation Question Q1a

There is a widespread use of macroeconomic forecasts as inputs or a framework, or for formulating economic policy. It is worth noting that they have greater importance among the MS (and even the non-MS) Services than within the Commission Services. In the Commission, DG ECFIN is by far the main user of macroeconomic forecasts.

Most users of macroeconomic forecasts use those of DG ECFIN, but not exclusively. Abundant use is made of the fully-fledged forecasts, less of interim forecasts and only minor use of monthly forecasts. User preference for DG ECFIN's forecasts stems from their comprehensive coverage of all EU countries and their focus on fiscal variables.

4.2 Evaluation Question Q1b

What are the actual needs of the different users of the forecasting services and to what extent are they met in terms of:

- *geographical scope,*
- *nature and level of detail of key indicators and variables,*
- *frequency,*
- *timing,*
- *reliability, and*
- *relevance of forecasting outputs and products.*

To what extent are the users interested in the exact values of the variables or/and the underlying story of the projections, in future or recent development, in policy analysis? What have been the consequences of the recent separation of the forecasts and the BEPGs processes in terms of target populations' satisfaction?

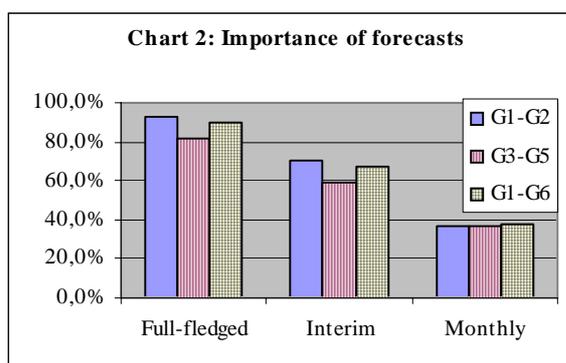
4.2.1 Explanation and coverage

This question relates to the relevance of DG ECFIN forecasts. It aims at examining whether the main features of DG ECFIN forecast, including their coverage, technical specifications and presentation modalities, correspond to the need of the users. Moreover the intervention logic mainly covers the links between operational and specific objectives.

4.2.2. Judgement criteria and validation

JC1b.1 There is high correspondence between the features of DG ECFIN forecasts and the needs of the users.

The first element taken into account for this JC is the opinion of users regarding the different categories of forecast. Chart 2 is derived from question 16 of the survey of Annex 5 and summarises the importance of the forecast for different user categories. Comparison is made respectively for Groups 1 and 2 (MS and non MS services), Groups 3-5 (Commission and other EU Institutions), and all groups (those above and the international institutions).



The chart indicates the percentage of users for whom the forecasts are important, very important or essential. More than 90% of all groups view the fully-fledged forecasts as important. The percentage remains above 50% for the interim forecasts, but it is essentially the national services (MS and non-MS) which use these forecasts. Within the Commission and other EU Institutions only 5%

consider these forecasts as important. Only a minority of users considers the monthly forecasts important.

Table 4 (from question 18 of the questionnaire) summarises the needs expressed by the users concerning the geographical coverage of the forecasts.

Figures in bold in table 4 indicate zones which more than 50% of users in the different groups identify as needs. Zones in which more than 75% of users of forecasts have expressed an interest are shaded.

The table shows that there is a strong and homogeneous demand for aggregate forecasts for the **EU-27**. The **Euro zone** is most demanded by the MS and non-MS; it is also important for the Commission and other EU Institutions but demand is less than 75%. There is similarly a high demand for forecasts covering **all MS** but this demand is lower than that for the **EU-27**. This is somewhat contradicted by opinion gathered during interviews which pointed to strong interest in individual MS forecasts. It is worth noting that the **large MS and aggregations of the small MS** option attracts lower demand than either **EU-27** or **all MS**.

The other geographical categories, with the exception of the acceding countries, are needed only by a minority of users. Positive indications on other countries mainly concerned India, Brazil, South Africa and “potential candidate” countries and came mostly from Group 3.

Turning to the indicators most needed by the users, Table 5 (from question 21 of the questionnaire) shows that most indicators included in the ECFIN’s forecasts meet the needs of a very large majority of users in all groups. All indicators are needed by more than 50% of users, and only a few ones by less than 75% of users (i.e. those that are not shaded in green in the table).

Table 4: Needs in terms of geographical scope
(% of respondents of the groups)

	G1-G2	G3-G5	G1-G6
Euro zone	86.5%	65.0%	79.5%
EU-27	76.9%	80.0%	76.7%
All MS	63.5%	60.0%	61.6%
USA	63.5%	60.0%	61.6%
Whole world	61.5%	40.0%	56.2%
Japan	42.3%	40.0%	41.1%
Large MS & aggreg.small MS	44.2%	30.0%	39.7%
Acceding countries	34.6%	55.0%	39.7%
China	38.5%	35.0%	37.0%
Candidate countries	28.8%	45.0%	32.9%
World regions	38.5%	15.0%	31.5%
Russia & CIS	23.1%	10.0%	19.2%
ASIA	11.5%	15.0%	12.3%
Latin America	5.8%	15.0%	8.2%
Others		20.0%	5.5%
MENA countries	1.9%	10.0%	4.1%
Sub-Saharan Africa	1.9%	10.0%	4.1%

Table 5: Most used indicators
(% of respondents of the groups)

	G1-G2	G3-G5	G1-G6
GDP at constant prices	100.0%	90.0%	97.3%
Exports (goods and services)	98.1%	85.0%	94.5%
Imports (goods and services)	98.1%	85.0%	94.5%
Harmonised Index of consumer prices	98.1%	80.0%	93.2%
Gross fixed capital formation	94.2%	85.0%	91.8%
Private consumption	94.2%	70.0%	87.7%
General government balance	90.4%	80.0%	87.7%
Unemployment rate	90.4%	75.0%	86.3%
Current account balance	86.5%	85.0%	86.3%
Employment	86.5%	75.0%	83.6%
GDP Deflator	82.7%	80.0%	82.2%
Trade balance	82.7%	80.0%	82.2%
General government gross debt	84.6%	75.0%	82.2%
Unit labour costs	82.7%	70.0%	79.5%
Compensation of employees/head	80.8%	70.0%	78.1%
Cyclically-adjusted budget balance	80.8%	70.0%	78.1%
Saving rates of households	75.0%	65.0%	72.6%
Private consumption deflator	73.1%	70.0%	72.6%
Net lending/borrowing vav ROW	61.5%	75.0%	65.8%
GNI at constant prices	53.8%	55.0%	53.4%

Question 21 of the survey was completed by an open question relating to possible additional indicators needed by respondents. The following suggestions were formulated:

- exports and import deflators and prices (G1-G2)
- prices of primary goods (G1-G2)
- potential growth, output gap (G1-G2)
- exchange rates, real exchange rates (G1-G2), (G3-G5)
- unit labour costs per hour (G3-G5)
- GFCF broken down by sector (public, private non residential, private residential)

There is a high demand (question 25 from survey of users) for more disaggregating of VA, employment and external trade forecasts. The respondents to the open question 26 also cited labour force, GFCF, and HICP with and without energy.

Table 6 (built up from question 23 of the annex 5 questionnaire) indicates the needs of the different user categories in terms of periodicity of the forecast indicators. For each indicator the figures in bold refer to the periodicity most demanded by the respective groups.

For many purposes most users are satisfied with annual data. It is only for the main aggregates (GDP and the main components of aggregate demand, prices, labour costs and current account balance) that there is heavy demand for quarterly forecasts. The views of the different user groups are very similar.

Monthly data forecasts, with the exception of that for the harmonised consumer price index, very seldom respond to the needs of more than 10-15% of users.

Table 6: Desired periodicity of indicators
(% of respondents of the groups)

	G1-G2			G3-G5			G1-G6		
	Annual	Quart.	Monthly	Annual	Quart.	Monthly	Annual	Quart.	Monthly
GDP at constant prices	35.2%	63.0%	1.9%	27.3%	50.0%	9.1%	32.5%	59.7%	3.9%
Private consumption	42.6%	50.0%	1.9%	31.8%	36.4%	4.5%	39.0%	46.8%	2.6%
Gross fixed capital formation	42.6%	50.0%	1.9%	31.8%	40.9%	4.5%	39.0%	48.1%	2.6%
Exports (goods and services)	42.6%	50.0%	5.6%	31.8%	40.9%	9.1%	39.0%	48.1%	6.5%
Imports (goods and services)	42.6%	48.1%	5.6%	31.8%	40.9%	9.1%	39.0%	46.8%	6.5%
GNI at constant prices	35.2%	31.5%		36.4%	27.3%	4.5%	35.1%	29.9%	1.3%
Employment	37.0%	37.0%	13.0%	36.4%	27.3%	13.6%	36.4%	35.1%	13.0%
Unemployment rate	40.7%	40.7%	13.0%	36.4%	27.3%	13.6%	39.0%	37.7%	13.0%
Compensation of employees/head	42.6%	35.2%	5.6%	31.8%	31.8%	4.5%	39.0%	35.1%	5.2%
Unit labour costs	37.0%	42.6%	5.6%	36.4%	31.8%	9.1%	36.4%	40.3%	6.5%
Saving rates of households	40.7%	31.5%	3.7%	36.4%	27.3%	4.5%	39.0%	31.2%	3.9%
GDP Deflator	42.6%	40.7%	1.9%	36.4%	36.4%	4.5%	40.3%	40.3%	2.6%
Private consumption deflator	40.7%	33.3%	3.7%	36.4%	22.7%	13.6%	39.0%	31.2%	6.5%
Harmonised Index of consumer prices	27.8%	37.0%	33.3%	27.3%	31.8%	18.2%	27.3%	36.4%	28.6%
Trade balance	44.4%	38.9%	3.7%	36.4%	31.8%	9.1%	40.3%	35.1%	7.8%
Current account balance	44.2%	40.4%	1.9%	31.8%	36.4%	9.1%	40.3%	39.0%	5.2%
Net lending/borrowing vav ROW	38.9%	29.6%	1.9%	31.8%	27.3%	4.5%	36.4%	29.9%	2.6%
General government balance	55.6%	33.3%	1.9%	40.9%	31.8%	4.5%	50.6%	33.8%	2.6%
Cyclically-adjusted budget balance	55.6%	25.9%	1.9%	36.4%	22.7%	4.5%	49.4%	28.6%	3.9%
General government gross debt	55.6%	25.9%	3.7%	36.4%	31.8%	4.5%	50.7%	28.8%	2.7%
Other indicated above - first (if relevant)	22.2%	14.8%		22.7%	13.6%	4.5%	22.1%	14.3%	1.3%

Interviews with informants from DGs other than DG ECFIN and from EU institutions other than the Commission confirmed that for them the information provided by the forecasts generally exceeds their needs, sometimes by far. However, this is not viewed as an issue by most of them, since they find the subset of information (which differs according to the service or institution) they are looking for. Nevertheless some pointed out that this abundance of information gives the forecasts a technocratic aspect and discourages some users, although this issue is more one of presentation and popularisation of the results than of substance.

Table 7 (from question 24 of user survey) shows that whereas two forecasts a year would adequately serve the needs of the Commission and EU Institutions, the national Services of MS and non-MS include a significant share of users who need quarterly forecasts.

Table 7: Desired frequency of publication of forecasts
(% of respondents of the groups)

	G1-G2	G3-G5	G1-G6
Once a year	0.0%	0.0%	0.0%
Twice a year	46.3%	68.2%	51.9%
3 times a year	3.7%	0.0%	2.6%
4 times a year	46.3%	18.2%	39.0%
No answ.	3.7%	9.1%	5.2%

The Evaluation Question also raises the issue of the separation of forecasts and BEPG processes and the effects on user satisfaction. The questionnaire survey investigated the issue (questions 29a¹⁹).

Table 7a: Separation of forecasts and economic policy guidelines
(% of respondents of the groups)

		G1-G2	G3-G5	G1-G6
Have you noticed it in the results of the forecast?	Yes	16.7%	9.1%	14.3%
	No	81.5%	81.8%	81.8%
	No answ.	1.9%	4.5%	2.6%

The answers show without ambiguity that the vast majority of users, whether or not they belong to the Commission or other EU Institutions, have not noticed this separation. Interviews with different informants conveyed the same message. This therefore raises an issue of communication to be dealt with under Evaluation Question 5a.

Overall this judgement criterion can be considered as validated. Combining the results of table 7 with those of tables 4 and 6, and taking into account the opinion of interviewed informants, one can conclude that the current rhythm of production of forecasts responds to the needs of most users. Indeed the fully-fledged and interim forecasts cover four times a year the aggregates and the geographical zones for which most users wish to have forecasts. The coverage of the forecasts also responds to the needs expressed by the users. Whereas there is evidence that the ECFIN forecasts provide their users with what they request, there are also indications that more is produced than is needed by a majority of users .

The analysis of this judgement criterion raises the question of the adequate dimensioning of the forecasts to the needs of the users. More is offered than is required. It is therefore necessary to investigate whether the additional products (monthly forecasts, geographical forecasts for various regions of the rest of the world, etc.) are needed to improve the quality of the main forecasts or whether forecasts could be produced with a lower concentration of variables.

JC1b.2 The quality performance of DG ECFIN forecasts is adequate according to accepted scientific standards

The analysis of this judgment criterion is based on quantitative analysis of the reliability of the forecasts presented in Annex 8²⁰.

This analysis permits the conclusion that there is little evidence that the DG ECFIN

¹⁹ The survey asks whether the separation has been noticed (question 29a) and, if yes, whether it improved user satisfaction (29b). The latter point seems to have been misunderstood by the interviewees as more people answered question 29b than those who responded in the affirmative to question 29a. Therefore, question 29b cannot be interpreted and is not used here.

²⁰ The methodology of this analysis is presented in annex 7.

forecasts are biased, inefficient or irrational, at least as a general rule. Furthermore, there is little evidence that the forecasts are based on an asymmetric loss function. Direction-of-change forecasts are highly informative and useful as a compass in an uncertain world. However there is evidence that forecasts for some countries tend not to fulfil the requirements of non-bias and rationality. This is true for Italy and Portugal in the case of growth forecasts; for Spain, Portugal and Italy in the case of inflation forecasts; and for Luxembourg, Germany and Sweden in the case of deficit forecasts. Here some work seems to be necessary to avoid such errors in future. However the forecasts have so far only been investigated in relation to a naïve benchmark, namely the "no change" forecast. The team will investigate if the "benchmarks" are facing the same problems, which in turn would point to large unforeseen shocks and structural breaks which were unknown to the forecasting community in general. Under such circumstances DG ECFIN cannot be blamed for committing the same errors (which anyway only turned out to be errors *ex post*).

On the basis of the foregoing and of the analysis of Annex 8 this judgement criterion may be considered as validated insofar as the forecasts meet accepted scientific standards even if there may be room for improvement.

JC1b.3 The forecast precision and the consistency of the story are important aspects for the users and these are satisfied by these characteristics of DG ECFIN forecasts.

Tables 8 and 9, derived respectively from questions 27 and 28 of the questionnaire survey, illustrate the extent of satisfaction of all groups of users.

Table 8: Accuracy of the forecasts
(% of respondents of the groups)

	G1-G2	G3-G5	G1-G6
The accuracy of the forecasts is not important for me	0.0%	9.1%	2.6%
It is important and I am satisfied with the quality of the forecast	87.0%	77.3%	84.4%
It is important and I am not satisfied with the quality of the forecast	11.1%	4.5%	9.1%
No answer	0.0%	9.1%	2.6%

Table 9: Consistency of the accompanying story
(% of respondents of the groups)

	G1-G2	G3-G5	G1-G6
The consistency and the explanatory story accompanying the forecasts are not important for me	1.9%	9.1%	3.9%
It is important and I am satisfied with the quality of the explanation accompanying the forecasts	92.6%	81.8%	89.6%
It is important and I am not satisfied with the explanation accompanying the forecasts	5.6%	0.0%	3.9%
No answer	0.0%	9.1%	2.6%

Interviews, including those with groups whose rate of response to the questionnaire was low, confirm the questionnaire survey insofar as satisfaction with the quality of the forecasts and of the accompanying background commentary are concerned. Many informants who use the ECFIN forecasts have pointed that in their view the material provided is excellent and compares favourably with that of other international institutions and exceeds by far the standards of private institutions' forecasts.

The consistency of the forecasts seems satisfactory to most interviewees and the provision of an homogeneous set of macroeconomic data for all MS is regarded as a very valuable element when the data are used as input by users in their own work. However, it has been pointed that in certain areas (notably employment) a lack of consistency of forecasts based on AMECO data and in the statistical information provided by Eurostat is an issue that limits severely the interpretation of some results and the message that could be drawn from them. Members of the European Parliament also tend to mistrust the database used in the context of the forecasting activities and, in consequence, the accuracy of the forecasts.

On the basis of this evidence the JC can be considered as validated.

Answer to Evaluation Question Q1b

Overall the users of the forecasting products of DG ECFIN consider that they respond to their needs in terms of geographical scope, nature and detail of indicators, frequency and periodicity.

The scientific quality of the forecasts is adequate and an overwhelming majority of users express satisfaction with the accuracy of the forecasts and the consistency of the accompanying background commentary.

In terms of relevance the major issue is the adequacy of the wide range of forecasts offered (in terms of geographic coverage, detail of tables, frequency and periodicity, etc.) *vis-à-vis* the apparently less demanding needs of a majority of users. This results from the wide variety of users, several of whom are interested only in specific subsets of results. The issue is therefore more one of presentation that fails to address these specific needs than of an inadequate range of results.

4.3 Evaluation Question Q1c

What are likely to be the future needs of users and what, if any, are the new issues and problems that should be specifically addressed by the DG's forecasting services?

4.3.1 Explanation and coverage

This question also relates to the relevance of DG ECFIN's forecasts. It aims at identifying possible future needs of users and the related possible improvements in DG ECFIN's forecasts. Insofar as DG ECFIN is the main user of its forecasts in the framework of the SGP and the Convergence report, the question will address the extent to which DG ECFIN's planned developments are likely to contribute to meeting the requirements of the Council report "Improving implementation of the Stability and Growth Pact" of 21/3/2005. The question also aims to capture the extent to which the intended developments meet the needs expressed by other users.

This question also covers the links between operational and specific objectives.

4.3.2 Judgement criteria and validation

JC1c.1 The features and organisational modalities of the forecasting process needed to respond to the Council Report on Improving the implementation of the SGP are met by the intended developments in DG ECFIN's forecasting activities.

The Council Report on Improving the implementation of the SGP (European Council, 2005) recognises the importance of realistic and cautious macroeconomic forecasts and it also recognises the important contribution that Commission forecasts can provide for the coordination of economic and fiscal policies. A number of recommendations in the report could have an impact on the production process for DG ECFIN's macro-economic forecasts.

- The report insists that, in their macroeconomic and budgetary projections, the Member States, in particular euro area MS and those participating in ERM II, should use the "common external assumptions" if provided by the Commission in good time. Member States are free to base their stability and convergence programmes on their own projections. However, divergences between national and Commission forecasts should be explained in some detail. This explanation will serve as a reference when assessing forecast errors *a posteriori*.

This recommendation has implications for preparation of the common assumption

since ideally they should be prepared jointly in order to avoid divergences between some national assumptions and those of the Commission or, at least, to better identify and justify the eventual assumptions.

- The report insists on the adjustment path to the medium-term objectives and this should plead in favour of a longer horizon for the forecasts and projections.
- Sensitivity analysis and the development of alternative scenarios is also recommended by the report, with obvious consequences for the preparation of forecasts and drafting of the accompanying background commentary.
- Finally the report recommends taking into account structural reform so as to enhance the growth-oriented nature of the SGP. Implementation of this recommendation should aim at establishing a bridge between short-term forecasts and analysis conducted in the context of the Lisbon Agenda. The implications for the production process for the forecast may be quite important in respect of variables and tools.

The extent to which the intended developments in DG ECFIN's forecasting activities respond to these Council Report recommendations must be understood on the basis of the current trends in the forecasting practices of DG ECFIN as there is no formal description of the intended reorganisation or adaptation of the DG's working modalities.

Several points indicate that the nature of the changes and adaptations that are currently taking place are in line with these recommendations. In particular there is:

- a trend towards increased involvement of the country desks in structural analysis, and participation of country desk staff in analytical work in the context of the Lisbon agenda;
- increased use by some country desks of models and increased liaison with the unit in charge of econometric models and medium term studies.

On the other hand, the recent trend in the involvement of the technical expert group in the forecasting process has been questioned by some informants. The group used to be involved, before the final storage of the forecasts, in a exchange of views on the results. Owing to leaks in 2006 it was first decided not to convene the group any longer. This decision has however been reversed and the group again meets although rather to discuss thematic topics of importance for the forecasts, not the draft forecast results themselves. On the one hand this is a move in the direction of analysing structural issues in the context of the forecasts, on the other hand it may reduce Member States' ownership of (or adhesion to) the forecasts.

The JC can be considered as partially validated. The needs identified in the Report of the Council of the Improvement of the Stability and Growth Pact are gradually being met by the current trend in practices, but there has so far been no formal re-direction of the organisation and methods needed to address them.

JC1c.2 The current intended developments in DG ECFIN's forecasting activities also meet priority needs expressed by users other than DG ECFIN²¹.

Needs and priorities expressed by users other than DG ECFIN are very similar to those implied by the recommendations of the Report of the Council on the Improvement of the SGP:

- need for policy dialogue around the results and implications of the forecasts;
- need to develop better linkage between the structural reform needs identified by the short-term forecasts and the impact on the short-term forecasts of the structural reforms involved;
- the need for a longer-term perspective as a consequence of the afore-mentioned need for improved linkage ; *and*
- the need to complement the forecasts with simulation of scenarios.

Another need identified by some users is that of more accessible presentation of the forecasts, for instance, a segmentation by themes corresponding to the main interests of different categories of user. The point is more one of communication strategy and is addressed under Evaluation Question 5a.

In terms of coverage the DG ECFIN forecasts seem to satisfy the users.

It must be noted that since the Spring 2007 forecasts the publication has included a chapter "Risks to the Forecast". Whereas a qualitative analysis of the upside and downside risks of the forecasts existed in the previous publications, this new assessment of the risks is quantified. It is based on a sensitivity analysis around the central forecast results. The DG ECFIN macro-econometric model is used to simulate scenarios involving alternative exogenous developments of oil prices, world demand, developments in the US economy, and internal demand. Probabilities, emanating from the views of the country desk experts and the hierarchy are attached to these alternative assumptions and in turn permit computation of the probability of deviation of key variables from the central forecast.

Outside the circle of scientific and technical staff no informant consulted mentioned this assessment of risks as being of importance. However it constitutes a important element of appreciation of the relevance and precision of the forecasts as well as an important interface between pure forecast exercises and analysis of alternatives.

The JC can be considered as partially validated. The coverage and the periodicity of the forecasts give satisfaction to the users. Other needs cited by most informants are similar to that identified in the Report of the Council on the Improvement of the SGP and therefore the conclusion is the same than for JC1 c.1

²¹ Validation/invalidation: yes, if on average the intended developments in DG ECFIN forecasting activities cover the points identified as main needs by the respondents to the questionnaires.

Answer to Evaluation Question Q1c

The most important future needs currently perceived by different categories of users correspond to a very large extent to those identified in the Report of the Council on improving the Stability and Growth Pact. They entail greater continuity and interaction between short-term economic forecasts and longer-term analysis centred on the identification of necessary structural reforms and their impact on economic developments.

There is a convergence in the views of the staff of DG ECFIN and other users of the Commission as well as representatives of the Member States, to the effect that greater and better use of the forecasts would require greater continuity and interaction between the forecasting exercises and the analysis of structural reforms. The recent evolution of some activities and practices in DG ECFIN, such as the greater involvement of the country desks in analytical work, go into the right direction, but there is so far no formal reorganisation strategy aimed explicitly at these objectives.

4.4 Evaluation Question Q2a

To what extent can the current mix of forecasting products be considered as optimal with respect to designated goals? Do portfolios exist in other international organizations? How do they compare in terms of strengths and weaknesses?

4.4.1 Explanation and coverage

With respect to the intervention logic, the question refers to forecasting methods and the forecasting portfolio. It asks whether the forecasting products are optimal with respect to designated goals or whether they should be extended. The evaluation has to compare the forecasting outputs with those of other international institutions and identify comparative strengths and weaknesses.

The evaluation is predicated on the appropriateness of the current forecasting products to the designated goals. These goals refer to the specific objectives of the forecasting process, such as displayed in the structure of the intervention logic in figure 3. They cover:

- i) monitoring and surveillance of budgetary positions within the EU as well as implementation of the SGP;
- ii) coordination of economic policies within both the euro area and the full EU;
- iii) support to the enlargement process; *and*
- iv) analysis of EU and of third country economies.

The forecasting activities of DG ECFIN were analysed in detail in section 2.2. The output includes the biannual fully-fledged forecasts for the current year and the year ahead, interim forecasts as regular updates of the fully-fledged forecasts and a variety of alternative short term (quarterly and monthly) forecasts. The fully-fledged forecasts are the most important element in the portfolio.

4.4.2 Judgement criteria and their validation

JC_2a_1 The current mix of forecasting products is necessary with respect to the designated goals

JC_2a_2 The current mix of forecasting products is sufficient with respect to the designated goals

The current mix of forecasting products is necessary for **all** designated goals. In particular, fully-fledged forecasts are a major element of the SGP as they are at the heart of the preparation and assessment of stability and convergence programmes as well as of convergence reports. Other components of the mix of forecasting products (interim and short term forecasts) are necessary both for updating and checking the consistency of the fully-fledged forecasts or for providing more specific focus on the euro area.

The mix of forecasting products is sufficient mainly for the designated goals and objectives related to multilateral surveillance of budgetary positions and implementation of the SGP. This is however less true for the other designated goals. Forecasts introduce a common basis for the dialogue that should take place within the context of the coordination of economic policies and provides a valuable source of information on EU and third country economies which is widely used by the MS, international organisations and EU institutions in various stages of their work²².

However, forecasting products are mainly related to the short run. This would be appropriate if the designated goals refer to cyclical, not structural issues. But this is hardly the case in every respect. *Inter alia* the sustainability of certain budgetary policies, the support for economic policy coordination and structural reforms, and in particular implementation of the Lisbon Agenda, require a broader perspective which also addresses the medium and long terms. These goals are covered by macro-econometric models (QUEST II, DSGE) which are also used for scenario analysis. Although their potential contribution to the designated goals seems quite high, they play only a minor role in current forecasting activities. DSGE is still at an experimental stage.

On the basis of the foregoing, the first judgement criterion can be considered as validated but the second cannot insofar as the designated goals seem to require more focus on medium and long term issues such as structural reforms or the implementation of the Lisbon Agenda, for which the existing forecasting products offer a less-than-optimal response.

JC2a.3 The current mix of forecasting products compares favourably with those of other international organisations (OECD and IMF)

Forecasting products of other international institutions such as the OECD, IMF and ECB were analysed in detail in section 2.5. The most important products of the OECD and the IMF are respectively the Economic Outlook (EO) and the World Economic Outlook (WEO). The EO and WEO refer to the world economy, particular regions and individual countries. The ECB produces a short term outlook for the euro area in its Macroeconomic Projections (MP) to support its monetary strategy. The euro area forecasts are based on national forecasts for the individual MS. All these products are conducted on a biannual base, as is the case with the fully-fledged forecasts of DG ECFIN.

Overall, the forecasting portfolios of the other institutions include similar products and compare with those of DG ECFIN. Nevertheless, the implementation of the forecasting process is quite different (see also Evaluation Question 2d). Medium term forecasts or econometric models are more important in other institutions. For example, the OECD supplements the EO short-term forecasts with a set of medium-term projections with a 5-year horizon. Country experts' forecasts are compared with model predictions based on econometric relationships. Substantial deviations in the projections from the path indicated by the equation point to the need for further discussion as to why historical relationships might have broken down, whether a breakdown should be seen as temporary or permanent, as so on. This may also help improve the economic story behind the forecasts.

²² This is mainly in the case of the fully-fledged forecasts.

In addition, other institutions have a more pronounced practice of embedding their forecasts in the context of a broad, medium-term policy analysis. For instance the difference between the OECD and DG ECFIN forecasting product mixes is mainly that DG ECFIN has intermediate and monthly forecasts in addition to the biannual fully-fledged forecasts. The OECD biannual forecasts are related to the production of the EO which analyses current major trends and examines the economic policies required to foster high and sustainable growth in member countries. Forecasts are then another element in an economic analysis of the main developments in OECD and major non-OECD economies.

The JC can be considered as partially validated. The mix of DG ECFIN's forecasting products compares quite well with those of other institutions. However, the latter rely more intensively on formal models and also have a higher propensity to use and include forecasts in longer-term economic policy analysis.

Answer to Evaluation Question 2a

Overall, the forecasting activities support the achievement of the designated goals. But current practices do not seem to be optimally designed, as the goals are related not only to the short term, but also the medium- and long-term perspectives. For goals such as better policy coordination, sustainability of national public finances as part of the SGP, or preparation of and support for structural reforms, the current products offer a less-than-fully-adequate response. A larger weight of medium- and long-term forecasts is indispensable for supporting discussion of structural issues.

The elements of the forecasting portfolio of other international institutions are broadly comparable. However, medium- and long-term outlooks play a larger role in the process, especially at the OECD and IMF. Given the priority it attaches to proper implementation of monetary policy, the ECB is more interested in the short run and cyclical issues.

4.5 Evaluation Question Q2b

To what extent do the current forecast processes ensure a sustained high quality of forecasting output?

4.5.1 Explanation and coverage

This question refers to the organisation of the forecasting production process with respect to the sequencing of different forecasting stages (external assumptions and their coordination, internal discussion rounds, consultation of experts, consistency exercises, revisions etc), division of tasks between the forecasting unit and the country desks, resource allocation between the desks, and the appropriateness of the variety of approaches applied. Furthermore, the effectiveness of the production process and the extent to which activities contribute to achieve operational and specific objectives are addressed.

The production process for the fully-fledged forecasts is elaborated in figure 1. In summary, it follows a bottom-up approach. Global assumptions on exchange rates, interest rates, oil and gas prices and so on are discussed in an initial meeting with experts. Subsequently country forecasts are prepared by independent country desks which prepare their forecasts in a more or less isolated manner, with different techniques (formal and judgemental methods) being applied. National forecasts are then integrated into a trade matrix which, after iteration with the country desks and revision of forecasts, leads to trade results that are consistent in an arithmetic sense. After provisional results have been derived, an expert meeting is finally conducted to confirm the results of the forecasts.

4.5.2 Judgement criteria and their validation

JC2b.1 The current forecast processes ensure the accuracy of the forecasting outputs.

The accuracy of the forecasts can be investigated by an analysis of past forecast errors. An updated analysis is included in Annex 8 of the report. Forecasts of GDP growth, inflation and the budget deficit can more or less be regarded as unbiased, rational and efficient. Some country forecasts do not seem to fulfil these requirements. The forecasts often outperform a naive forecast especially if one considers the predicted direction of a change in a variable.

However, the accuracy of forecasts is not fully supported by current practices. In particular, a systematic analysis of errors is required and should be an integral part of each forecasting exercise, together with a discussion of developments which might have caused the errors. Analysis of past forecasting errors is done only occasionally in a few DG ECFIN papers and there are no clear forecasting intervals that would permit distinction between significant and insignificant errors. Significant errors deserve further analysis. In contrast,

insignificant errors could even be compatible with the economic story behind the forecasts. Even if the risk factors do not materialise, uncertainty surrounding forecasts should be specifically highlighted.

On the basis of the foregoing, the analysis in Annex 8 and the arguments supporting JC1b.3, this judgement criterion can be considered as validated in a general sense. However accuracy could be improved by regular analysis of forecasting errors and the application of forecasting intervals.

JC2b.2 The current forecast processes ensure a high consistency of the forecasting products and a high quality of accompanying stories

One can examine consistency of results in three ways: first of results obtained through various methods; second of national results *vis-à-vis* the broader international context; and third of results *vis-à-vis* baseline scenarios derived from mainstream economic theory.

As far as the first approach is concerned, forecasts are indeed derived not only from the fully-fledged forecasts but also in other ways. Different techniques can produce different forecasts. However it is unclear how potential discrepancies are resolved and even whether they are discussed at all. As long as there is no divergence between alternative methods, no problems arise. But when results conflict, no procedural rules seem to have been established so far. It is also unclear how differing results are used to further address the risks surrounding the forecasts or give rise to intensified discussions between the participants in the forecasting exercises.

Consistency of national forecasts with the broader international context is achieved through the trade consistency exercise described above which mechanically leads to results that are consistent from an arithmetical point of view. However, this approach has many degrees of freedom; and arithmetical consistency does not necessarily ensure the consistency of forecasting results and accompanying background commentary.

The same holds true for baseline scenarios derived from mainstream economic theory. In particular, the country desk forecasts are predicated on certain economic theories, which may not be consistent across the desks. The forecasting process is indeed not based on any common cross-desk multi-country model that would foster consistency between country desk approaches and with a common theoretical foundation.

The forecasting process, which is based on a penetrating analysis of the economies of the countries involved and close relationships between country desks and the corresponding national authorities, is conducive to the high quality of the accompanying background commentaries. This feature has been underlined by the vast majority of users (see JC1.b3).

This criterion is considered as only partially validated. The quality of the accompanying background commentary is high and users have expressed evident satisfaction with the consistency of the background commentaries accompanying the forecasts. On the other hand, the trade consistency exercise is supposed to ensure global arithmetical

consistency between the forecasts of individual country desks but the process does not guarantee consistency with the accompanying background commentary. It is also not clear how discrepancies between different forecasting products are resolved. Furthermore forecasts might be conditional on certain economic theories which can vary between country desks. To this extent arithmetical consistency does not ensure consistency in the broader sense or with any common theoretical background shared by the country desks.

JC2b.3 *Bottom-up approach contributes better to the quality of the forecasts as opposed to a multi-country model approach.*

The current bottom-up approach is definitely an important factor for achieving high quality and efficient dialogue with the MS. However there is no evidence that a bottom-up approach contributes better to the quality of forecasts as compared with a multi-country approach. Instead, a multi-country model might be better suited, for instance, for ensuring economic consistency or allowing for the analysis and understanding of forecast errors.

There is no evidence supporting either validation or invalidation of this JC.

Answer to Evaluation Question 2b

Current forecast processes are appropriate for maintaining high quality of the forecasting output. Nevertheless, accuracy can be further improved by a regular analysis of forecasting errors and the application of forecasting intervals. Consistency of the fully-fledged forecasts is ensured arithmetically via the trade matrix. However individual country forecasts might be based on conflicting economic theories, implying that consistency in a broader sense may be not established. Also the results taken from different forecasting products might lead to different outcomes. Rules for resolving discrepancies between outcomes do not seem to have been established. The same seems to hold true for interaction between country desks and trade specialists. The bottom-up approach is not complemented by an approach based on multi-country models.

4. 6 Evaluation Question Q2c

To what extent do the current forecast processes in DG ECFIN ensure the independence of forecast results, particularly with regard to variables that are relevant for fiscal surveillance purposes (e.g. in the framework of the Stability and Growth Pact)?

4.6.1 Explanation and coverage

Independence of the forecast results is a key issue since the main purpose is to provide a rational and objective basis for the opinions or recommendations transmitted by the Commission to the Council on how the Member States should redirect their economic policies with a view to better functioning of economic and monetary union. Such notifications necessarily entail high political involvement and there might be contradictory pressures either from the Commission hierarchy or from Member States authorities to push forecasts in conflicting directions.

The purpose of this question is therefore to check whether the Commission's forecasts are free from biases due to political interference.

4.6.2 Judgement criteria and their validation

Four judgement criteria are proposed. The first relates to the regulatory and organisational status of the production process for the forecasts; the second to the degree of pressure to which the forecasting Services are subjected; the third compares the DG ECFIN process with that of similar institutions; and the fourth compares the DG ECFIN forecasts with those of other institutions with a view to detecting whether there are systematic biases.

JC2c.1 The organisational structure, the status of the staff and the forecasting process of DG ECFIN compare favourably with that of similar institutions and provide reasonable guarantees for the independence of the results

Neither interviews nor contacts nor an examination of DG ECFIN's structure revealed any abnormal organisational conditions or status. On the contrary they highlighted the fact that the Commission has the absolute freedom to choose the themes on which it will focus as well as the methods it will use. This freedom is not evident everywhere. For instance, OECD, as a Secretariat of its Member States, does not have the same margin of manoeuvre when undertaking new methodological developments.

DG ECFIN's forecasting process includes contacts with MS experts, which is also a common practice within other institutions. These contacts have never been cited as occasions when the independence of DG ECFIN's results could have been threatened.

This judgement criterion can be considered as validated.

JC2c.2 The staff of DG ECFIN is not submitted to significant pressures from the Member States or from its hierarchy

The questionnaire survey on the pressures experienced by staff, the results of which are reported in Annex 6, is absolutely conclusive as regards the absence of pressures both from the hierarchy and from the Member States.

This judgement criterion can be considered as validated

JC2c.3 The forecasts of DG ECFIN do not reveal a systematic bias (more optimistic or more pessimistic outlook) when compared with those of other institutions.

Neither post-mortem analysis of forecasts nor the analysis reported in Annex 8 support a view of systematic optimism or pessimism in DG ECFIN's forecasts.

On that basis this judgement criterion can be considered as validated.

Answer to Evaluation Question 2c

There is abundant evidence of great freedom in the Commission Services in the elaboration of their forecasts and the choice of methods they adopt.

4.7 Evaluation Question 2d

In what way do forecasting approaches of other international organisations differ? What recent innovations have been taken and why? To what extent are experiences transposable?

4.6.3 Explanation and coverage

This question focuses on the organisation of the forecasting production process in other international institutions. Forecasting methods and recent innovations needed to be identified. In addition, the evaluation discusses whether or not the experiences are transferable. The question relates to the effectiveness of the production process and the extent to which activities contribute to achieving operational and specific objectives.

4.6.4 Judgement criteria and validation

JC2c.1 *The current forecasting approach differs from that of other international organisations*

Forecasting practices at OECD, IMF, and ECB are described in section 2.5 of the report. Although the process is built on similar ingredients, such as a mixture of formal and judgemental methods, the intertwining of forecasting results with those of macro-econometric models is more intensive in other institutions. This also allows integration of forecasts into examination of medium- and long-term issues.

The judgement criterion can be considered as validated.

JC2c.2 *Other international organisations have adopted recent innovations*

One recent innovation refers to the development of DSGE models, especially at the IMF and the ECB. In these models policies can be discussed in a more straightforward manner within a framework of optimised households and firms. Because the equations are built on microeconomic principles, they are more robust when judged in the context of the Lucas critique of policy-dependent parameters.

The judgement criterion can be considered as validated

JC2c.3 *The approaches adopted in other international organisations could be transposed to DG ECFIN*

The forecasting process in other institutions is built on similar ingredients. For example, those of the EO (OECD) and the WEO (IMF) are comparable to the fully-fledged forecasts of DG ECFIN. However, formal methods as well as assessments to medium- and long-term horizons are more important in the forecasting exercises of other institutions. Expert views are appreciated by formal methods, as is the case for example at the ECB. Both types of forecaster (experts and modellers) subsequently adjust their forecasts over the duration of the iteration process. Compared to the current forecasting practices at DG

ECFIN, adaptation would involve a significant shift of resources to forecasting products more related to structural issues. Recent innovations have already been adopted. In particular a DSGE model is currently at an experimental stage in DG ECFIN.

The judgement criterion can be considered as validated.

Answer to Evaluation Question 2d

The forecasting portfolios of other institutions include similar ingredients. Nevertheless, DG ECFIN's forecasts can benefit from them in several respects. In particular, the weight of econometric methods in the forecasting portfolio should be increased, as the medium- and long-term analyses required for the designated goals can be improved.

Recent innovations at other institutions relate to the construction of DSGE models (IMF, ECB). At DG ECFIN, a DSGE model is still at an experimental stage, but is definitely needed for addressing medium- and long-term issues in a framework that is more robust when judged in the context of the Lucas critique.

4.8 Evaluation Q3a

To what extent is the conducting of forecasts within DG ECFIN necessary as a means of maintaining and enhancing its internal knowledge and skills base of the DG, in particular in relation with the implementation of the Stability and Growth Pact and the Lisbon agenda? Are there examples of extensive outsourcing of forecasting activities in other administrations and bodies, and if so what have been the consequences for their knowledge and skills base and activities relying on forecasts as an input?

4.8.1 Explanation and coverage

This question examines whether the rationale for DG ECFIN's maintaining its in-house forecasting activities can be linked to the spill-over of forecasting activities on to the knowledge base of DG ECFIN and investigates the possible consequences of outsourcing all or some of them. To do so it examines whether examples of such outsourcing exist and can be used to make comparisons.

4.8.2 Judgement criteria and their validation

JC_3a_1 Some forecasting activities are necessary to maintain a sufficient level of knowledge and skills needed by the SGP and Lisbon agenda

The first step in testing the validity of this JC is to clarify the type and nature of the knowledge and skills base required for the implementation of the SGP and the Lisbon agenda.

1° SGP

As mentioned in section 2.1 of this report, articles 99 and 104 of the Treaty require the Commission to monitor public finance developments in the Member States with a view to preventing the emergence of significant budget imbalances. The process is based on Stability or Convergence Programmes submitted to the Commission and the Council by the Member States. Stability and Convergence programmes include some **complex concepts** related to public finance - such as structural public deficit - and their assessment requires the capacity to gauge the global macroeconomic framework and the impact of different types of measure or reform on the macroeconomic situation, in particular the budgetary and debt position. This exercise must be conducted not only on observed *ex post* variables but also on the short- and medium-term forecasts relating to them.

Moreover, since the reform of the SGP, the medium-term objectives specified in Stability and Convergence programmes are differentiated for individual Member States. Their assessment therefore requires a **deep understanding of each Member State's economy**. Member States are free to base their Stability or Convergence Programmes on their own

projections but significant divergences between national and Commission forecasts need to be discussed and explained in some detail.

Based on the Commission's assessment, the Council may invite the Member States to strengthen their programmes or to take adjustment measures to prevent an excessive deficit. In the case of a worsening subsequent budgetary position, the Council can recommend prompt corrective measures and could decide to activate the Excessive Deficit Procedure that might lead to imposition of fines on the Member States concerned. In such a context, it is widely recognised that, in terms of its knowledge, skills and technical capacities, the Commission needs to be highly **credible** in the eyes of the Member States but also in comparison with other institutions such as the IMF, OECD or ECB.

2° The Lisbon Agenda

Implementation of the Lisbon Strategy is based on an open coordination method, which entails agreement on a set of objectives and indicators set out in the integrated guidelines on which the monitoring of the process is based, and which brings together most of the policy coordination mechanisms in place within the EU. DG ECFIN is involved in monitoring and implementation of most processes related to the coordination of economic policies implemented in the EU. This includes assessments of Member States' progress in implementing the BEPGs recommendations; progress in the areas identified by the Lisbon and Gothenburg European Councils, namely employment, innovation, economic reform, social cohesion and sustainable development; structural reforms by Member States in production, capital, labour markets and by the Internal Market DG (in the context of the Cardiff Process); assessment of Member States' National Action Plans for employment (in the context of the Luxembourg process); and participation in and provision of technical inputs for the macroeconomic dialogue (in the context of the Cologne process).

Implementation of the Lisbon Agenda requires DG ECFIN to provide analysis of, and therefore capacities relevant to, a **wide range of economic policies** including the Internal Market, taxation, information society, competition policy, labour market and social policy, regional policy, the Common Agricultural Policy, environmental policy, and transport and energy policy.

The second step entails gauging the extent to which forecasting activities contribute to maintaining the knowledge and skills base identified above, namely:

- mastering complex concepts and issues related to public finance;
- developing a deep understanding of each Member State's economy;
- building credibility on the foregoing and on the capacity to manipulate related technical instruments;
- providing a significant capacity for analysis covering a wide range of economic policies.

All the parties interviewed underline the central role of forecasting activities in developing and maintaining such knowledge and skills and ensuring the associated credibility. The most frequent arguments cited are (indicating in *italics* in each case the main criteria fulfilled):

- the necessity to produce in-house forecasts for the conduct of discussions or negotiations on equal ground with Member States (in particular in the context of the SGP) or other institutions (IMF, World Bank, OECD, EIB, ECB), and to enhance the external visibility of the Commission and particularly DG ECFIN: ***credibility***,
- the numerous synergies with other activities that in-house production of forecasts makes possible, in particular those which relate to the monitoring of the macroeconomic framework and which contribute to enhancing the information base and analytical capacity of the Commission (e.g. forecasts are incorporated in the AMECO database and allow expansion of the time span, with forecasted observations harmonised with *ex post* observations in scope and form): ***analytical capacity***,
- knowledge and experience with regard to the main economic mechanisms brought about by in-house forecasts is which crucial for feeding the policy dialogue between the different Commission Services or between the Commission and third parties or other institutions. However, this process seems more effective in the context of the SGP than in the implementation of the Lisbon Agenda. DG ECFIN's forecasts are used in assessment of the National Reform Plans (NRPs) and provide the macroeconomic framework on which elaboration of the BEPG is established. The focus of forecasting and related activities remains however very much concentrated on public finance aspects and less on wider economic policy aspects that are relevant in the context of the Lisbon agenda: - ***credibility, analysis capacity, understanding of EU economies***,
- the production of forecasts has fostered the expertise of DG ECFIN in the use, and sometimes the development, of concepts, instruments and methodologies relevant to the monitoring and analysis of EU economies (e.g. the need to forecast structural public deficits has led to discussion and agreement between the Commission and third parties on the methodology used for computing potential output): - ***credibility, mastering of complex concepts and issues***.

From the foregoing, the JC is considered as validated and the contribution of forecasting activities to the development and maintenance of a knowledge and skills base is judged to be important. However, it seems to be more effective for aspects related to the SGP than for those more specifically related to the Lisbon agenda.

JC_3a_2 Those activities that are viewed as necessary for knowledge and skills can be outsourced

Most of the knowledge and skills mentioned in the preceding JC stem from the in-house production of forecasts. None could reasonably be expected to materialise if the forecasting activities were instead outsourced. Outsourcing would also deprive the Commission of important benefits linked to in-house production of forecasts. The most commonly cited is the fact that, although forecasts are published at precise and fixed points in the year, in practice their in-house production allows several Commission Services to have access to a permanent and continuous source of information on EU economies. This aspect of continuity was repeatedly mentioned as an extremely valuable asset by staff of other DGs and is consistently reported as crucial for maintaining high capacity in monitoring and analysis of various economic issues (e.g. public investment strategies of

Member States in the context of implementing EU regional policy, accession negotiations, community budget preparation).

Such proximity between users and producers would of course be significantly diminished if the Commission relied on outsourced expertise to produce forecasts. For some issues the permanent availability of forecasting inputs is crucial. In particular, DG ECFIN's surveillance mandates require permanent monitoring of the economies of the Member States and entails a complete intertwining of DG ECFIN's forecast and surveillance activities. This could not be supported by outsourced forecasts.

The most documented case of a public institution outsourcing part of its forecasting activities is that of the Canadian central government. It is therefore an interesting benchmark for assessing performance against that of other institutions relying on an in-house production approach. From this point of view, the paper by Mühleisen and al. (2005) is particularly interesting as it offers a comparison of Canadian central government budget forecasting with that of other industrial countries²³. The benchmark group consists of most of the other G7 countries, plus Australia and New Zealand (two commodity exporting countries), the Netherlands, Sweden, and Switzerland (all representing smaller industrial countries with advanced budget practices). The paper follows a two-pronged approach, covering both structural and quantitative aspects.

As part of a comprehensive reform of budget formulation process, fiscal forecasting practices in Canada were drastically revised in the mid-1990s in response to a rapid build-up of public debt and the fact that financial markets had begun to discount the government's fiscal policy plans after economic assumptions had turned out to be consistently over-optimistic. The production of forecasts is now organised as follows:

- For macroeconomic forecasts the Department of Finance surveys approximately 20 private sector forecasters each quarter after the National Accounts are released. Indicators covered are real GDP growth, inflation, labour market indicators, interest rates and exchange rates. Their annual averages form the basis of the government's macroeconomic assumptions, possibly after the Department has refined the forecasts following meetings with outside economists. The Department then uses the assumptions in its internal macroeconomic model (the Canadian Economic and Fiscal Model) to construct aggregate revenue and expenditure projections consistent with the private-sector forecast.
- Revenue and expenditure forecasts are produced by the Department of Finance and the respective spending agencies. Within the Finance Department it is principally the Fiscal Policy Division that generates the revenue and expenditure forecasts. Some smaller elements of revenue are forecast by the Department's Tax Policy Branch using micro-simulation models. Similarly, the Department's Economic Development and Corporate Finance Branch and certain Crown corporations are also consulted and provide information to help formulate the non-tax component of the revenue forecast. Other departments provide spending forecasts based on three-year business plans, which are reviewed by the Treasury Board Secretariat;

²³ Martin Mühleisen, Stephan Danninger, David Hauner, Kornélia Krajnyak, and Bennett Sutton (2005), "How do Canadian budget forecasts compare with those of other industrial countries?", IMF Working Paper WP/05/66.

The main conclusions of the IMF paper are:

- (i) Canadian budgets have followed a particularly cautious forecasting approach in recent years with larger and more conservative fiscal forecast errors than most other countries;
- (ii) A considerable part of this outcome relates to a forecasting bias in the macroeconomic component, namely that obtained from private forecasters. The negative mean error or bias in growth and revenue forecasts in Canada appears to be fully explained by a combination of prudence indicators and macro-volatility (which is supposed to enhance pessimistic growth projections);
- (iii) Forecast error distribution (root mean square error - RMSE), which is a better measure of overall forecast quality, appears little affected by macro-volatility, and Canada remains the country with the second highest residual after New Zealand;
- (iv) Canada could benefit from further improving the transparency of its budgetary forecasts, notably by involving private forecasters in producing revenue estimates and providing more information about critical parts of the forecasting process, in particular the assumptions and methods used for transforming macroeconomic forecasts into fiscal projections.

These conclusions call for several comments:

- (i) Presenting Canada as a textbook example of a public administration outsourcing its forecasting activities is not completely accurate and could mislead. In reality the Canadian authorities take their macroeconomic assumptions from out-house forecasters but then use them to produce in-house forecasts of public revenues and spending. Moreover, this process is judged less transparent than that of other countries where forecasts are integrally produced in-house by the public administration²⁴;
- (ii) The performance of private sector forecasters compares unfavourably with that of public sector ones. It is therefore not clear that outsourcing could be justified by seeking higher quality of forecasts. Moreover, the case of Canada highlights the fact that private sector forecasters are likely to internalise the bias of the contracting authority. Private forecasters have indeed been as prudent as the Canadian administration although they were not supposed to carry the responsibility for possible forecasting errors. Relying on outsourcing therefore does not seem to provide a guarantee of increased independence of the forecasting process *vis-à-vis* potential policy bias;
- (iii) Outsourcing does not seem a necessary condition for guaranteeing the transparency of the forecasting process. Some countries in which forecasting activities are not outsourced have indeed installed mechanisms that produce a forecasting process which is judged more transparent than Canada's;

²⁴ Mühleisen and al. (2005) cite the examples of Australia and New Zealand, which have adopted transparency legislation to boost public understanding of fiscal forecasts, or other countries such as Germany and the Netherlands where academic bodies or independent agencies participate in the forecast.

- (iv) Forecasting activities still generate and maintain skills and knowledge within the Canadian administration as the central variables are still the object of an in-house forecasting process.

From the above, the JC is considered not to have been validated. Knowledge, skills and the quality of services related to forecasts, in particular those necessary in the context of the SGP and the Lisbon agenda, are to a large extent tied to the in-house nature of production of forecasts. Moreover, there do not seem to be examples of a genuine outsourcing of forecasting activities by a public administration. The most frequently cited case of Canada is, in the end, one in which authorities use private sector forecasts for macroeconomic assumptions and where the superiority of the outsourced services *vis-à-vis* in-house production is not demonstrated.

Answer to EQ 3a:

Conducting forecasts within DG ECFIN appears a major element in the maintenance and development of the DG's knowledge and skills. This is especially true in the context of the Stability and Growth Pact which requires DG ECFIN to be highly credible in mastering complex issues related to public finance and in developing a profound understanding of Member States' economies. However, the contribution of forecasting activities to this knowledge-building process seems less pronounced for aspects more specifically related to the Lisbon agenda (JC_3a_1). Moreover, there are no convincing examples of extensive outsourcing of forecasting activities in other administrations, and in those instances where partial outsourcing does take place the superiority of that approach is not demonstrated (JC_3a_2).

4.9 Evaluation Question 3b

What would be the likely effects of a decision to stop producing forecasting services for the current users?

4.9.1 Explanation and coverage

This question examines whether DG ECFIN's rationale for maintaining in-house forecasting activities can be linked to the nature and quality of the services provided to users and the extent to which users could rely on alternative sources of forecasts to obtain similar services.

4.9.2 Judgement criteria and their validation

JC_3b_1 Stopping would deprive users of a useful source of information for which there is no comparable alternative²⁵

The vast majority of respondents (see table 10) indicate that a decision to terminate DG ECFIN's forecasting services would deprive them of a useful source of information for which there is no comparable alternative. This is particularly true for fully-fledged forecasts (85%) and for respondents in Groups 1, 2 and 3, that is respectively representatives of Member States' services and institutions, representatives of non-member States services and institutions, and selected DG ECFIN staff.

This is in line with findings from other questions, namely that DG ECFIN's forecasts are effectively used in the decision-making processes (Q12(a), Q13(a), Q14(a), Q14(b)) and that the majority of answers indicate that users judge DG ECFIN's fully-fledged and interim forecasts to be important or even essential for the working of their institution (Q16(a), Q16(b)). However this does not seem coherent with the fact that the majority of respondents report having access to potential alternatives to DG ECFIN's forecasts²⁶. Again, this response profile was the most frequent for respondents in Groups 1, 2 and 3.

This result is confirmed by interviews with different types of user who generally indicate that in-house production of forecasts leads to valuable direct or indirect advantages that would not materialise if forecasting activities did not take place within the Commission Services (see EQ 3a). Indeed, there is no comparable alternative to meeting the requirements of the Euro zone forecasts and of a focus on fiscal issues at EU level. Furthermore, stopping the in-house forecasting activities would deprive DG Budget of a safe source of information for drawing up the annual EU Budget. In fact, DG Budget is

²⁵ The validation of this criterion is based on the following typology of answers to different questions retrieved from the questionnaire that was addressed to different categories of users (see annex 5).

²⁶ Although some respondents to the open question 15b of the survey indicated, together with the alternative forecasts, that <they were less convenient than those of DG ECFIN in terms of detail and timeliness.

obliged to use DG ECFIN forecasts for the calculation of the annual EU Budget, which nonetheless is based on the forecasts received from the MS in respect of GDP. In consequence, if DG Budget were to use external forecasting products, each Member State could then claim that such a process would generate political sensitivities. At the very least, the in-house forecasts, while developing and maintaining knowledge and skills (understanding of EU economies, expertise in concepts, instruments, methodologies etc.), ensure the credibility needed to conduct discussions with Member States - especially in the context of the SGP - or with other institutions (IMF, World Bank, OECD, EIB, ECB).

The open survey question 15b permits identification of the main alternatives to DG ECFIN's forecasts. 60 respondents answered that open question, of which 47 were from Group 1. Several answers from each respondent were possible. The distribution of alternatives cited is as follows:

- IMF (WEO): 35
- OECD: 28
- National forecasts from public or private institutions: 9
- Consensus forecast: 7
- ECB forecasts: 6
- Own forecasts: 6
- Other (Global Insight, Euroframe, other): 5

The judgement criterion that stopping in-house forecasting activities would deprive users of a useful source of information for which there is no comparable alternative is therefore considered as validated.

Table 10			Percentage of answers ⁽¹⁾						
			G1	G2	G3	G4	G5	G6	Total
Q12(a)	To what extent DG ECFIN's forecasts are used, as such, in your decision making process ?	Regularly	45.8%	66.7%	46.7%	40.0%	50.0%	100.0%	48.1%
		On Occasion	39.6%	33.3%	40.0%	40.0%	50.0%		39.0%
		Never	14.6%		13.3%	20.0%			13.0%
		No ans.							
Q13(a)	Are some outcomes in the decision making process of your institution influenced by DG ECFIN's forecasts ?	Yes	66.7%	50.0%	73.3%	80.0%	100.0%	100.0%	68.8%
		No	31.3%	50.0%	26.7%	20.0%			29.9%
		No ans.	2.1%						1.3%
Q13(b)	If YES, which forecasting products influence the decision making process of your institution?	Spring and autumn	100.0%	100.0%	90.9%	100.0%	100.0%	100.0%	98.1%
		Interim economic	43.8%		72.7%	50.0%		100.0%	47.2%
		Monthly economic			36.4%	25.0%		100.0%	11.3%
		No ans.							
Q14(a)	Are there some outcomes in the decision making process of your institution for which forecasts of DG ECFIN are used as triggers (i.e. determining the nature of the decision on the basis of preset critical values)?	Yes	29.2%	33.3%	40.0%		50.0%		29.9%
		No	66.7%	66.7%	60.0%	100.0%	50.0%	100.0%	67.5%
		No ans.	4.2%						2.6%
Q14(b)	If YES, which DG ECFIN forecasts do you use as triggers?	Spring and autumn	92.9%	100.0%	100.0%		100.0%		95.7%
		Interim economic	28.6%		33.3%				26.1%
		Monthly economic	7.1%						4.3%
		No ans.							
Q15(a)	Are there potential alternatives to DG ECFIN's forecasts as an input of your work ?	Yes	89.6%	50.0%	33.3%		100.0%	100.0%	70.1%
		No	8.3%	50.0%	66.7%	100.0%			28.6%
		No ans.	2.1%						1.3%
Q16	Importance of DG ECFIN's forecasts for you own work or the working the one of your institution.								
Q16(a)	Spring and autumn economic forecasts	Not important	8.3%		13.3%	20.0%			9.1%
		Important	39.6%	16.7%	20.0%	40.0%	50.0%		33.8%
		Very important	31.3%	66.7%	13.3%		50.0%	100.0%	29.9%
		Essential	20.8%	16.7%	46.7%	40.0%			26.0%
		No ans.			6.7%				1.3%
Q16(b)	Interim economic forecasts	Not important	31.3%		26.7%	40.0%	100.0%		29.9%
		Important	35.4%	33.3%	33.3%	20.0%		100.0%	33.8%
		Very important	29.2%	33.3%	20.0%	40.0%			27.3%
		Essential	4.2%	16.7%	13.3%				6.5%
		No ans.		16.7%	6.7%				2.6%
Q16(c)	Monthly economic forecasts	Not important	58.3%	16.7%	33.3%	60.0%	100.0%		50.6%
		Important	27.1%	16.7%	20.0%	40.0%		100.0%	26.0%
		Very important	6.3%	50.0%	20.0%				11.7%
		Essential							
		No ans.	8.3%	16.7%	26.7%				11.7%
Q17	Would a decision to stop DG ECFIN's forecasting services deprive you from a useful source of information for which there is no comparable?								
Q17(a)	Spring and autumn economic forecasts	Yes	87.5%	66.7%	80.0%	80.0%	100.0%	100.0%	84.4%
		No	12.5%	33.3%	13.3%	20.0%			14.3%
		No ans.			6.7%				1.3%
Q17(b)	Interim economic forecasts	Yes	56.3%	50.0%	46.7%	60.0%			51.9%
		No	33.3%	16.7%	46.7%	20.0%	50.0%	100.0%	35.1%
		No ans.	10.4%	33.3%	6.7%	20.0%	50.0%		13.0%
Q17(c)	Monthly economic forecasts	Yes	35.4%	16.7%	33.3%				29.9%
		No	50.0%	50.0%	46.7%	80.0%	50.0%	100.0%	51.9%
		No ans.	14.6%	33.3%	20.0%	20.0%	50.0%		18.2%

⁽¹⁾ Percentages of respondents of the group or of those who responded yes to the main question.

JC_3b_2 Stopping the production of forecasting services would not significantly increase the amount of resource available for analysing the economic situation and preparing policy decisions.

Forecasting activities occupy around 70 persons within DG ECFIN, which amounts to a significant part of its human resources. The question of the resources that would be released if DG ECFIN ceased its forecasting activities is therefore relevant. It is the mandate of DG ECFIN to provide and use forecasts for achieving several of its dedicated missions. Stopping in-house production of forecasts would entail outsourcing such production and, to be profitable, would require the use of the freed internal resources for other analysis and tasks.

It is of course difficult to assess the net gain of resources if forecasting activities were outsourced. There is no example of an administration which directly uses forecasts provided by external sources. From this point of view the case of Canada is interesting. As described under Evaluation Question 3a, the Canadian administration relies on the private sector for macroeconomic assumptions which are then used in the in-house process of forecasting budget positions for the short-to-medium term. Although no data could be collected for measuring the resource devoted to this process, it is unlikely to be marginal.

On the other hand, DG ECFIN's missions need credibility and the capacity to provide a consistent background commentary alongside forecasts. Reasonable outsourcing options would therefore still necessitate a significant in-house processing of forecasting results obtained from external sources and one should not underestimate the volume of resources that would be needed to achieve it.

Given the absence of comparable experience permitting assessment of the net gain accruing from outsourcing of forecasting activities, this judgement criterion cannot be considered either firmly validated or invalidated. The evidence, and the opinion of almost all informants interviewed, suggests that given the mandate of DG ECFIN, the volume of resources that would be freed for analysing the economic situation and preparing policy decisions may not justify stopping in-house production of forecasting services.

Answer to Evaluation Question 3b

The DG ECFIN's missions, particularly in the context of the SGP, necessitate a credible in-house capacity for providing a consistent background commentary alongside forecasts and a deep understanding of Member States' and other countries' economies (JC_3a_1). Moreover, its mandate requires DG ECFIN to provide forecasts for different economic indicators (section 2.1). Outsourcing forecasting activities would therefore not completely eliminate a substantial amount of in-house processing of forecasting results obtained from external sources and it is not guaranteed that such an option could lead to increasing significantly the resources available for analysing the economic situation and preparing policy decisions (JC_3b_2). Furthermore, from the point of view of the majority of actual users, stopping in-house production of forecasts would entail the loss of a useful source of information for which there is no comparable alternative (JC_3b_1).

4.10 Evaluation Question Q4a

Beyond the legal requirements, to what extent have the forecast products been used by the EU Institutions in policy formulation and implementation?

4.10.1 Explanation and coverage

DG ECFIN's forecasts are used within the framework of the SGP and the preparation of the convergence reports, which constitute their main legal basis. This question aims at examining whether DG ECFIN's forecasts are also used by EU institutions in the broader context of policy formulation and implementation. As regards the intervention logic, the question focuses on particular channels through which DG ECFIN's forecasts contribute to achievement of intermediate objectives.

4.10.2 Judgement criteria and their validation

JC4a.1 The institutions considered use forecasting outputs in their policy formulation and implementation

The validation of this criterion is based on the following typology of answers retrieved from the questionnaire addressed to users.

From table 11 below it appears that:

- (i) the majority (about 70%) of respondents report that DG ECFIN's forecasts influence their decision-making process. Interestingly this is true for all groups of users considered in this evaluation. Fully-fledged forecasts play the most prominent role while interim while monthly forecasts appear to have less influence (Q13(a), Q13(b));
- (ii) About one-third of respondents use DG ECFIN's forecasts as triggers in their decision-making process, basing some of their decisions on preset critical values for given indicators. Again, fully-fledged forecasts are the main products used in this way, at least by users in Groups 1 (representatives of Member States' services and institutions), 2 (representatives of non-member States services and institutions), 3 (selected DG ECFIN staff) and 5 (Representatives of EU institutions other than the Commission - European Parliament, European Economic and Social Committee, Committee of the Regions, European Investment Bank) (Q14(a), Q14(b));
- (iii) DG ECFIN forecasts are mainly used as such, that is without further processing by users, in their decision-making process (Q12(a)).

Table 11			Percentage of answers ⁽¹⁾						
			G1	G2	G3	G4	G5	G6	Total
Q12(a)	To what extent are DG ECFIN's forecasts used as such in your decision making process ?	Regularly	45.8%	66.7%	46.7%	40.0%	50.0%	100.0%	48.1%
		On Occasion	39.6%	33.3%	40.0%	40.0%	50.0%		39.0%
		Never	14.6%		13.3%	20.0%			13.0%
		No answ.							
Q13(a)	Are some outcomes in the decision making process of your institution influenced by DG ECFIN's forecasts ?	Yes	66.7%	50.0%	73.3%	80.0%	100.0%	100.0%	68.8%
		No	31.3%	50.0%	26.7%	20.0%			29.9%
		No answ.	2.1%						1.3%
Q13(b)	If YES, which forecasting products influence the decision making process of your institution?	Spring and	100.0%	100.0%	90.9%	100.0%	100.0%	100.0%	98.1%
		Interim	43.8%		72.7%	50.0%		100.0%	47.2%
		Monthly			36.4%	25.0%		100.0%	11.3%
		No answ.							
Q14(a)	Are there some outcomes in the decision making process of your institution for which forecasts of DG ECFIN are used as triggers (i.e. determining the nature of the decision on the basis of preset critical values)?	Yes	29.2%	33.3%	40.0%		50.0%		29.9%
		No	66.7%	66.7%	60.0%	100.0%	50.0%	100.0%	67.5%
		No answ.	4.2%						2.6%
Q14(b)	If YES, which DG ECFIN forecasts do you use as triggers?	Spring and	92.9%	100.0%	100.0%		100.0%		95.7%
		Interim	28.6%		33.3%				26.1%
		Monthly	7.1%						4.3%
		No answ.							

⁽¹⁾ Percentages of respondents of the group or of those who responded yes to the main question.

These results must nevertheless be qualified for the following reasons. First, for Group 3 it is impossible from the questionnaire to distinguish whether the decisions considered by respondents do or do not relate to policies beyond the legal requirements of DG ECFIN. Second, the EU institutions most likely to be involved in such policies are found within Groups 4 and 5. For these groups the results displayed above should be interpreted with caution given the low rate of response (about 30%). This rate is itself an indication that the Institutions covered by Groups 4 and 5 do not rely extensively on DG ECFIN's forecasts in their decision-making processes. This is moreover confirmed by interviews with officials of such institutions, forecasts being reported to be mainly sources of information but with no clear contribution to the decision-making process. This is related mainly to the nature of the tasks entrusted to these institutions which, beyond the legal requirement, generally focus more on economic policy aspects pertaining to medium-to-long-term perspectives (e.g. DG Employment or Economic Policy Committee) or on specific issues not covered by macroeconomic forecasts (e.g. DG Regio). Within DG ECFIN itself, units involved in formulation and implementation of policies related to structural reforms or macroeconomic coordination report making only limited use of forecasts.

Based on these observations, the judgement criterion that the institutions considered use forecasting in their policy formulation and implementation is considered as validated, but with the qualification that, beyond the legal requirements, the institutions considered mainly use forecasts for establishing the macroeconomic framework as an element in the policy formulation and implementation process.

JC4a.2 The institutions considered that are using forecasting outputs in their policy formulation and implementation, use those provided by DG ECFIN

Question 12(a) “To what extent are DG ECFIN's forecasts used as such, in your decision making process ?” with options “Regularly”, “On occasion”, “Never” is complemented by the open question 12(b) “If never, why?”. Ten respondents answered “Never” to question 12(a), seven in Group 1, three in Group 3 and one in Group 4. For question 12(b), two respondents reported using their own forecasts while one respondent in Group 3 was involved in accounting and risk management and therefore did not use DG ECFIN’s type of forecast. Moreover, the analysis provided for the preceding Judgement Criterion shows that EU institutions do not extensively use forecasts in formulation and implementation of policies related to topics beyond the legal requirement.

The judgement criterion is considered as validated. Institutions requiring forecasts for the policy formulation and implementation process mainly use DG ECFIN’s forecasts.

Answer to Evaluation Question 4a

From the foregoing, it seems reasonable to formulate the hypothesis that the extent to which DG ECFIN’s forecasting products have been used by the EU institutions in their decision-making process beyond the legal requirement is in fact limited. Beyond the legal requirement, DG ECFIN’s forecasts are mainly used as just another source of background information, generally for establishing the macroeconomic framework or the global context relevant to policy formulation or implementation.

4.11 Evaluation Question Q4b

To what extent have the forecasting products and outputs influenced Commission activities and EU policies in design and formulation?

4.11.1 Explanation and coverage

Question 4a aims to assess the actual use made of DG ECFIN forecasts by EU institutions, for instance as opposed to those provided by other sources. Question 4b examines the extent to which DG ECFIN's forecasts and their outputs have affected the process of policy design and formulation, in particular by the Commission, and whether they play a central or marginal role in this process. The question relates to the same channels through which DG ECFIN's forecasts contribute to achieving intermediate objectives as those targeted by question 4a.

4.11.2 Judgement criteria and their validation

JC4b.1 Policy design and formulation significantly rest on the use of DG ECFIN's forecast products

The analysis provided in the preceding Evaluation Questions points to limited or unclear use of DG ECFIN's forecasts in the formulation and implementation of policies outside DG ECFIN. Based on this finding, it is unlikely that other institutions would record that DG ECFIN's forecasts significantly influence the formulation and implementation of EU policies. The forecasts are rather used as background information. In the case of DG ECFIN, forecasts definitely influence the formulation of macroeconomic policies, particularly within the framework of the Commission's surveillance of economic developments and policies in the Member States, in the euro area, in the EU as a whole, and in the coordination of economic policy. In particular, DG ECFIN's forecasts are used in the elaboration of the BEPG and influence the formulation of subsequent recommendations. Forecasts also determine the position of the Commission and the Council *vis-à-vis* Member States (through the assessment of Stability and Convergence Programmes), accession countries (Convergence Reports) and candidate countries (Pre-Accession Programmes).

The judgement criterion cannot be considered as either validated or invalidated. DG ECFIN's forecasts influence part of the policy formulation and design process but this is mainly true for policies falling directly within the responsibilities of DG ECFIN. For other users, forecasts seem to be used merely as just another piece of background information.

JC4b.2 DG ECFIN's forecast products are used as triggers in the decision-making process

The information retrieved from the questionnaire addressed to different types of user concerning this issue is summarised as follows (table 12).

Table 12			Num ber	Percentage of answers ⁽¹⁾						
			Total	G1	G2	G3	G4	G5	G6	Total
Q14(a)	Are there some outcomes in the decision-making process of your institution for which forecasts of DG ECFIN are used as triggers (i.e. determining the nature of the decision on the basis of preset critical values)?	Yes	23	29.2%	33.3%	40.0%		50.0%		29.9%
		No	48	66.7%	66.7%	60.0%	100.0%	50.0%	100.0%	67.5%
		No answ.	2	4.2%						
Q14(b)	If YES, which DG ECFIN forecasts do you use as triggers?	Spring and	22	92.9%	100.0%	100.0%		100.0%		95.7%
		Interim	6	28.6%		33.3%				26.1%
		Monthly	1	7.1%						4.3%
		No answ.								

⁽¹⁾ Percentages of respondents of the group or of those who responded yes to the main question.

The same remarks as those formulated for JC 4a.1 and JC4b.1 apply here. Considering the groups relevant to this Evaluation Question, a significant proportion of Group 3 respondents (40%) report using DG ECFIN's forecasts as triggers while the results for Groups 4 and 5 have no statistical significance given the limited number of answers on which they are based. Again, DG ECFIN's forecasts seem to be an important determinant of policy formulation and implementation of those policies directly connected with DG ECFIN's activities, but this is less clear for other EU Institutions and related policies.

As a consequence of the foregoing, JC4b.2 can be considered as neither validated nor invalidated, the justification for this indeterminacy being the same as for JC4b.1.

Answer to Evaluation Question Q4b

As for Evaluation Question 4a, it seems that the extent to which DG ECFIN's forecast products and outputs have influenced Commission activities and design and formulation of EU policies varies substantially from one policy to another. Policies related to the SGP and the coordination of economic policies in which DG ECFIN plays a prominent role are without doubt influenced by DG ECFIN's forecasts. But their influence is much more limited in other policies or activities, particularly those falling within the scope of medium-to-long-term perspectives.

4.12 Evaluation Question Q5a

What are the strengths and weaknesses of the current Communication strategy for the Commission's forecasts as compared with other international organisations? What is the press coverage of the Commission forecasts as compared to that of other international organisations?

4.12.1 Explanation and coverage

The main purpose of the question concerns the communication and interaction channels between the Commission and end users of forecasts on the one hand and the Commission and the general public – via the media – on the other. The question covers a comparison with other international organisations. Albeit without explicit mention of the fact, the question therefore entails a comparison with the IMF, the OECD and the ECB (as these institutions were mentioned elsewhere in the text).

4.12.2 Judgement criteria and their validation

Communication of the forecasts pursues two objectives:

- informing the public about the existence of the forecasts, their coverage and results;
- sensitising targeted audiences to the issues and challenges raised by the forecasts.

Three types of actor involved in this communication are:

- the technical units of DG ECFIN, which determine the communication strategies, the content of and dissemination needs for the forecasts results. Within DG ECFIN, Unit R4 is in charge of external communication and provides advice to the Service and to the spokesperson (see *infra*) but its main focus is on promotion of the euro area.
- Cabinet: forecasts are sensitive issues and hence numerous iterations take place between the forecasting Services and the Cabinet before final approval is given to the contents, and it is only when clearance has been obtained that results go for publication; nothing is communicated outside the institution before the forecasts are presented, and simultaneously published, at a news conference with the aid of a Powerpoint presentation by the Commissioner.
- the spokesperson Services in DG Communication; those Services are informed in advance by the Communication Unit of DG ECFIN of progress with the forecasts. The Communication Unit also provides advance notice to EFC and EPC. Press releases and notes are prepared by the technical forecasting units of DG ECFIN and are finalised by the spokesperson.

There are essentially two forms of dissemination:

- via publications of scientific matters (in this case the review European Economy) for which there is an annual programme. Once the programme is adopted there is no longer any need to obtain clearance from the Cabinet for the individual issues.
- via websites, of which there are two: the Commissioner's website and DG ECFIN's. The latter is managed by the Communication Unit of DG ECFIN. The forecasts are made available on the website as soon as the official release has taken place.

The degree of publicity given to the forecasts is high and there is abundant evidence that the affected public is aware of their existence:

- the experience of the spokesperson Services suggests that press coverage of the Commission forecasts is as good as, if not better than, those of other forecasters, probably owing to the fact that the Commission has the largest number of journalists accredited to an international institution or government anywhere in the world.
- Access to the website is important. According to the monitoring of their website by the Commission Services during the months September 2006-January 2007, the economic forecasts were always among the top 10 pages consulted, with about 20.000 pages viewed in November 2006 (first publication of the 2006 autumn forecast).

Table 13 (based on question 31 of the survey) shows that the main channels of information are the website and seminars and workshops organised by DG ECFIN.

Table 13: Sources of information about the forecasts
(% of respondents of the groups)

		G1-G2	G3-G5	G1-G6
How are you informed about the availability and the content of DG ECFIN forecasts ?	You subscribe to the publication.	14.8%	13.6%	14.3%
	You regularly consult the website.	55.6%	31.8%	48.1%
	You are on a mailing list.	27.8%	40.9%	32.5%
	You participated in seminars or workshops organised by DG ECFIN	48.1%	13.6%	37.7%
	No answ.		4.5%	1.3%

Table 14 demonstrates that users are highly satisfied with the contents of the fully-fledged forecasts: more than 75% of users consider that the information they receive on each main section of the publication is sufficient. The percentage is only slightly lower for the Services of the EU Institutions as regards information supplied on accession and non-EU countries and the statistical annexes.

Table 14: Assessment of the relative importance given to various sections of the publication of the spring and autumn forecasts
(% of respondents of the groups)

		G1-G2	G3-G5	G1-G6
<i>Overview</i>	Not sufficiently developed	1.9%	4.5%	2.6%
	Sufficient	85.2%	81.8%	84.4%
	Too much developed	0.0%	0.0%	0.0%
	No answ.	13.0%	13.6%	13.0%
<i>Chapter 1: The world economy"</i>	Not sufficiently developed	9.3%	4.5%	7.8%
	Sufficient	83.3%	77.3%	80.5%
	Too much developed	0.0%	4.5%	1.3%
	No answ.	7.4%	13.6%	10.4%
<i>Chapter 2: The economies of the euro area and the EU</i>	Not sufficiently developed	3.7%	4.5%	3.9%
	Sufficient	90.7%	81.8%	88.3%
	Too much developed	0.0%	0.0%	0.0%
	No answ.	5.6%	13.6%	7.8%
<i>Chapter 3: Members States</i>	Not sufficiently developed	11.1%	0.0%	7.8%
	Sufficient	83.3%	86.4%	84.4%
	Too much developed	0.0%	0.0%	0.0%
	No answ.	5.6%	13.6%	7.8%
<i>Chapter 4: Acceding Countries</i>	Not sufficiently developed	9.3%	9.1%	9.1%
	Sufficient	77.8%	77.3%	77.9%
	Too much developed	3.7%	0.0%	2.6%
	No answ.	9.3%	13.6%	10.4%
<i>Chapter 5: Candidate Countries</i>	Not sufficiently developed	7.4%	18.2%	10.4%
	Sufficient	79.6%	68.2%	76.6%
	Too much developed	3.7%	0.0%	2.6%
	No answ.	9.3%	13.6%	10.4%
<i>Chapter 6: Other non-EU Countries</i>	Not sufficiently developed	3.7%	13.6%	6.5%
	Sufficient	83.3%	63.6%	77.9%
	Too much developed	1.9%	4.5%	2.6%
	No answ.	11.1%	18.2%	13.0%
<i>Statistical Annex</i>	Not sufficiently developed	11.1%	4.5%	9.1%
	Sufficient	81.5%	63.6%	76.6%
	Too much developed	0.0%	4.5%	1.3%
	No answ.	7.4%	27.3%	13.0%

Table 15 (based on question 33 of the survey) shows without ambiguity that the quality of the publication is regarded as excellent or above average by a majority of users. This result needs to be somewhat qualified by information collected through interviews, particularly with representatives of EU Institutions other than the Commission. Whereas persons familiar with consultation of large macro-economic reports and forecasts easily find the information they need in the published forecasts, certain categories of users consider that these publications are too technical and too comprehensive. Their use would be made easier if, in addition to the main publication, smaller self-standing documents could convey

the main results and explanation on specific themes, targeted on specific audiences. The issue of language has also been occasionally evoked as an obstacle as the forecasts are published exclusively in English.

Whereas there is little doubt that the communication strategy achieves its goal insofar as it consists of informing the public of the existence of the forecasts, it is less easy to assess the extent to which it conveys its main messages on the issues addressed by the forecasts.

Indeed a major feature of the communication strategy of the Commission is its neutrality. The forecast results are published with an extensive accompanying background commentary but without any message transmitting the views of the Commission on the main economic policy issues raised by these results. In the Commission's communication strategy such analyses and messages are published in other publications. The recent separation of the presentation of the forecasting results and discussion of the BEPG (cf. the discussion of Evaluation Question Q1b and table 7b) goes in this direction²⁷ and further separates discussion of economic prospects from that of the underlying policy issues.

This "strict neutrality" communication policy of the Commission is explained by the fact that the Commission is both the technical body preparing the forecast and an actor involved in policy making; it therefore fears that by committing itself to interpretation of the forecasting results might undermine the credibility of the forecast. This justification is generally not shared by the informants met during this evaluation. With few exceptions, they generally express a demand for clearer policy messages to be associated with the presentation of the results so as to generate dialogue and discussion on the policy issues. Several informants, particularly from DGs other than ECFIN and from the Member States, pointed that for this reason their dialogue with the OECD or IMF was more fruitful than with DG ECFIN

The policy of other international institutions is indeed very different. For example OECD communications are based on

- global press conferences (Japan, Korea, Australia, Mexico, ...);
- tours by the Secretary-General;
- meetings with Member States' governments;
- use of different media vehicles so as to ensure wide public dissemination of the results.

Even though raw forecast outcomes are published, the main thrust of the communication strategy is in reality the publication of the results of the economic policy analyses of selected themes. These have been chosen with the members of the organisation at the beginning of the forecasting exercise in the light of recent developments and of the current sensitivity to specific economic issues. Forecasts results are clearly used and referred to in such analyses. This is made possible by the deep intertwining of forecast results with medium-term policy debates and analyses which are of more interest to policy-makers and the public than are the forecast results *per se*.

²⁷ As an illustration, the 2007 Brussels Economic Forum was held three weeks after the publication of the Spring forecast but did not include in its programme a specific presentation of its implications.

Answer to Evaluation Question Q5a

The availability and quality of the information provided by the Commission on the results of its forecasts is assessed very positively by a majority of users and there are indications that it compares favourably with the communications provided by other international institutions.

The effectiveness of the communication strategy in feeding the economic policy debate suffers from a deliberate strategy to separate the presentation of forecasting results, in a format as neutral and factual as possible, from an analysis of their policy implications. Whereas this is explained by the double function of the Commission as technical provider of the forecasts and policy actor, it is regarded by several informants as weakening the potential impact of the forecasts. Other international institutions have a different approach that seems to be more appreciated by several categories of informant.

4.13 Evaluation Question 5b

Which other target populations/locations, if any, should the Communication strategy for the Commission forecasts focus on and why?

4.13.1 Explanation and coverage

The question can be considered as a request for a recommendation.

4.13.2 Judgement criteria and their validation

JC5b.1 The actual target population is not different from the required target population.

The previous Evaluation Question suggests that those who need access to the Commission forecasts can obtain them without difficulty. Information is available, adequate publicity is given, and overall the communication strategy, insofar as it consists of making the forecasts known and accessible, is comparable to that of other institutions.

The crucial assessment of the communication strategy, however, depends very much on the degree of realisation of its second objective “sensitising target audiences to the issues and challenges raised by the forecasts” evoked under the previous judgement criterion. A departure from the current “neutral” communication strategy and a move towards a combination of publication of forecasts along with an analysis of specific policy issues would require more effective targeting, particularly on audiences concerned with the policy issues investigated.

The evaluation also indicates that there is demand for additional targeting in terms of accessibility to subsets of the forecasts. In particular a segmented presentation allowing particular audiences to access directly the themes in which they are interested has been indicated as desirable. In a similar vein, aside from the general comprehensive publication there seems to be a demand for a simpler popularised presentation, possibly in several languages.

5 5. Conclusions

Based on the previous analysis and findings three groups or clusters of Conclusions emerge:

- Conclusions on the products, the process and the methods.
- Conclusions on the contribution of the forecasts to the specific and intermediate objectives of the users, as defined in the intervention logic.
- Conclusions related to the effectiveness of the communication strategy.

5.1 Conclusions on the products, the process and the methods

a) On the product

Conclusion 1.1

The portfolio of products is characterised by its short-term horizon and its diversity. The fully-fledged forecasts are the main output; this product is unique on the market and generally appreciated by users.

The main product and flagship of DG ECFIN forecasting activities consists of the spring and autumn fully-fledged short-term forecasts.

They are a unique product on the market for forecasts due to their geographical coverage and their focus on the fiscal situation of the Member States' economies. The whole world is covered and distributed in forecasts for each of the Member States' economies, for the Euro zone and accession countries, and also for a number of major economies (nations or regions). Their focus on fiscal issues is also very specific.

The other DG ECFIN forecasts have a different status among the activities of the DG. Either they have been developed to keep track of and provide intermediate updates on the fully-fledged forecasts (intermediate forecasts), or they are viewed by DG ECFIN as necessary tasks to keep abreast of economic developments and update information (monthly forecasts and other forecasting exercises such as turning-point forecasts). DG ECFIN makes the most of this information as a public good available to users.

The fully-fledged forecasts and their subsidiary, the intermediate forecasts, are generally appreciated by the users, in terms of both content and quality.

The incorporation in the recent publication of a risk analysis relating to the forecasting results is a commendable effort to offer the reader a means of assessing the degree of probability in the economic outlook presented.

This conclusion is based on EQ1b, JC2d.1

Conclusion 1.2

Although the elaboration of country forecasts remains in substantial demand, the trend in the responsibilities and mandate of the Commission makes a case for additional types of forecast.

The product is very much characterised by its past history (initiated for preparing the economic budget) and the requirement for macro-economic surveillance under the SGP. It therefore focuses on country forecasts. With the development of the single market there is a demand for regional and sector forecasts and projections that is not met by the current products. Whereas there is evidence that actors involved in the management of the single market and the preparation of regional policy are using the forecasts of DG ECFIN, there are also clear indications that they only find in them a very partial answer to their information needs.

This conclusion is based on EQ1b and EQ1c.

b) On the process

Conclusion 1.3

The process is designed to maximise the credibility of the forecasts *vis-à-vis* the Member States and to provide a platform of discussion with the MS and other EU Institutions (EFC), mainly on fiscal issues. This objective favours theoretical aspects in the choice of process and methods.

The process of elaboration of the main forecasts (fully-fledged) is based on the work of the country desks of DG ECFIN submitted for and constrained by a trade consistency exercise. It is therefore a bottom-up process, judgemental in nature with iterations between the country desks and the unit in charge of ensuring the overall consistency of the process.

The consequence of this approach is that it offers a platform for continuous dialogue between DG ECFIN and the Member States as well as with other EU Institutions, principally the EFC. This dialogue is focused on the fiscal situation. The approach is very satisfactory in terms of forecasting accuracy; indeed in the short term judgemental forecasts are usually superior to those obtained from econometric models. It also offers guarantees of credibility of the forecasting results *vis-à-vis* the MS. The “acceptability” of the forecasting results by the Member States is a major objective sought by DG ECFIN when elaborating its forecasts because it is a key pre-condition for constructive discussion on the fiscal issues. This objective is reinforced by two other characteristics of the forecasting process:

- The adoption of common technical assumptions by all country desks; the common technical assumptions will have been previously discussed with the MS in the context of the expert group meetings²⁸. These common assumptions are normally also adopted

²⁸ The practice has been modified recently to avoid information leakages.

by the MS in their own forecasting exercises and, when that is not the case, they are supposed to justify the use of alternative assumptions.

- There is an acknowledged high degree of independence of the forecasts and forecasting services of DG ECFIN, as evidenced by the questionnaire survey and interviews. It is worth noting that the status of the Commission (which is not a Secretariat of the MS) is regarded as making it more independent than some other international institutions in the choice of its methods.

The development of the AMECO database is a major tool which provides a common platform for analysis and discussion of forecast results.

These characteristics of the forecasting process and the strong emphasis on a bottom-up judgemental approach imply limited theoretical consistency and weak linkage with medium-term analysis and elaboration of alternative scenarios for analysing structural reforms. The arithmetical consistency of the forecasts is guaranteed by the trade consistency exercise but it is not comparable with the theoretical consistency provided by the use of a consistent multi-country model. Currently country desk forecasts may be based on different underlying economic theories.

This conclusion is based on section 2.2, EQ2b, EQ2c.

Conclusion 1.4

The production of the forecasts is an essential part of the activity of DG ECFIN and could not be entirely externalised. The reasons are the following:

- it is an indispensable activity for supporting the in-house economic analysis of the MS and the international environment;
- it provides a valuable common and consistent macroeconomic framework, using a common database that covers historical data and forecasting periods, thereby offering a unique basis for dialogue and scenario analysis;
- there is a necessary continuity in the preparatory and analytical work that could not be achieved through the use of an external supplier; the Services in charge of the preparation of the forecasts are required by their hierarchy to provide all manner of analytical work, studies, punctual information and so forth, which are by-products of their activity and could not be obtained if the work were not done internally;
- the Commission's forecasts for the MS have considerable political weight; the DG ECFIN forecasts have an authority that exceeds that of alternative forecasts because of their potential implication for the interpretation of the fiscal policy of the MS in relation to the excessive deficit criterion and the SGP;
- outsourcing the forecasting activity would deprive the Commission of a recurrent opportunity to communicate on economic developments in the Union; the release of the forecasts and their presentation by the Commissioner would not enjoy the same status if the product came from an external source.

This conclusion is based on JC1a2, EQ3a, EQ3b.

c) On the methods

Conclusion 1.5

DG ECFIN forecasts are of a good scientific standard but the methods adopted limit their theoretical consistency and their usefulness for further medium-term and structural analysis

Post-mortem analyses permit the conclusion that the forecasts are of good quality and generally compare favourably with those of other institutions. However; their embedding in broad and medium-term policy analysis is less developed than in the practices of the OECD and IMF.

As a result of the methods adopted, trade consistency is mainly arithmetical but does not offer the same guarantee of theoretical consistency offered by a model-based approach. Different forecasts on different horizons are produced without clear rules on how to arbitrate between contradictory forecasts (e.g. a judgemental forecast and one resulting from the DFM).

The focus on the importance of medium-term projections and elaboration of scenarios, as highlighted in the Report of the Council on the Improvement of the SGP is not yet reflected in the current process, though moves are being made in this direction.

This conclusion is based on Annex 8, JC2a3, EQ2b, EQ2d, EQ1c.

5.2 Conclusions on the contribution of the forecasting activities to their specific and intermediate objectives

This cluster of conclusions focuses on the use of DG ECFIN's forecast products and their contribution to the objectives identified in the derivation of the intervention logic, in particular to the specific objectives which, for the sake of argument, are regrouped according to the following typology:

- i) improve implementation of the multilateral surveillance of budgetary positions and of the SGP;
- ii) improve coordination of economic policies;
- iii) improve analysis capacity; and
- iv) improve the macroeconomic information base.

Conclusion 2.1

DG ECFIN's forecasts are used by a wide variety of actors and institutions. The purposes for which they are used strongly vary from one type of user to another.

DG ECFIN's forecasts are extensively used by all categories of user as a source of macroeconomic background formation, which is perceived as extremely valuable and for

which complementary sources (IMF, OECD, ECB) exist but plausible substitutes do not. DG ECFIN's forecasts are also used for analysis in support of the design and implementation of economic policies but this is mostly restricted to implementation of the multilateral surveillance process and the SGP. Identically, their use in the process of economic policy coordination differs from one issue to the other, being particularly effective for coordination of fiscal and budgetary policies but less so for others.

This conclusion is based on EQ1a, EQ1b, EQ1c and EQ4a, EQ4b

Conclusion 2.2

DG ECFIN's forecasts are resource-consuming but (i) they are also central to the working of particular EU institutions and (ii) their production generates important spill-over.

The production process for DG ECFIN's forecasts, based on a bottom-up approach and inputs from country desks, entails mobilisation of substantial resources. However, this approach is partly dictated by the provisions of the SGP which requires (i) close relationships between DG ECFIN and the authority of each Member State and (ii) a high degree of credibility of the capacity of DG ECFIN to conduct forecasts at the level of the Member State economies. Moreover, the production of forecasts within DG ECFIN contributes to maintaining and developing important knowledge and skills. This is particularly true with regard to an understanding of EU and third country economies, to the mastering of complex issues related to public finance, and to the capacity to use and develop up-to-date technical instruments.

This conclusion is based on EQ1a, EQ1b, EQ1c and EQ3a, EQ3b

Conclusion 2.3

The organisation and production of DG ECFIN's forecasts are not invariably supportive of the achievement of designated goals.

The production process and the design of DG ECFIN's forecasting products are appropriate to the meeting of designated goals relating to short-run issues, in particular those related to the multilateral surveillance mechanism and the SGP, and to the provision of comprehensive and coherent macroeconomic information on EU and third country economies. On the other hand DG ECFIN's forecasting activities and products are less likely to contribute to designated goals more related to medium-to-long-term issues. This is for instance the case in the contribution of DG ECFIN's forecasts to the design, implementation and coordination of economic policies that require more penetrating medium- and long-term outlooks, such as those forming the backbone of the Lisbon Agenda. From this point of view, DG ECFIN's forecasts cannot effectively contribute to the policy dialogue on such issues.

This conclusion is based on EQ1a, EQ1b, EQ1c, EQ2a, EQ2b, EQ3a, EQ4a, EQ4b.

5.3 Conclusions on the communication strategy

Conclusion 3.1

The communication of the forecasts aims at providing the general community of potential users with a public good, and succeeds in doing so.

The forecasts, in particular the “official” spring and autumn and intermediary forecasts, are communicated to the general public in the form of a comprehensive publication, available in both paper and electronic formats, the latter posted on the internet site of DG ECFIN. The spring and autumn forecasts are announced by the Commissioner. at a press conference

The forecasts are provided on a regular basis and widely disseminated. Every indicator including the results of the interviews and questionnaires, the distribution of the publication, and the number of hits on the Commission’s internet site, points to the fact that the existence of these forecasts is well known to every individual or institution that may have some reason to use them, and that their availability is unrestricted.

This conclusion is based on JC1a2, EQ5a.

Conclusion 3.2

The communication of the forecasts is not the object of a clear Commission strategy involving objectives (other than those mentioned under Conclusion 3.1.) commonly agreed between DG ECFIN, the Cabinet of the Commissioner and DG COMM.

There is no clear Commission communication strategy for the economic forecasts. The communication objectives of the technical units of DG ECFIN, of the Commissioner and of DG COMM are not developed in common and are not linked with or supportive of each other. This limits the potential policy message that could be issued along with with the economic prospects.

This conclusion is based on EQ5a, EQ5b.

Conclusion 3.3

The communication policy is deliberately neutral and not targeted on specific users; this limits its utility and its impact on the decision-making process.

As a consequence or an explanatory factor of the previous conclusion, the communication policy is deliberately neutral and disconnected from analysis of the economic policy issues. In that respect it differs significantly from the communication strategies of institutions such as the OECD and IMF; those organisations select in advance particular policy issues and topics to be investigated in the context of a forecast and also to guide the way in which the issues are presented.

The policy adopted by the Commission limits the utility of the forecasts through a lack of selective targeting on those who might be most interested in this or that particular issue, and also limits their impact on the decision-making process. The communication is purely factual, leaving the analysis of the consequences to other fora and publications.

This conclusion is based on EQ2d, EQ5a, EQ5b.

Conclusion 3.4

The communication of the forecasts is too technocratic for certain categories of user.

Whereas the technical quality of the presentation of the forecasts and that of the accompanying background commentary is widely acknowledged, there is a concern, particularly among EU Institutions others than the Commission which are more involved in political issues, that the publications are too technocratic and comprehensive for effective use by this type of audience.

This conclusion is based on EQ5a, EQ5b.

6. Recommendations

Based on the previous conclusions and analysis, three groups of Recommendations have been formulated with the objective of:

- improving the efficiency of forecasting activities ;
- increasing the contribution of the forecasts to improvements in policy-making ;
- making better use of the communications strategy to ensure that the policy messages of the forecasting exercises are understood and taken into account by decision-makers.

6.1 Recommendations regarding the efficiency of forecasting activities

Recommendation 1.1

Strengthen the theoretical consistency of the forecasts by making more use of the consistency and theoretical characteristics of econometric models and reorganising the production process of DG ECFIN's forecasts so as to foster deeper intertwining of short-, medium- and long-run analysis.

- Objective of and justification for this Recommendation

Since economic theory should guide economic policy-making, the role of econometric models in the forecasting process should be expanded with a view to providing a more rigorous framework of theoretical consistency. It would permit development of a strategy for increasing the consistency between the different elements of the forecasting process and between the forecasting techniques used for different horizons. Contributing to the policy dialogue on medium- or long-run issues is clearly one of the designated goals of DG ECFIN's forecasting activities. In addition, the Council Report on the improvement of the SGP emphasises the importance of medium-term projections and elaboration of scenarios. The Recommendation thus targets the need for a reorganisation of the production process and the design of DG ECFIN's forecasting products so as to ensure that the forecasting activities contribute to designated goals related to medium- or long-run issues such as those forming the backbone of the Lisbon Agenda. Adoption of this Recommendation would also strengthen the scientific credibility of the forecasting exercise and help defend it in the presence of the academic community.

- The current situation

The current situation is best described as a bottom-up approach with heavy weight given to country desks. To some extent this is justified insofar as deep institutional knowledge at national as well as regional level is necessary for evaluation of the effects of policy measures on the forecast. Overall (see conclusions 1.3, 1.5, 2.3), the situation is not entirely satisfactory as there exists no common model that integrates the different elements of the

forecasting process and helps cope with potential deviations between them. The QUEST model includes different country blocs, but the nature and extent of its real usage in the forecasting process is far from clear. There are certain elements, developed over the last couple of years, which point in the right direction: the further development of the QUEST model, and the development of DSGE models for individual countries. The current situation is furthermore characterised by very limited interaction between short-term judgemental forecasting exercises on the one hand, and on the other hand medium-to-longer-term analysis based mainly on the use of macro-econometric models. The forecast results are used as pseudo-observations for the first years of simulation. Moreover the direction of the relationship is mostly one way: At each forecasting round, medium-term projections are made for each Member State, based on the forecasts of country desks. In contrast simulation results are not - or are only in a very limited way - used for improving country desk forecasts. The goals related to long-term issues are covered by macro-econometric models (QUEST II, DSGE) which are also used for scenario analysis. Although their potential contribution to the designated goals appears quite high, they play only a minor role in current forecasting activities. DSGE is still at an experimental stage.

▪ Proposed actions

The evaluators strongly recommend further development of a system of fully-fledged econometric models based on the following principles:

- the models should contain fully-fledged supply and demand sections, based on optimisation behaviour, modern approaches to formation of expectations and a well-specified fiscal block;
- the models should be based on modern macroeconomic growth theory to allow simulation of spill-over to the economy of supply-side effects, as intended by the Lisbon process;
- the models should be integrated into multi-country models and include modelling of trade spill-over between different national economies;
- there should be models for the national economies of the major countries.

Model-based forecasts ensure a consistent framework for the country desks. We recommend strengthening the forecasting process by:

- Using Quest II or another, still to be developed, model based on sound theoretical principles including a multi-country framework feeding and linking the work of country desks. In particular, the results of the first storage of country desk forecasts obtained *via* a judgemental approach could be used to launch a simulation based on QUEST II which in turn would (i) contribute to improved consistency through a theoretical framework common to all country desks, and (ii) complement the trade consistency exercise.
- Conducting an analysis of the effects of alternative policy scenarios on the forecasting period, so as to facilitate assessment of their medium-term consequences as an integral part of the forecasting exercise. This should be done in parallel with elaboration of short-term forecasts by those ECFIN country desks and Services in

joint charge of model simulations and projections. This implies cooperation between the country desk and the Services in charge of structural analysis.

- Responsibilities/actors involved

The primary responsibility should rest with the technical units of DG ECFIN (country desks and those concerned with forecasts and economic situations, and with econometric modelling). An important role should be given to the coordinator of the annual and biannual forecasting rounds. Support should be given by the external co-operation units, organised *via* the “Economic Research Centre” (see Recommendation 1.3).

- Degree of priority

As contributing to policy dialogue on medium- or long-run issues is clearly one of the designated goals of DG ECFIN’s forecasting activities, this Recommendation should be accorded high priority. Moreover the Recommendation complies with the Recommendations of the Council on improvements to the SGP. The more the Commission engages in development of continuity between forecasting and analytical activities, the more important it is to use, develop and implement theoretically justified and consistent models.

Recommendation 1.2

Pursue and deepen existing efforts to conduct systematic analysis of past forecast revisions.

- Objective and justification of this Recommendation :

More thorough analysis of past forecasting errors would contribute to higher forecasting accuracy, increase the credibility of the forecasting institution and maybe also improve the background commentary on the forecasts. Such analysis has been more systematically developed by other international institutions and should be an integral part of each forecasting round. Analysis of forecasting intervals can help rationalise the process of judging whether or not errors are significant, and therefore whether or not the background commentary or forecasting method needs to be changed.

- The current situation

Over the last couple of years several in-house studies have been published which analyse the forecasting rationale, accuracy and bias over longer horizons (Keereman, 1999, Melander, 2007). Even the role of external assumptions was analysed (Keereman, 2003). These studies are very helpful but in the end are only isolated events. There is a need for an institutional mechanism which guarantees frequent surveillance of forecast revisions to improve forecasting methods progressively.

- Proposed actions

This recommendation essentially entails preparation of a special paper which could be called "Analysis of Forecast Revisions: Comparison with the last Forecast" – which should be an integral part of a forecasting round (at least once a year). The analysis should certainly contain an investigation of the reasons for a forecast revision. However, it is not sufficient to discuss only GDP growth and HICP inflation. As forecast errors might cancel out in highly aggregated series, the exercise should also cover additional variables such as the main demand components with a view to assessing the appropriateness of the underlying economic arguments. Ideally, the forecast errors should be broken down into their major contributors such as errors due to revision, different exogenous assumptions, a change in interpretation of developments, parameter instability, short- *versus* long-run effects and so on. Such an exercise would also facilitate a conclusion on whether forecast errors are significant or not. Whether this analysis should remain restricted to an internal and technical audience or broadly disseminated merits discussion, as both approaches have their advantages and drawbacks. Furthermore, the forecasting unit should regularly report to the Director-General on how analysis of forecasting revisions is taken into account in future forecasting exercises (e.g. by improving the database, stimulating research on "critical areas", improving modelling capacities).

- Responsibilities/actors involved

The primary responsibility should be with the econometric and technical units of DG ECFIN (country desks, Unit responsible for forecasts and economic situation). The evaluators suggest that the coordinator of the regular annual and biannual forecast should encourage each country desk to analyse the revisions of the last forecasting rounds.

- Degree of priority

The degree of priority is high; the Recommendation should be seen as a necessary and integral contribution to each forecasting round.

Recommendation 1.3

Without outsourcing forecasting activities, devise a system which draws on external cooperation for developing models and methods and enhances the role of external cooperation in discussion of forecasting results and their policy implications, and in linking forecasts to medium-term projections and scenarios.

- Objective of and justification for this Recommendation :

This Recommendation can be justified on several grounds. First, an established system of external cooperation helps strengthen the power and credibility of DG ECFIN's forecasts and forecasters *vis-à-vis* those of other institutions and the academic community. Second, the Recommendation helps guarantee scientific standards in the forecasting process and overcome staffing bottlenecks. Last but not least external cooperation can help build the necessary bridge between medium-term and long-term projections.

- The current situation

There are several levels of external (scientific, academic) cooperation in DG ECFIN, with several of its Units cooperating with high-level researchers and guest researchers visiting DG ECFIN. Joint papers are written and published. However, there is little external cooperation on forecasting models and tools or on linkage of model-based tools to day-to-day forecasting exercises. There also exists cooperation in the area of modelling between DG ECFIN and the Joint Research Centre in ISPRA.

- Proposed actions

The evaluators propose an extension of the responsibilities of the Econometric Models Unit. The Economic Advisors Group could play a more prominent role in the process of coordinating external cooperation for forecasting activities. The Group could also contribute to improving theoretical consistency (Recommendation 1.1)..

- Responsibilities/actors involved

The primary responsibility would rest with the "Economic Studies and Research" Unit in close cooperation with other Units (technical Units, ECFIN-E).

- Degree of priority

This is a medium-term Recommendation. The priority has to be set within the context of Recommendation 1.1.

6.2 Recommendations concerning the contribution of forecasts to policy-making improvements

Recommendation 2.1

Reinforce the involvement of country desks in the monitoring and analysis of medium- and long-run national policies and structural reforms, in particular those related to the Lisbon Agenda, by fostering their involvement in the production of model-based long-term forecasts.

- Objective of and justification for this Recommendation

The current production process for DG ECFIN's forecasts is based on a bottom-up approach and on inputs from country desks. It permits deep analysis of the national economies concerned and takes advantage of close relationships between country desks and the national authorities. The high-quality information on which its work is based fosters the building-up of capacities relevant to a wide range of economic policy analysis. In consequence further involvement of country desks in the model-based analysis of

policies and reforms, in particular those related to the Lisbon Agenda, would contribute to meeting the stated need for dialogue on the policy implications of forecasts.

- The current situation

DG ECFIN's current production process contributes to maintaining and developing knowledge and skills, notably within country desks, relevant to the monitoring and analysis of medium- and long-run national policies and structural reforms. This is particularly true for understanding of EU and third country economies, for mastering complex issues related to public finance, and for building up capacity to use and develop up-to-date technical instruments.

However, the existing skills and information remain underused. Long-run issues and respective projections are mainly produced using models, based for example on the production function block of Quest II or on other (e.g DGSE) models, which guarantees theoretical consistency but fails to take account of institutional factors and country-specific knowledge located at the country desks.

Recent developments in some DG ECFIN activities and practices, with greater involvement of country desks in analytical work, go in the right direction. Examples are:

- a trend to increased involvement of country desks in structural analysis, and participation of country desk staff in analytical work in the context of the Lisbon agenda;
- increased use by some country desks of models and liaison with the Unit in charge of econometric models and medium-term studies.

- Proposed actions

The actions proposed below aim at supporting the current trend to greater involvement of the country desks in analytical work:

- Besides their involvement in the monitoring and analysis of medium- and long-run national policies and structural reforms, country desks and technical units (e.g. Econometric Models Unit) should further their collaboration in the production of medium- and long-run analysis and forecasts of relevant variables (e.g potential output and NAIRU estimates, labour supply forecasts). On the one hand this could serve as a tool for transferring knowledge of state-of-the-art-oriented models from the Econometric Models Unit to the country desks. On the other hand, institutional factors and country-specific knowledge, as well as the good relationships between the country desk staff and national authorities, will surely help improve the medium-to-long-run forecasts and projections.
- Attempt as far as possible to include some monitoring of the Lisbon indicators in short term forecasts, in particular those with a macroeconomic dimension.
- Further develop relationships between the EPC and Directorate E's Structural reform, Lisbon strategy and economic evaluation Units on the one hand, and the

country desks on the other, so as to develop continuity between the forecasting and analytical activities.

- Responsibilities/actors involved

This essentially involves internal organisation and process issues, so the primary responsibility should be at Director-General level. The technical Units of DG ECFIN (country desks, Forecasts and Economic Situation Unit) along with the EPC and Directorate E should be involved. Support could also be given by the “Economic Research Centre” (see Recommendation 1.3 and box).

- Degree of priority

Changes and adaptation in the right directions are currently taking place and the actions proposed above are in support of those trends. This Recommendation, like the previous one, is of high importance for the objective of using the forecasts to initiate and feed into the policy dialogue.

Recommendation 2.2

Further develop dialogue with MS and other EU institutions on the policy implications of forecasting results, in particular on aspects beyond public finances.

- Objective of and justification for this Recommendation

This Recommendation is also meant to increase the contribution of forecasts to analytical capacity and policy-making so as to enrich the policy dialogue with MS and EU institutions.

- The current situation

Forecasting results are published with an extensive accompanying background commentary and the policy implications of the forecast are discussed in the College of Commissioners, the EFC and the EFC Council. However, public finance aspects are predominant in this policy dialogue. It is therefore recommended that the role played by forecasts in the dialogue on other dimensions and policy issues raised by these results should be increased. Furthermore it should be recalled that, owing to leakages in 2006, the expert group now meets only to discuss thematic topics concerning structural analysis in the context of the projections, but this could result in reduced Member State acceptance of the forecasts.

- Proposed actions

- maintain the role of expert group meetings in discussion of thematic topics of importance for forecasting and, in addition, use them on the occasion of the forecasting exercise for making an annual selection of focal topics to be investigated in greater depth, so as to enrich the policy dialogue with MS and EU institutions;

- use the expert group meetings to discuss any policy issues highlighted by the short-term forecasts;
- further develop the practice of occasional joint working sessions or seminars involving both expert groups and the Economic Research Centre²⁹;
- within the limits of the confidentiality needed, make public finance data available and debate public finance forecasts within the expert group meetings..

As an effective communications strategy gives rise to high-quality dialogue, implementation of communication strategy Recommendations (cf. section 6.3) should also contribute to this objective.

- Responsibilities/actors involved

The primary responsibility should be with the econometric and technical Units of DG ECFIN (country desks, Forecasts and Economic Situation Unit), the forecasts coordinator, and other Units concerned with the focal topic. The MS expert group should of course be a participant in this dialogue and both the EPC and Directorate E could also be involved.

The decision to restore the expert group meetings in their initial capacity and to redefine their mandate remains the prerogative of the Commissioner and his Cabinet.

- Degree of priority

The degree of priority is linked to Recommendations 1.1 and 1.2. The more the forecasts take into account medium- and long-run issues, the more relevant policy implications (i.e structural policy) become and the more important will be the dialogue and the focal topics. As contributing to the policy dialogue on medium- or long-run issues is clearly one of the designated goals of DG ECFIN's forecasting activities, this Recommendation should be regarded as a top priority.

²⁹ Experience of this kind gained from the organisation of joint ad-hoc workshops with desk involvement (e.g. a recent workshop on potential output estimates for Spain) or from the forum "country workshops" during which the main challenges are analysed in a forward looking perspective could provide an interesting basis in this view.

6.3 Recommendations concerning the communications strategy

Recommendation 3.1

Develop a goal-oriented communication strategy involving DG ECFIN, the Commissioner and DG COMM aimed at conveying not only the results but also the policy message of the forecasts.

- Objective of and justification for this Recommendation :

Currently the communications strategy consists of making information on the forecasting results available to the wider public in a comprehensive and neutral form. Whereas it appears that this objective is currently being successfully achieved, it is not on its own sufficient to maximise the contribution of DG ECFIN's forecasting activities to the higher objective of better economic policy formulation and decision-making in the EU institutions and the MS.

This Recommendation is therefore complementary to the Recommendations in group 1. Its main objective is to use the communications strategy to ensure that forecasting results are not only an important information output of DG ECFIN's activities but are also an input into the work of the actors who prepare and make economic policy decisions, so that the implications of the forecasts are duly taken into account.

- The current situation

The different types of forecast are made available to a large public *via* a diversity of means (formal presentation by the Commissioner at a press conference, comprehensive publication in *European Economy*, display of full documentation for the fully-fledged forecasts on the website of the DG, various publications, and availability on the website of other forecasting products).

The general rule is that presentation of forecasts is separated from discussion of economic policy issues and of the policy messages that may emerge from the forecasts

It is a conclusion of this evaluation that there is a need and a demand for improved interfacing between information on the economic outlook and analysis of its implications.

- Proposed actions

This Recommendation concerns essentially presentation of the fully-fledged (and to a lesser extent) intermediate forecasts. It involves three main actions:

- a) Identification of the most important messages conveyed by the forecasts and their implications for policy issues. The message could be related to the general macroeconomic evolution of the EU or to individual components (Eurozone,

particular groups of MS) or to specific themes that are the object of special analytical attention by the Commission and the Member States (cf. Recommendation 1.3).

- b) Agreement with the External Communication Unit of DG ECFIN, the Cabinet of the Commissioner, and DG COMM on how communication of the forecasts will be organised so as to highlight the intended messages and communicate them as effectively as possible to targeted audiences. This could cover the following:
- + how the message should be conveyed in the Commissioner's communication (press conference);
 - + using internet facilities (podcasts, videocasts) to increase access to a broader audience;
 - + editorial boxes in the publications to highlight the policy implications of the forecast results;
 - + interviews with selected economic newspapers or media with national and international coverage; the selected newspapers or other media should not be the same for every forecast but should be chosen and targeted in relation to the potential interest of their audience in the subject at hand;
 - + similarly workshops and seminars could be organised with targeted groups (officials of MS administrations or EU institutions, professional associations) to convey and streamline the policy messages emerging from the forecasts.
- c) Include in the presentation of the forecasts, as far as possible, references to the objectives of the BEPG and to whether the forecast trends are likely to converge on the indicators related to these objectives or, on the other hand, diverge from them. This would be a departure from the current strategy of separating communication of forecasts from economic policy discussions, but it would offer a desirable interface between information output and economic policy analysis.

Practical aspects:

- Insertion of conclusions on the specific topic related to the forecast results.
 - Insertion as bullet points of brief notes summarising the results for each country. These notes would be sent to all EC individual country representations which would each be responsible for translating the document into the national language. This publication would be separated from press releases to avoid confusion over the messages delivered.
- Responsibilities/actors involved

The primary responsibility should be with the technical Units of DG ECFIN (country desks, Forecasts and Economic Situation Unit) which should identify the key policy messages of a forecast. The conclusion on the specific topic should be delivered by the Forecasts and Economic Situation Unit, while brief bullet points should be delivered by the country desks.

Where a forecast permits delivery of messages relevant to specific structural reforms or ongoing analysis in the context of the Lisbon Agenda or functioning of the internal market

(see Recommendations 1.1 and 1.2), communication of these outcomes should be done in consultation with the Services of DG ECFIN or other DGs or institutions with relevant expertise and interest in the specific subject.

Finally, as already mentioned, the different parties to a Communication strategy (Technical Units of DG ECFIN, External Relations Unit of DG ECFIN, Cabinet spokespersons, DG COMM) should consult together before launching the communication strategy for a particular forecast.

- Degree of priority

The degree of priority for this Recommendation largely depends on the implementation of the Recommendations in group 1. The more the Commission engages in development of continuity between the forecasting and analytical activities, the more important it is to disseminate the analysis of the policy implications of the forecasts.

Recommendation 3.2

Improve accessibility of the forecasting results to users interested only in selected aspects or who are interested more in broad results than in technical detail.

- Objective and justification of this Recommendation.

The objective of this Recommendation is to facilitate access by different categories of user to the information most relevant for them.

- The current situation

The fully-fledged forecasts are the object of very comprehensive dissemination; other forecasting products are made available specifically to interested users (website, publications).

Nevertheless some potential users, particularly those in EU institutions very close to the political actors, face difficulties in determining what they need and distinguishing the different forecasting products. Moreover, the fact that the comprehensive publications are, for evident reasons, issued only in one language is sometimes perceived as a source of problems.

On a different plane some users experience difficulties in interpreting results due to particular technicalities they do not understand. This is the case for instance with the interpretation of some statistical tables by users who are used to Eurostat data but are unfamiliar with national accounts.

In current practice press releases on forecasting activities are translated into all languages and give a short and non-technical summary of the forecasts. This is commendable but there is also a certain demand for documents at intermediate level in terms of technicality and more limited coverage.

- Proposed actions

- In addition to the general forecasting publications, development of simpler or more popular short presentations on particular topics (growth and employment, foreign trade, etc.). These presentations should be prepared in such a way as to maximise easy access to the message rather than to the technical explanations. They could be issued in a larger number of languages.
- In addition to the publications on the results, simple explanations on how they are produced might be useful to some users. For instance, the importance of the AMECO databases in providing a consistent quantitative framework should be highlighted together with an explanation as to why and how they may differ from statistical sources and how they should be interpreted.

- Responsibilities/actors involved

This is essentially an effort to popularise information that could be delegated to communications professionals working under the guidance and supervision of DG ECFIN's technical Units.

- Priority

Given the fact that the forecasting information is currently very comprehensive and gives satisfaction to a large majority of users, this Recommendation should not be regarded as a top priority. However its implementation would increase the overall impact of the forecasts, particularly among groups of users that have only limited time to absorb the information and are interested in receiving it in a form that makes it as easily usable as possible in circles primarily concerned with political issues.