

# The Annual Conference

*The Society's Annual Conference took place this year at the University of Nottingham, 21st-23rd of March. This report on the event was contributed by Heather Stewart of the Observer newspaper.*

**A**CADEMIC ECONOMISTS could once safely be confined to peering into the Treasury and Threadneedle Street, thinking they could probably do much better — or dizzying the rest of us with elegant but esoteric mathematical tricks. These days they're everywhere: in the board-room, in the wine-cellar, on the battlefield — they're even in your bedroom. Many of the hundreds of economists who gathered at this year's annual conference of the Royal Economic Society, in Nottingham University's leafy campus, were eager practitioners of this cradle-to-the-grave economics, striding gleefully across the entire horizon of human affairs. Sitting in on their efforts was, I can report, a bracing experience, even for someone whose grasp of the minutiae of time-series analysis and general equilibrium modelling is somewhat tenuous.

## Economics and marriage

For example, it ought to be a truth universally acknowledged that asking an economist for advice about your love-life is a terrible idea: one number-cruncher I knew used to say that the reason he stayed with his current girlfriend was the 'search costs' of finding someone else. However, on Tuesday afternoon Nick Powdthavee, from Warwick University, marched straight into an analysis of love and marriage, which, his research suggests, go together like a horse and carriage. He began by holding up his bare ring-finger and warning that he was approaching the question 'without first-hand experience' - but when did that ever stop an economist?

Nick explained that when two people are in love, they share each other's happiness (or — trust an economist to take the romance out of it — 'since loving someone usually involves affectionate caring about what happens to him or her, if  $M$  cares about  $F$ , this implies that  $M$ 's utility levels depend on  $F$ 's utility levels'). Using panel data about men and women's self-reported health and happiness, Powdthavee has found that for married couples, this psychological link shows up clearly. For example, one happy, healthy partner can help to offset the negative effects of unemployment on the happiness of the other, in a process Powdthavee calls 'mental risk-sharing'.

Apparently, however, these psychological trade-offs don't work nearly so well for unmarried, co-habiting partners: a finding which runs counter to the standard economic analysis, which would suggest that the division of labour, and utility-sharing, which make being in a couple worthwhile, would already exist between co-habiting couples. Perhaps, Powdthavee speculates in his paper, there is a selection bias at work here: 'Couples who live together may only agree to marry one another if there is enough reciprocal sharing of satisfactions between them'. Mercifully, he didn't pursue that line of thought any further.

Politics, as well as love, was high on the agenda at the uninspiringly named East Midlands Conference Centre. It may have

been the fact that a general election was due within six weeks or so, but there was plenty of advice for policymakers - and a series of government initiatives came in for tough scrutiny.

## Pensions and retirement

A useful lesson in the law of unintended consequences was offered in the session on 'Retirement and Retirement Policy'. Stakeholder pensions, the low-cost saving schemes with a stamp of government approval, launched in 2001, were pronounced a complete failure by the Institute for Fiscal Studies, which had a number of provocative papers at the conference. Although stakeholders were aimed at persuading middle-earners without an occupational pension to save more for their retirement, much of the increase in saving which has taken place since has instead been among lower earners.

The IFS's Matthew Wakefield speculated that this could be an unexpected (though with hindsight perhaps rather predictable) by-product of the reforms. At the same time as stakeholders were introduced the government increased the amount of money which could be saved into a pension without incurring tax. Wakefield said it was this change, not the stakeholder schemes themselves, which appeared to have altered savings patterns. In fact, the largest increase in saving among low earners has been by those with high-earning spouses, suggesting there may simply have been a transfer of pension contributions between couples. The impact of the much-vaunted stakeholder schemes themselves, meanwhile, has been almost nil. With radical pension reform very much in the offing in the next couple of years, this is a cautionary tale Whitehall policy wonks would be wise to bear in mind.

The much-maligned Child Support Agency has been more effective in altering behaviour, according to a paper by Yu Zhu and Ian Walker. Despite serious teething troubles since it was introduced 12 years ago, the CSA has changed the costs and benefits of separation significantly, they found. A parent contemplating leaving the family home now has a very different financial decision to make. Zhu found that without the introduction of child support payments, divorce rates would have been 14 per cent higher.

## Road pricing

Evidence of the glacial pace of government decision-making was on show on Monday afternoon, in the special session on road-pricing, which Transport Secretary Alistair Darling has since suggested could be implemented within the next few years. Tom Worsley, who worked on the recent Road Pricing Feasibility Study for Mr Darling, said the idea had been discussed since the 1920s. The Ministry of Transport, as it then was, produced a policy paper on the subject in 1964.

The problem itself is familiar: driving has significant externalities, from the costs of road repairs, to accident costs, and of course congestion. To an economist, the answer is obvious: ration road-use by charging for it, instead of through the current system of taxing fuel and vehicle ownership, which has an imprecise connection with the social costs of driving. London's successful introduction of a flat-rate, £5 a day Congestion Charge has sparked renewed interest in the idea. At present, when the volume of cars on a particular stretch of road reaches a certain level, the social cost of road-use starts to exceed the private costs falling on the drivers. Worsley and his colleagues found that even a revenue-neutral road-pricing scheme, replacing the current fuel and excise duties on motorists, and capping costs at 80p per kilometre, would generate 'significant' benefits, and cut congestion dramatically, if it was designed in a sophisticated way, with costs varying by place, time, road-type and so on.

As the discussion in the session revealed, however, there is certainly no consensus about whether, and how, such a scheme would work. Worsley himself stressed the difficulty of creating a market in road-use, when motorists have become accustomed to jumping in their cars without a thought. David Newbury, of Cambridge University, raised further questions about feasibility, arguing that a system which genuinely charged drivers the marginal social cost of each kilometre would have to price by road-junction, not just broad area. Furthermore, the revenue falls away rapidly as people adjust their behaviour. Newbury advocated imposing charges only in major cities, leaving the traditional system of fuel tax to meet the cost of building new motorways.

Stephen Glaister, of Imperial College, said the costs of establishing a road-pricing system — as revealed by the feasibility study — could be as high as £60bn, with running-costs of £5bn a year. In London, about two-thirds of the revenue from charging is gobbled up by the costs of running the scheme. Now that Worsley and his team have designed what they believe is an effective system, though, Glaister called for what Sir Humphrey Appleby would have called a 'brave' decision, from the Department of Transport. 'A national scheme, if it were ever to be successful, would require an extraordinary amount of political leadership,' Glaister said: Alistair Darling, beware.

## Spending on the regions...

Mr Darling was also implicated in a paper by Peter McGregor, of Strathclyde University, on a painful-sounding predicament called the 'Barnett squeeze'. The ever-controversial Barnett formula adjusts public spending to take account of population, and is gradually reversing the advantage Scotland has had for many years, in receiving more cash per head than England. In 1997, when he was Chief Secretary to the Treasury, Darling shifted to an annual updating of the population weights which determine the formula. Prof McGregor analysed the consequences of that decision using a general equilibrium model: economists' latest favourite toy, judging by how frequently they were mentioned in a multiplicity of sessions around the conference. Economists are often so fond of their models, they like to give them names: this one was called Amos, for A Model of Scotland (get it?).

Prof McGregor and his colleagues have used Amos to show that the current system has potentially powerful knock-on effects on Scotland's economy. As the population of a region declines, it receives a lower allocation of Whitehall cash; but less government activity tends in turn to lead to economic slowdown, job losses, and outward migration. Prof McGregor's analysis comes to the startling conclusion that eventually, the long-run effect of an annually re-weighted Barnett formula will be a four per cent reduction in the size of the labour force, as Scottish workers migrate to more prosperous areas.

## ...and the young

Giacomo de Giorgi of University College London gave the government's New Deal for Young People scheme the thumbs-up. Using 36,000 observations of men falling just on either side of the age threshold for inclusion in the scheme (25), he calculated that it had increased the long-term employability of those who were included by more than 6 per cent: though as was pointed out during subsequent discussion, balancing those benefits against the costs of the policy would be a necessary next step if his analysis is to contribute to policy-making.

## Corporate governance

From the nuts and bolts of the welfare state, to the workings of global capitalism: on Monday afternoon, Bengt Holmstrom — who is that rare thing, an economist with plenty of hands-on business experience — gave the packed conference hall a provocative, first-person analysis of corporate governance. Holmstrom, who sits on the board of Nokia, as well as his

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wife's family business, turned the familiar story of the corporate excesses of the dotcom boom upside down. He believes the stock option bonanza of the late-1990s was an essential 'lubricant' for the dramatic

restructuring of the corporate sector which had to take place so that firms could profit from the new technologies of mobile phones, the internet and so on. Because 'big firms exploit better, and small firms explore better', billions of dollars were reallocated from large firms to small ones — and stock markets were the best mechanism for doing that. 'Stock options were there to grease this restructuring wave... Basically these were bribes: if you can't use the stick, you have to use the carrot.'

The misdemeanours uncovered in cases like Enron were a direct consequence of that process: 'the more you are pressuring managers to perform, the more they are starting to misbehave... pressure was high enough on these people to perform that they essentially found it valuable — in their private calculation at least — to do immoral things.' Chief executives are also able to bid up their own value dramatically, because the board always has far more to lose in terms of the company's share price if the boss walks out, than if they agree to pay him a few (million) dollars more.

Holmstrom's prescription, which he tries to apply to the boards he works on — every economist loves a natural experiment, after all — is for stock options to be granted with longer time horizons, carefully benchmarked against what other firms are offering, and given in small, regular amounts, instead of one-off hand-outs. The board's function is to 'decide who decides'

— to pick an executive team, not to second-guess every decision; but with increasing pressure from shareholders, it can be hard to resist being aggressive and over-bearing, rather than risk being seen as a ‘sissy board’.

Like a good board chairman, Holmstrom raised as many questions as answers in his paper; but he did show that the pat analysis of corporate governance, in which greedy and unscrupulous chief executives are given free rein by weak directors and passive shareholders, is misleading, and can lead to knee-jerk solutions to complex problems.

Sean Holly, of Cambridge University, had been busy scrutinising that well-studied experiment in committee decision-making, the Bank of England's Monetary Policy Committee. He took the usual classification of inflation ‘hawks’ and ‘doves’, and made it more complicated, with a division between the more and less ‘activist’ members: those who like to be preemptive, and those who are more likely to wait and for more evidence before acting. Charlie Bean, the Bank's chief economist, apparently sits bang in the middle, as ‘median man’.

For those people who find their work-days constantly interrupted by computer glitches, there was some reassuring news from Helen Robinson, of Cardiff Business School. However frustrating it is to be slave to a lump of silicone and plastic, those workers who spend at least some of their day in front of a computer should be able to see the difference in their pay-packet. Robinson and her colleagues used panel-data to compare computer use and pay, and found that women who use computers at work earn 32 per cent more — and men 43 per cent more — than their lower-tech counterparts.

## Accounting for life

Matters of life and death were also high on the agenda in Nottingham, as the daffodils burst into life outside. Orley Ashenfelter, of Princeton, delivered a bravura lecture about the value we — or at least, gas-guzzling American motorists and the voters who determine their speed-limits — attach to the value of a human life. A speed limit of 55mph was imposed in the US in 1973, when the oil crisis made saving gasoline a national project. Not surprisingly, road fatalities per mile dropped sharply — but people were late. Thirteen years later, states were given the choice of raising speed limits on rural roads. Ashenfelter argued that the trade-off between losing more lives per mile driven, and gaining more minutes, as is often the case, Ashenfelter pointed out, Homer Simpson put it best: ‘Fifty five? That's ridiculous! Sure, they'll save a few lives, but millions will be late!’ With a bit of help from Homer, Ashenfelter put the statistical price of a life at about \$1.5m: but he quickly drowned out that answer with a blast of a quite dreadful 1984 song (complete with lyrics), by curly haired rocker Sammy Hagar: ‘I Can't Drive at Fifty Five’ (from the album ‘VOA’, also including the track ‘Rock is in my Blood’, in case anyone present was tempted to rush out and buy it).

Admittedly, some of the parallel sessions at the conference were so sparsely attended that it was clear the point of delivering a paper was to be able to say it had been given, rather than to stimulate discussion. However, there was plenty of lively debate at other sessions, plus a good helping of gossip over lunch about which papers were more worthwhile, who's up and who's down.

## The economics of war

One of the better attended seminars was on war — the main conclusion being that armed conflict is a rather costly business, and certainly more expensive than governments tend to estimate when they charge into it. Professor Keith Hartley, of York University, who specialises in the economics of war, set out his calculations for the costs of the Iraq war, and the continuing deployment of troops in the Gulf State. Britain will have spent more than £4bn by 2006. Hartley said he was keen for his analysis to inform decision-makers, but it might also have been handy for anti-war protesters: ‘Not in my name’ is a powerful enough moral argument, but ‘not with my money’ might have carried as much weight with politicians.

However, Britain's expenditure on the Iraq conflict has been dwarfed by the \$253bn of US taxpayers' money poured into the project: more than half the cost of the protracted Vietnam war. Hartley, with a characteristic economist's slant on geopolitics, suggested that if President Bush had simply offered Saddam Hussein \$20bn to leave the country, and given the Iraqi people \$50bn to reconstruct their country, everyone would have been better off.

## On pragmatism in model building

This pragmatism, which was displayed again and again at the many parallel sessions, must have impressed Sir Clive Granger, a man with no patience for pie-in-the-sky theorising. The formidable Nobel laureate, (and, according to conference chairman Richard Disney one of the ‘Top 100 Welsh heroes’, along with perma-tanned crooner Tom Jones), was warmly welcomed back to his home turf. He was an undergraduate and doctoral student at Nottingham, and taught there for a number of years, before leaving for the sunnier climes of California, where he has been based since the mid-1970s.

Granger offered a wealth of acerbic advice to aspiring number-crunchers, about the pitfalls of economic model-making, something he is well-qualified to do, having won his Nobel prize — with Robert Engle, in 2003 — for contributions to time-series analysis. Constructing a mathematically elegant model which ‘isn't any good’ was pointless, Granger insisted: ‘we need to know the purpose of the model’. In reality, he said, in a characteristic side-swipe at his profession, ‘we all know what the purpose is: the purpose is for this guy to get promoted.’ Instead of showing off their models, though, he urged economists to be ‘pragmatic’, and ask themselves, ‘does it work? Is it relevant?’ He recommended that economists do what the general public would like to think they are doing: help decision-makers to make better decisions.

War and peace; life and death; love and marriage: as an outsider sitting in on this year's conference, it was refreshing to find economists busily doing exactly what Sir Clive Granger had exhorted them to do: helping decision-makers, whether on the board of multi-million dollar corporations, or in the corridors of Whitehall. In all, the three days were a reminder that economics is a way of looking at the world, which extends well beyond questions of high finance. In fact, as far as improving my own decision-making is concerned, my only regret was not to have made the session on the economics of wine.