A farewell from Germany

For many years, readers have enjoyed Ray Rees’s reflections on life and work in Germany, and also his occasional contributions on other topical issues (remember the ‘Great Welsh Leek Bubble’). But sadly, all good things must eventually end and so it’s with much regret that we have to announce Ray’s last Letter from Germany. All readers will want to thank him for the entertainment he has provided for so long and to wish him a happy and lengthy retirement. On a happier note, we can report that future letters will come from Michael Burda at Berlin’s Humboldt University.

This being the July issue, we have the Report on the Society’s Annual Conference. This is another heroic achievement in capturing the highlights of a huge event, achieved this time by Richard Davies of the Economist.

We also have an interesting suggestion, following recent discussions about revising the curriculum in light of the recent crisis, that more attention should be given to the insights of classical economics. There is also a report on the 2012 survey of women in the economics profession and some evidence of the importance of getting a ‘better’ class of degree in UK economics.

Two other features address topical issues: the effects of QE and proposals for taxing financial activity in some way. Both look capable of generating future reactions.

Joining the Society or renewing membership? Please do it online. See p.22
ROYAL ECONOMIC SOCIETY
NEWSLETTER

Editor
Prof Peter Howells,
Centre for Global Finance,
Bristol Business School,
UWE Bristol,
Coldharbour Lane,
Bristol BS16 1QY
Email: peter.howells@uwe.ac.uk

Administration Officer
Mrs Amanda Wilman,
Royal Economic Society,
School of Economics and Finance,
University of St. Andrews,
St. Andrews, Fife, KY16 9AL, UK
Fax: +44 (0)1334 462444
Email: royaleconsoc@st-and.ac.uk

Published quarterly in
January, April, July and October

Next issue
Newsletter No. 163 - October 2013
Articles, features, news items, letters, reports etc. should be
sent to the Editor by:

15 September 2013

Items concerning conferences, visiting scholars and
appointments should be sent to the Administration Officer
by:

16 September 2013

Contributions from readers
The Newsletter is first and foremost a vehicle for the dis-
semination of news and comment of interest to its readers.
Contributions from readers are always warmly welcomed.
We are particularly interested to receive letters for our cor-
respondence page, reports of conferences and meetings,
and news of major research projects as well as comment
on recent events.

Readers might also consider the Newsletter a timely outlet
for comments upon issues raised in the Features section of
The Economic Journal. We can normally get them into
print within three months of receipt.

Visit our website at:

www.res.org.uk

Newsletter - subscription rates
The Newsletter is distributed to members of the Society free
of charge. Non-members may obtain copies at the following
subscription rates:

• United Kingdom £5.00
• Europe (outside UK) £6.50
• Non-Europe (by airmail) £8.00

Visit our website at:
www.res.org.uk/view/resNewsletter.html
In 1993, when I first moved to Munich, Germany was moving into a period of a decade or so characterised by critics both inside and outside the country as one of economic stagnation and malaise. The hackneyed term ‘sick man of Europe’ was often applied. Now, just as I am moving back from Germany to Wales, I read an article in the Economist criticising Germany’s leaders for refusing to accept its responsibilities as the dominant European economic power, to become its ‘hegemon’, the shaper of Europe’s future and the guardian of its stability. That is quite a long way to travel in two decades. How did Germany do it?

Part of the answer is that the state of the German economy then was not so dire, and its state now not so unproblematic, as the contrast suggests. When we deflate for the inevitable exaggerations of the critics, the distance between the two end-points is not so great. A constant factor throughout has been the strength of Germany’s core manufacturing sector, with its leading-edge technology, well-trained labour force and ability to generate huge export surpluses. Then, as now, Germany had the lowest youth unemployment rate in Europe, thanks to its excellent apprenticeship system. The rest of the answer is that one of the two problems that dominated this decade of malaise up to the mid-2000’s, secular growth of long-term unemployment and relatively slow growth of per capita output, appears to have been solved. The other, the depressed state of East Germany that was the outcome of the botched unification of the East and West German economies, remains unsolved but seems not to matter so much anymore. But other problems remain that will fully engage German policy makers for some time to come and make it very unlikely that they will want to adopt the role of Masters of Europe. If indeed any one country alone can play that role, which I very much doubt.

Throughout the 1980’s and ‘90’s, up until 2004, Germany had an amazingly generous unemployment benefit system. On becoming unemployed, workers received 67 per cent of previous net earnings if they had children and 60 per cent if not, for a period of 32 months. They were free to turn down job offers that they felt were not commensurate with their qualifications and experience. After that period, if still unemployed, they received respectively 57 per cent or 53 per cent of previous net earnings until they reached retirement age. In addition to this high earnings replacement rate, there was a standard poverty trap, with liability to pay health and social security contributions being incurred and welfare benefits lost on taking a job. Finally, it was often advantageous to take early retirement and so the de facto average retirement age was 59. It is then hardly surprising that throughout the 1980’s and ‘90’s, each successive unemployment cycle had a higher peak and a higher trough than the one before. Over the same period, German labour costs were rising rapidly relative to those of its competitors. Extrapolation of these trends naturally presented a picture of economic disaster, even if the current picture was one of relative stagnation at a high level of prosperity.

In 1993, the euphoria surrounding the fall of the Berlin Wall and the beginning of the reunification process had given way to the sobering realisation that the economics of this process had been dreadfully mismanaged. The economic naivety of leading politicians and administrators and the cynical pursuit of self interest by West German employer associations and trades unions in ‘negotiating’ uncompetitively high wage rates for East German workers had wiped out large swathes of the East German economy. High and growing unemployment was the result. Because of the application of West German standards of unemployment benefit and social welfare payments, many people in East Germany enjoyed higher living standards than they had had as workers in the socialist DDR. But the consequence was a sharp increase in the German budget deficit and a continuing redistributive burden that severely impacted the budget deficits and growth rate of the newly united Germany.

In 1993, the euphoria surrounding the fall of the Berlin Wall and the beginning of the reunification process had given way to the sobering realisation that the economics of this process had been dreadfully mismanaged. The economic naivety of leading politicians and administrators and the cynical pursuit of self interest by West German employer associations and trades unions in ‘negotiating’ uncompetitively high wage rates for East German workers had wiped out large swathes of the East German economy. High and growing unemployment was the result. Because of the application of West German standards of unemployment benefit and social welfare payments, many people in East Germany enjoyed higher living standards than they had had as workers in the socialist DDR. But the consequence was a sharp increase in the German budget deficit and a continuing redistributive burden that severely impacted the budget deficits and growth rate of the newly united Germany.
At the root of much of the intensity of the critical comment in the decade from the mid-90’s was the sense that Germany’s rulers, whether the conservative government of Helmut Kohl in the period up to 1998 or the social democrat/Greens government of Gerhard Schroeder that succeeded it, were unable or unwilling to understand the problems and to do anything about them. Kohl, apparently undaunted by the failure of his vision of a flourishing East German economy within 3-5 years after 1989 to materialise, was heavily involved in the negotiations setting up the Euro currency area. An interesting insight into Kohl’s attitude to this has just emerged.3 He admits that he had had to act ‘like a dictator’ in forcing Germany’s entry into the Euro area on the German electorate, who, he was sure, would have overwhelmingly rejected the proposal if a referendum had been held. He felt that politicians had to be above the ‘ebb and flows of opinion’ as manifested in elections, and saw himself as safeguarding the future Europe from the wars that had devastated its past. Be that as it may, he was voted out in the following election.

The coalition of Social Democrats and Greens that replaced him brought with it some sense of the possibility of change, but not in the area that most concerned critical economists, the failing labour market and social security system. The new Kanzler (Prime Minister) Schroeder was reluctant to confront the left wing of his party and its supporters in the trades unions, who fiercely opposed what they called the ‘neo-liberal’ proposals for reform. Perhaps it was the near loss of the election in 2002 to the Bavarian conservative Edmund Stoiber, together with the ever-worsening economic prospects, that finally convinced Schroeder to take up the cause of reform. In March 2004 he announced his Agenda 2010, which, as the name suggests, was a list of reforms that were intended to restore the competitiveness of the German economy by the end of the decade. It included raising the official retirement age from 65 to 67 while also reducing pension benefits, cutting health insurance premiums, which are levied as a payroll tax, while also making some reductions in coverage, and exempting certain types of low paid jobs from social security contributions. The centrepiece however, and the main source of contention, was a drastic re-structuring of the unemployment benefit system. Following redundancy, unemployment benefit was to be paid for 12 months, not 32, and after that would be replaced by payments under the social welfare system, which were on a much lower scale. The Federal Labour Office was to become much less of an agency administering unemployment compensation and far more one with the function of getting people back to work. Schroeder spent the rest of his term of office fighting to get these reforms implemented.

Compared to the struggles Margaret Thatcher had with the British trades unions in the 1980’s, Schroeder’s battles were relatively tame. Nevertheless they cost him first the party leadership, then his position as Kanzler, when he lost the 2005 election to Angela Merkel, and finally his political career. Yet, as it has turned out, these reforms, much helped by a decade of restraint in wage settlements, have been a success. Germany’s unemployment rate fell steadily from over 11 per cent in 2005 to under 6 per cent in 2012, and its unit labour costs are now well below those of its competitors. The economy’s rapid rebound in 2009 from the recession following the 2007/8 financial crisis, which went further and faster than those of other countries, though helped by the wise policy of subsidising short-term working to avoid layoffs, must owe a lot to the increased flexibility of the labour market. As economists we probably underestimate the importance of circuses relative to bread. In 2006 the Football World Cup was held in Germany and, even though the German team did not reach the final, the success Germany had in staging the event and its improved sense of how it was perceived in the rest of the world led to a major lifting of the national mood. This has interacted with the improved economy to create a sense of confidence about the future reflected in, among other things, Angela Merkel’s high ratings in the public opinion polls.

Problems of course remain, and are well discussed in the Economist article I referred to earlier. Energy policy has to solve the problem of exploding electricity prices following the ambitious attempt to change the energy mix relatively rapidly from coal and nuclear generation to wind and solar power. An ageing population and declining labour force presents challenges to policies dealing with immigration, education, family support and female labour supply as the means of counteracting them. As far as the most pressing immediate problem is concerned, that of devising a mechanism to deal with the risk of sovereign default in Eurozone countries, I think the brief sketch of recent economic history I have given here makes the German attitude very easy to understand. Though insistence on economic competitiveness and sound public finances as a place to start may appear to lack vision, the alternative is far worse. Helmut Kohl had great visions of blossoming East German meadows and a single currency forever banishing conflict among the countries of Europe. I much prefer a leader who thinks like a boring economist. Think Angela Merkel.

To close on a personal note, now that I have exchanged the charms of one of Europe’s great cities for the magic of the mountains of Snowdonia, I did not think I could reasonably go on writing these letters, much as I have enjoyed doing so. I am pleased to say that Michael Burda of the Humboldt University, Berlin, has agreed to take over from me, and I very much look forward to reading his letters in the future.

Notes:
1. Ray Rees is Professor Emeritus at the University of Munich and an Associate Fellow in the Economics Department, University of Warwick.
News from the Economics Network

Developments in Economics Education Conference

The 2013 DEE conference will be held at the University of Exeter on the 5th and 6th September 2013. This will be the seventh DEE conference and the Network hopes to continue its previous success by addressing the most pressing issues faced by higher education economics and presenting new and innovative teaching ideas and solutions. This year’s DEE will have a particular focus on recent changes in higher education, their impact on students’ expectations and how economics can tackle these challenges. The keynote address will be given by John Kay.

Economics Network Interdepartmental Research Project

At the beginning of this year, the Economics Network launched a collaborative research project, which explores how economics students' expectations, attitudes and behaviour may have changed as a result of the changes to funding in higher education and in particular the rise in tuition fees. The project also aims to consider how economics teaching and learning practice and curricula might be adjusted to respond to emerging needs.

Over twenty UK economics departments are engaged in the project. The Economics Network has surveyed first and second year students at these universities and over the summer will begin the analysis on the data. We will present initial findings at the DEE conference in September.

More information on this project is available at: www.economicsnetwork.ac.uk/projects/research2013.

Economics Network workshops

With the support of the Royal Economic Society and the Scottish Economic Society, the Economics Network is once again running its autumn programme of workshops for graduate teaching assistants and new lecturers.

The GTA workshops are specifically designed to meet the needs of economics postgraduate teaching assistants/tutors with a focus on small-group tutorials, seminars and workshops.

The New Lecturers’ workshop is a two-day residential workshop aimed at new and early-career economics lecturers. The focus of the workshop is to discuss and evaluate what makes effective teaching of economics: including lectures; seminars and small-group teaching; assessment and feedback; e-learning; module/unit design; classroom experiments and games.

Feedback from our 2012 programme (15 workshops):

New Lecturers:
‘Overall, this was a highly interesting course, which was very useful. I have attended generic teaching and learning courses at my institution and it was far more useful to come to this workshop, which was tailored to the particular issues faced in effectively teaching economics.’

Postgraduates:
‘The presenters were great — very knowledgeable and well experienced. Happy to listen to questions and grievances.’

‘After this workshop I’m more calm and I know that tomorrow I will face my first class in a very good way. Thank you.’

For more information, including dates and venues see: http://www.economicsnetwork.ac.uk/news.

RES Annual Conference, 2014

The 2014 RES Annual Conference will be held at the University of Manchester on Monday April 7 - Wednesday April 9.

The Programme Chair and Deputy are Oriana Bandiera (LSE) and Ethan Ilzetzki (LSE) and the Local Organiser is Denise Osborn (Manchester). The deadline for submission of individual papers is October 13, 2013, and the deadline for Special Sessions proposals is November 3, 2013. More information is available at the main RES conference website (http://www.res.org.uk/view/conference.html)
In this essay, I shall put forward an alternative to equilibrium economics, the paradigm that has dominated the mainstream of economic thought for the best part of a century. The progressive refinement of that theory during the twentieth century delivered determinacy of solutions together with simplicity of structural form, but the costs of this achievement have been substantial. In order to achieve the desired simplicity of formal structure for what is essentially a mechanistic metaphor, most of the essential ingredients of a market economy have been removed. All elements of human behaviour, most institutional arrangements, change of any kind that comes from within the system, together with the possibility of increasing returns or path dependency have disappeared. It is difficult to relate equilibrium theory to the empirical processes of an actual market economy, and so it provides us with a poor understanding of how the contemporary economy actually works.

Equilibrium theory and policymaking

This has had implications for policymaking. The hubristic belief that the business cycle had been conquered by recent developments in theory and practice must surely in part be attributable to the displacement from the academic curriculum half a century ago of the study of business cycles by macroeconomics, itself a version of static equilibrium theory. Likewise, if the study of the processes of economic growth had not been abandoned at around the same time in favour of modelling ‘equilibrium growth’, an oxymoron if ever there was one, perhaps policymakers might not be quite as helpless as they seem to have been recently in the face of political demands for the restoration of economic growth.

While equilibrium theory focuses our attention on issues surrounding the efficient allocation of a given set of resources amongst competing uses at a single moment of time, it does not address those features of a market economy that have principally impressed themselves on human history. These include the ability to sustain growth in aggregate productivity over long periods of time, periodic fluctuations in total output and employment, the existence and behaviour of markets themselves and the incessant change in the range and quality of both producer and consumer goods and services.

It is difficult to exaggerate the inappropriateness of using the concept of ‘equilibrium’ to try to analyse a market economy. A market economy is never at a state of rest. It is essentially restless, as Marshall understood. So what is the alternative method of analysis? The alternative is what may be called classical economics.

Defining ‘classical economics’

By ‘classical economics’ I do not mean that largely discredited body of doctrines, including the labour theory of value, the wages fund doctrine and ‘laissez-faire’, that faded away towards the end of the nineteenth century. I refer to an intellectual tradition that began with Adam Smith, was continued by Marx, Menger and Marshall, Schumpeter and Hayek and in the present day is represented by theorists of complexity.

The hallmarks of this classical tradition are principally three. The first is the belief that the growth of the economy, rather than relative prices, should be the principal object of analysis. Coupled with that belief is an understanding of the market economy as a collection of processes of continuing change rather than as a structure, and that the nature of this change is self-organising and evolutionary. Finally there is a conviction that economic activity is rooted in human nature and the interaction of individual human beings.

The differences between classical theory and equilibrium theory can be summarised in the following terms. Classical theory focuses on change and growth within open, dynamic nonlinear systems that are normally far from equilibrium. Equilibrium theory, on the other hand, analyses the theory of value within closed, static linear systems that are always in equilibrium. As to the essential nature of economic activity, classical economics makes no distinction between micro- and macroeconomics. Patterns of activity at the macro level emerge from interactions at the micro level. Evolutionary processes provide the economy with novelty, and are responsible for its growth in complexity. In equilibrium theory micro- and macroeconomics remain separate disciplines, and there is no endogenous mechanism for the creation of novelty or growth.
The behaviour of human beings in classical theory is analysed individually. People typically have incomplete information that is subject to errors and biases, and they use inductive rules of thumb to make decisions and to adapt over time. Their interactions also change over time as they learn from experience. In equilibrium theory, individual behaviour is assumed to be homogeneous and can be modelled collectively. It is assumed that humans are able to make decisions using difficult deductive calculations, that they have complete information about the present and the future, that they make no mistakes and have no biases, and therefore have no need for adaptation or learning.4

Carl Menger provides the principal link between the earlier classical school and their twentieth century successors. Menger’s name is frequently associated with that of Jevons and Walras, each having independently formulated the principle of the determination of price by marginal utility, but his analysis needs to be carefully distinguished from theirs. Whereas Jevons and Walras drew their methodological inspiration from classical mechanics, Menger had little interest in the concept of equilibrium. In addition to his emphasis on the subjective basis of economic activity, he made two other noteworthy contributions to economic theory. He noticed the emergence of social institutions as a consequence of what we should now call self-organising evolutionary processes. He also proposed an amended version of Smith’s theory of the progressive division of labour, one that foreshadowed Allyn Young’s later contribution.5 It was left to Hayek to build the intellectual bridge from Menger’s work to the theory of complexity.

**Classical economics and complexity theorising**

Following the publication in 1952 of his study of the mind, *Sensory Order*, Hayek began to cite works in cybernetics and systems theory. In 1964 he published his paper ‘The Theory of Complex Phenomena’, although that did not contain a fully worked out theory. His linking of the concept of what he called a ‘spontaneous order’ with the idea of a complex system provided him with a vehicle to re-organise his earlier arguments about methodology. He devised the concept of a hierarchy of complex phenomena to provide a common framework for the analysis of different classes of phenomena. At some time in the 1970s he is thought to have communicated with Ilya Prigogine, the Nobel Prize-winning chemist who was then becoming aware of the ubiquity of self-organising systems in natural phenomena, and pioneered the development of nonlinear dynamic systems to analyse them.6

By the 1980s complex adaptive systems had come to be regarded as forming a universal class in the natural world, with many common behaviours observed across traditional disciplines. In 1984 a number of natural scientists set up an Institute in Santa Fe, New Mexico to act as a centre for interdisciplinary research into the properties of such systems. One or two interested economists like Kenneth Arrow and Brian Arthur joined them. Unaware of Hayek’s earlier work, but following the lead of his scientific colleagues, Arthur began to model economies as complex adaptive systems. In an interview he gave in 1996, Arthur is quoted as saying:

> Right after we published our first findings we started getting letters from all over the country saying, ‘You know, all you guys have done is rediscover Austrian economics’. I admit I wasn’t familiar with Hayek and von Mises at the time. But now that I’ve read them, I can see that this is essentially true.7

The congruence of Austrian economics and complexity theorising is indeed remarkable:

- Austrians see market institutions as ‘spontaneous orders’ that have emerged from the self-organising processes of the economy. What Austrians called ‘spontaneous orders’ correspond to the aggregate patterns that emerge from complex adaptive systems.

- Both see economic systems as dynamic processes involving direct interactions between individuals. The fundamental Austrian principle of subjectivism insists upon an economic analysis that looks at things from the perspective of the individual human being. The corresponding methodological principle in complexity theory is agent-based reasoning.

- Austrians and complexity theorists recognise that agents may be heterogeneous in their objectives and in their behaviour. Both tend to model agents as rule-followers. Although Austrians believe that human beings act purposefully, they may follow rules of thumb to achieve their objectives. In both systems of thought, agents adapt their behaviour as a result of their interaction with one another.

- The Austrian principle of ‘verstehende’ or ‘understanding’ claims that one cannot describe human action without reference to human meanings. In other words, human action cannot be fully explained in terms of physical laws alone. The same point can be expressed in the language of algorithmic information theory.8

Algorithmic information theory also helps us to understand how limited is our capacity to predict the behaviour of complex systems, a favourite theme of Hayek’s. When we are dealing with complex phenomena, says Hayek, we can generate pattern predictions telling us that in certain general conditions, a pattern of a certain kind will appear. On the other hand, specific predictions are normally out of reach.9

Then there is the mutual recognition of ‘bounded rationality’, or the limits to human knowledge and powers of cognition and the computing power of the human brain.
Recognition of these limits is a long-standing principle in the classical tradition. It formed the basis of the arguments deployed by Mises and Hayek against the possibility of effective central planning in the socialist calculation debate of the 1930s.

So it is the theorists of complexity, not the neoclassical school, who are the rightful contemporary inheritors of the classical tradition in economic thought. Some people might suppose from the similarity of their names that the ‘neoclassical school’ is close to the ‘classical’. In fact, they are more nearly exact opposites.10

The implications for the teaching of economics

First of all, courses in economic history and in the history of economic thought should be a required part of the curriculum for every student of economics. The study of economic history, like the study of complex systems, reveals the importance of context in understanding economic behaviour. The study of the development of economic thought helps us to appreciate the weaknesses as well as the strengths of a theory. Macroeconomics should be downgraded, and give way to the study of business cycles.

Secondly, more space should be found for the analysis of dynamic processes at the expense of static theory. The study of the processes of economic growth should be restored to centre stage. This probably means a greater emphasis on nonlinear algebra.

At the same time, the limitations inherent in applying mathematics to economics need to be acknowledged. The importance of the human factor and of human institutions in economic activity means that more attention needs to be given to non-quantitative methods of analysis.

Notes:

1. The ideas in the article are elaborated in more detail in David Simpson (2013), The Rediscovery of Classical Economics, Cheltenham, UK and Northampton, MA, USA: Edward Elgar. David Simpson was Professor of Economics at the University of Strathclyde from 1975 to 1989, and thereafter Economic Adviser to Standard Life.

2. Within the term ‘equilibrium economics’ I include Neoclassical and neo-Keynesian theories, and any others that use the static equilibrium framework of analysis.


It is hard to judge the state of economics at the moment. From one perspective it is booming. In Britain, the number of students choosing economics A-level, flat before 2007, has been growing 10 per cent a year since then. In America, economics sits 5th in a ranking of the most popular undergraduate degrees. Even PhDs, maligned in other subjects, remain popular in economics. As far as the numbers go, economics is on the up.

But at the same time the subject seems in disarray. At the very top of academia debate takes the form of personal attacks between Nobel Laureates, played out in newspaper columns. Away from the limelight, any honest macro researcher has to concede the pre-crisis policy consensus—inflation targets, fiscal rules and freely-floating exchange rates—has been shattered. Much of microeconomics is in better shape, but in staple applications taught to undergraduate level (income inequality, for example) economies are moving in the wrong direction.

The truth is that economics is as confusing as it is popular. I went to the Royal Economic Society’s annual conference in search of some answers.

Learning to use the new tools

Perhaps the most important change in macroeconomics is the way post-crisis monetary policy works. It was fitting then that the conference opened with a session on ‘macroprudential policy’, chaired by Andrew Haldane of the Bank of England. This is central banks’ prized new tool—in reality a suite of balance-sheet levers (rules on capital, liquidity or funding) that are being created to lean against financial cycles.

Hélène Rey provided evidence on how important getting macroprudential policy right in financial upswings is. She pointed out a strong correlation between banks’ asset growth and leverage. The implication is that equity is very sticky: banks do not raise equity to match increased lending. This was not just a problem with unsophisticated small banks, she said, there was leverage pro-cyclicality at the world’s biggest banks too. The implication is that, in boom time, central banks should tighten capital ratios or liquidity requirements to offset this.

Whether the tools will work in the same way in a downswing is far harder to say. And it is that much harder question that today’s central bankers face: how to deploy macroprudential policy in a bust. Andrew Haldane set out the challenge, which he thought was partly psychological. The problem is that the correct response is ‘countercultural’: when recovering from a banking crisis the natural tendency is to tighten standards but the right thing to do might be to loosen.

Martin Wolf and Hélène Rey agreed on what macroprudential policymakers should aim to do. First, they must protect the financial sector from the economy by making sure that banks can withstand a downturn in real activity (i.e. an increase in non-performing loans. But the tool has to protect the economy from the financial sector too, by offsetting credit-fuelled booms.

But while there was agreement on the aims, views were divided on the prospects. Both Franklin Allen and Martin Wolf highlighted potential clashes between central banks’ two levers. Mr Wolf worried that from a macroeconomic perspective rate-setters might want to loosen policy, while from a stability point of view the capital-setters might want to tighten it. In the real world, these conflicts could be big, he thought. It is a problem that may arise in the later half of 2013, given the combination of moribund economies and frothy-looking markets.

The panel seemed to agree that a banking system with more capital would reduce these conflicts (interest rate setters would not have to worry so much about financial stability). But the prospects for a better capitalised system were poor, Wolf thought, since the Basel III ‘risk weightings’ used to work out capital ratios are near useless. A simpler capital system would be better. Hélène Rey proposed a different solution, something she called ‘finer radars’—essentially more granular financial stability warning systems. It seems a good idea, but the implication of fine radars would seem to be finer tools. That could mean varying loan-to-value ratios for different types of mortgage, or different capital weightings for loans in different parts of the country. These decisions would have distributional consequences. They might be tricky for independent central banks to make.

Rules and discretion

As the conference kicked off in earnest it became clear I was facing a huge capacity problem. There were 139 ses-
Some interesting micro studies were motivated by concerns about low productivity. One idea is that low workforce effort and motivation are to blame. Michèle Belot of Edinburgh University presented a test of different employee monitoring schemes. Ms Belot gave student volunteers 780 euro area coins and asked them to separate the coins into their different types (there are 160) in exchange for a payment of €20. The job allowed the researchers to measure various forms of counterproductive behaviour: inaccuracy (the coins could be badly sorted), tardiness (the task could be completed late) and theft. They then tested different configurations of monitoring and rewards. A control group was not supervised at all, being paid immediately regardless of performance. Two other groups were monitored and received performance-related pay. The first monitoring scheme was lax: workers lost just €1 for every ten mistakes. The second was much harsher: the payment was cut by €15 if more than two coins were wrongly identified. The results are interesting, with the middle option-lax monitoring unambiguously the worst: mistakes and lateness rose relative to the control group. Stricter monitoring does offer some benefits. Accuracy improved, with only 16 per cent of volunteers making more than ten mistakes. But workers slowed down, which Ms Belot interpreted as a sort of payback or ‘reciprocity’: the workers punished the monitor by cutting effort along a non-monitored variable (they were not fined for lateness, just inaccuracy).

Other papers also showed slack rules might be a bad idea. Maria Navarro Paniagua of Lancaster University found a link between pub opening hours and employee absence: more employees went sick. If link between pub opening hours and employee absence:

Maria Navarro Paniagua of Lancaster University found a link between pub opening hours and employee absence: more employees went sick. Other papers also showed slack rules might be a bad idea. Michèle Belot of Edinburgh University presented a test of different employee monitoring schemes. Ms Belot gave student volunteers 780 euro area coins and asked them to separate the coins into their different types (there are 160) in exchange for a payment of €20. The job allowed the researchers to measure various forms of counterproductive behaviour: inaccuracy (the coins could be badly sorted), tardiness (the task could be completed late) and theft. They then tested different configurations of monitoring and rewards. A control group was not supervised at all, being paid immediately regardless of performance. Two other groups were monitored and received performance-related pay. The first monitoring scheme was lax: workers lost just €1 for every ten mistakes. The second was much harsher: the payment was cut by €15 if more than two coins were wrongly identified. The results are interesting, with the middle option-lax monitoring unambiguously the worst: mistakes and lateness rose relative to the control group. Stricter monitoring does offer some benefits. Accuracy improved, with only 16 per cent of volunteers making more than ten mistakes. But workers slowed down, which Ms Belot interpreted as a sort of payback or ‘reciprocity’: the workers punished the monitor by cutting effort along a non-monitored variable (they were not fined for lateness, just inaccuracy).

Creating a quarterly panel data set covering hospital admissions in the London boroughs between 1997 and 2009 allowed the impact of a de-criminalisation policy by Lambeth (in 2001-02) to be tested. The idea with the policy, popular in the Netherlands and Portugal, is that de-criminalising ‘softer’ drugs frees up police time, so that resources can be spent on prevention (often education) rather than enforcement. But the case for de-criminalisation is not clear-cut: some argue that lowering the expected cost associated with illegal activity will increase its prevalence, and that soft drugs can for a pathway to harder narcotics.
But more recently, British productivity has ground to a halt. Here the report offers a host of ideas. A couple of themes stand out. The first is the importance of promoting exit as well as entry. Education is one example: Britain’s universities are good, but its schools fall short of the standards in comparator countries. The Commission’s research review found that teacher quality is the single most important factor. But the market for teachers is not a fluid one: qualifying is hard, and it is tricky to get rid of bad teachers. A market with more flexible entry combined with stronger performance assessment and tough sanctions for poor performers would be better. The same principle — simultaneously lowering the barriers to entry and exit — can be applied elsewhere, for example to setting up new schools and winding down poor ones.

The second theme is how to get politics and economics to work well together. At present, Britain’s infrastructure decisions can be slow, and not evidence based. The Commission found that it takes too long to start projects in Britain: a new energy bill took 12 years, for example. A less political decision-making process would help. The group recommends building on the model used by the Bank of England’s MPC or the National Institute for Health and Clinical Excellence. Its proposal — a new ‘Infrastructure Strategy Board’ — would be politically accountable, but have independent experts as decision makers. It would use economic analysis to test for the best policy and take decisions quickly, compensate those made worse off.11

If getting infrastructure right is important in Britain, it is even more so in Sub-Saharan Africa where close to 400,000 people living on less than $1.25 a day. The optimistic view is that the potential gains in Africa are huge, not least since road and rail densities are less than 10 per cent of those in Europe. The idea is that with better transport infrastructure, for example, the cost of trade should fall, leading to regional specialisation and higher trend growth. Alexander Morandi presented a historical test of this idea by looking at railway investment in Ghana.12 Between 1901 and 1903 a first railway was built to connect a port (Sekondi) to an inland mining town (Kumasi). Another followed, connecting Accra to Kumasi by 1923. The port-to-mine investments had another effect: opening up large tracts of fertile land. Fine spatial data on location and production reveals that the railways led to higher cocoa production and export. The impact was huge: around 30 per cent of cocoa production, or 4.5 per cent of GDP. The paper supports the idea that economic activity is path dependent: today, despite the fact that roads are more important, the areas around the railways have the largest manufacturing and service sectors.

With infrastructure so important in Africa, getting the politics right is vital too, as a paper on Kenyan road investment presented by Robin Burgess showed.13 Roads are the single largest public investment item, so the authors used historical road maps to construct a data set on the location of roads between 1963 and 2002. By combining this with data on the ethnicity and local origin of Kenya’s leading politicians, and with census data, the authors were able to test for ‘ethno-favouritism’. They found it: politicians tend to funnel cash for infrastructure back to their own districts, or to districts where their tribe (often Kikuyu, Luos or Kalenjin) is dominant, rather than to areas where the economic gains would be greatest. The effects this ethnic bias are big — favoured regions get close to five times more roads than their predicted share. But it is not all gloomy. Kenya has experienced lots of regime changes — flipping between single party rule and coalitions. And when a multi-party democracy is in charge, leaders do not just favour their own ethnic groups, but direct investment towards other unrepresented groups too. It is a rare call for more coalition politics.

The social network

If a conference is as a platform for making connections then the Royal Holloway provided a great one: a striking campus, generous food, drink and entertainment. On the final morning Matthew Jackson of Stanford University presented a paper on social networks. Since networks — the webs of relationships humans are embedded in — act as information conduits a person’s network determines whether they know things like the location of job opportunities, or about new technology. By transmitting this information, networks influence economic decisions.

But the quality (how quickly and how far) of transmission depends on the connectivity of the network. Mr Jackson showed nodes and link diagrams and outlined how different ‘centrality’ statistics — essentially measures of power or influence — work. Degree centrality is like a popularity measure: a simple sum of the connections a node has. Another measure — eigenvalue centrality — is more like a measure of how powerful your friends are (it takes into account your friends’ centrality, the centrality of their friends, and so on). Jackson proposes a new measure ‘diffusion centrality’: here a node’s influence is measured by how far information travels across a network in a given amount of time after it hits the initial node.

Jackson examined the take up of microfinance in 75 villages in Karnataka, India. The basic puzzle is that adoption varies widely, from 7 per cent in some villages to 44 per cent in others that are otherwise (in terms of demographics, and other explanatory variables) very similar. After mapping the villages’ networks Jackson examined the relative importance of two types of transmission through each of the village networks. They found that basic information passing (i.e. knowing that there are going to be loans available in the village) is much more important than peer influence (taking loans because friends are). Word of mouth is particularly strong when villagers were users: people are ten times more likely to tell their friends about microfinance if they participated in it rather than just knowing about it. In addition, because there was random variation between the connectivity of
the ‘injection points’ — the teachers and shopkeepers that were first told about the loans by the bank providing them — different diffusion models could be tested. The results suggested that injection points matter quite a lot. In finding the best person to tell about a new product or policy it is not enough to find the most ‘popular’ person: simple degree centrality does not explain diffusion well, the eigenvalue and diffusion measures do much better.

Productivity and policy

Nowhere is Britain’s economy odder than in the combination of slumping GDP and strong employment seen in the last five years. The combination—more workers, less output—means a big drop in labour productivity. Claire Crawford of the IFS started the last session of the conference with a detailed review of the data, focusing on wages.14 The paper shows the average wage is down 3.5 per cent since the start of 2008 (by contrast real wages continued to grow in previous recessions). Ms Crawford showed that compositional effects (replacing expensive workers with cheaper ones) do not explain the drop. Rather, unprecedented numbers — 70 per cent — of workers have taken real wage cuts.

This could be due to welfare reforms (rules that tie benefit payments to job search, boosting the potential workforce and keeping wages down) or weaker unions and wage bargaining. It is a view that sat well with Paul Gregg’s presentation. He put low real wage growth into a longer run perspective: it had started pre-crisis. He argued that this would be the norm, with weak wages lasting thing, even when the economy recovers. Both papers were interesting positive analyses, essentially recasting the productivity puzzle as a weak wage puzzle.

But Britain’s productivity puzzle is a question that requires normative analysis too. For example, if it is due to a permanent loss of supply capacity, then demand boosting policies will be self-defeating, leading to higher inflation. John Van Reenen’s paper grasped the policy nettle. Van Reenen started by observing that firms had faced a spike in the cost of capital (despite Bank Rate being low, the rates that firms pay have been high). That had reduced the quantity of investment. The quality of capital allocation was lower too, with many underperforming loss-making firms kept alive by banks willing to forbear on non-performing loans. This meant a big cut in the effective capital per worker. It also implied that there had been no large fall in efficiency (total factor productivity) in this recession compared to earlier severe downturns.

If Van Reenen is right, the argument that expansionary monetary or fiscal policy will simply result in higher inflation is wrong. It means schemes like the Bank of England’s Funding for Lending scheme, which now aims to channel bank credit to the SME sector should potentially be even bigger, and public investment prioritised by HM Treasury. It is an area where more research, papers and debate from the RES’s economists are badly needed.

Changes at the top

Outgoing RES president Richard Blundell gave the presidential address on inequality. He had been warmly introduced by Imran Rasul who thanked Richard for his vigorous support for research, his colleagues and students. The RES presidency passes into safe hands when Charlie Bean takes over. Are there any changes he should make to ensure that the rush of new blood economics is experiencing is well used? Having mulled over all the papers, I was left with three ideas.

Academic economists are working on the right questions, but sometimes duck giving a full answer. I was impressed by the range of studies on current policy problems, many mentioned in this write up. But Manski’s call for a practical economics — prescriptive as well as descriptive — is important. At times, economists slip into writing clever empirical papers and leaving out the policy implication. At its worst, academia can slip into pointless self-referential debates as the famous ‘two Cambridges’ spat shows. Of course, papers developing technical methods are vital. But perhaps an explicit bias towards using theory and econometrics to practical ends wherever possible is justified. It is the policy questions that attract students to economics in the first place, and it is the policymaker’s question to the professional economist — ‘So what?’ — that matters.

Finding the right answers requires joint work with non-economists. This is a common observation, as ‘interdisciplinary’ papers become more common. Matthew Jackson showed why it is an important development: he worked with computer scientists and specialists in graph theory to crack social networks. Elsewhere, Andrew Haldane and Robert May have combined finance and biology to understand financial networks,15 Hal Varian is combining microeconomics with machine learning.16 But these are the exceptions: most economists still operate in silos. And the structures in economics (including the conferences) often don’t help. I was sad to see that economic history was confined to a separate conference, in a different location, a few days after the RES. Capacity constraints may explain this, but some innovation is needed to bring researchers together.

Once economic research is complete and findings written up, getting the message out is a separate task. It requires yet more work, different skills and infrastructure. I’m not sure that European economics departments realise this. It is a simple fact that American departments are far quicker at dealing with enquiries about their findings and setting up meetings with their academics. Some European departments make an effort to be contactable-Warwick provides a useful ‘experts directory’. But getting through to others can be impossible. For those that are too busy to talk, shorter opinion pieces based on journal-length papers are helpful, as are portals like VoxEU. But there
are still very few good European academic blogs. Anything that could change any of this would be welcome.

These are practical problems. They are simple to rectify. The RES conference was fascinating. It is a great time to be an economist.

Notes:


2. Mr Haldane explained that this is why the Bank of England had recently set out a four-pronged loosening package. This includes bank funding (extended term liquidity), lending (the Funding for Lending scheme), liquidity (lower liquidity requirements) and capital (zero capital charges on lending to support the Funding for Lending scheme).


8. This is something some British policy institutions do already: the Bank of England uses interval forecasts, and HM Treasury uses upper and lower bounds for the impact of policies.

9. The Commission’s members were Philippe Aghion, Tim Besley, John Browne, Francesco Caselli, Richard Lambert, Rachel Lomax, Chris Pissarides, Nick Stern and John Van Reenen.


Royal Economic Society YouTube channel launches

The 2013 RES conference was a great success. One innovation this year was an invitation to Bob Denham of Econ Films (www.econfilms.tv) to make some short videos of highlights of the event, including our plenary lecturers and the winners of the 2012 Economic Journal prizes.

These videos are launched this week on the RES YouTube channel: http://www.youtube.com/user/RoyalEconomicSociety

Decisions in an Uncertain World

This year’s Sargan lecture given by Charles Manski of Northwestern University.

http://youtu.be/yQqQTmu7n8

Culture and Women in Work

This year’s Economic Journal lecture, given by Raquel Fernandez of New York University.

http://youtu.be/HH3mcV6rMo

Inequality and the Family

The RES Presidential Address, given by Richard Blundell of University College London.

http://youtu.be/ZAu0ARv76dQ

Why are there Cities?

Wen-Tai Hsu was the winner of the Austin Robinson Prize for the best Economic Journal paper in 2012 by an author within five years of receiving their PhD.

http://youtu.be/bqYfP3cpnBE

Does Aid Cause Growth?

Michael Clemens was the winner of the RES Prize for the best Economic Journal paper in 2012.

http://youtu.be/yV9jDgQSA0

Links to other RES videos, including full lectures from recent annual conferences and in the RES series of annual public lectures and policy lectures, will be made available on the RES website and via Twitter:

The EJ/RES Twitter feed is @EJ_RES

The RES media consultant Romesh Vaitilingam’s Twitter feed is @econromesh

Comments on this initiative, for the Newsletter, should be sent to: Peter.Howells@uwe.ac.uk
The RES
Women’s Committee Survey 2012

This report on the recent survey was prepared by Karen Mumford.

This report covers the ninth survey of gender balance in academic employment in economics in Britain in a series started in 1996 by the Royal Economic Society Women’s Committee and repeated bi-annually thereafter. The web pages of ninety two CHUDE (Conference of Heads of University Departments of Economics) departments and fifteen leading research institutes were surveyed in November 2012 by the Women’s Committee. The survey collected information on academic staff (full-time and part-time) by grade of employment, gender, and research discipline. It also collects information on promotions, new hires and job leavers. The survey entries were then emailed to respective institutions for verification in January 2013. The overall verified survey response rate from the 107 institutions is reasonable at 64 per cent (67 per cent or 62 responses from the 92 CHUDE departments, and 47 per cent or 7 responses from the 15 research institutes).

Summary of the main findings

• women constitute some 24 per cent of all academic staff in economics;
• women are under-represented among professors;
• the proportion of women is substantially higher in research jobs than in standard academic jobs;
• close to 10 per cent of males and females have part-time employment in the sector, however, these males are more often found in senior positions than the females;
• the most popular research discipline for both male and female economists is microeconomics, followed by macroeconomics and monetary policy.

It is also of interest to compare the results from the 2012 survey with that from 2010. Balanced sample comparison is less than perfect, nevertheless, the overall impression is:

• the proportion of women among academic economists increased from 21.9 to 23.9 per cent;
• the representation of women in each grade rank showed very little change;
• female professors are more commonly promoted internally rather than hired;
• job separations are rare for senior females;
• changes that are observed over the two years are not generally significantly different from zero making it hard to make any definite statement about short-term movements.

Comparing the 2012 sample results to those from earlier surveys:

• In aggregate, the proportion of the workforce that is female has increased substantially over the sixteen years of surveying (in 1996 women made up 17.5 per cent of the workforce, by 2012 this has risen to 23.9 per cent);
• the numbers of professors amongst all staff has more than doubled over the time period (from 14.2 per cent of all staff to 31.7 per cent);
• women are roughly twice as common in the standard academic grades in 2012 than they were in 1996 (in 1996 women made up approximately 15 per cent of the Lecturers, 10 per cent of the readers/senior lecturers and 4 per cent of the professors; in 2012 women make up some 30 per cent of the lecturers, 24 per cent of the readers/senior lecturers and 11 per cent of the professors). Amongst professors, however, these relative gains appear to be tapering off from 2008.

Table 1 reports the numbers of economists employed in academia in the UK from the total verified web survey returns, including both CHUDE departments and research groups.

<table>
<thead>
<tr>
<th>Primary employment function</th>
<th>Female</th>
<th>Male</th>
<th>Total</th>
<th>% female</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>All staff: full-time</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Professors</td>
<td>54</td>
<td>418</td>
<td>472</td>
<td>11.4%</td>
</tr>
<tr>
<td>Readers</td>
<td>30</td>
<td>131</td>
<td>161</td>
<td>18.6%</td>
</tr>
<tr>
<td>Senior lecturers</td>
<td>81</td>
<td>197</td>
<td>278</td>
<td>29.1%</td>
</tr>
<tr>
<td>Lecturers-permanent</td>
<td>160</td>
<td>392</td>
<td>552</td>
<td>29.0%</td>
</tr>
<tr>
<td>Lecturers-fixed term</td>
<td>7</td>
<td>19</td>
<td>26</td>
<td>26.9%</td>
</tr>
<tr>
<td>Senior researchers</td>
<td>29</td>
<td>54</td>
<td>83</td>
<td>34.9%</td>
</tr>
<tr>
<td>Researchers-permanent</td>
<td>24</td>
<td>25</td>
<td>49</td>
<td>49.0%</td>
</tr>
<tr>
<td>Researchers-fixed term</td>
<td>19</td>
<td>44</td>
<td>63</td>
<td>32.0%</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>404</td>
<td>1280</td>
<td>1684</td>
<td>24.0%</td>
</tr>
<tr>
<td><strong>All staff: part-time</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Professors</td>
<td>5</td>
<td>59</td>
<td>64</td>
<td>7.8%</td>
</tr>
<tr>
<td>Readers</td>
<td>1</td>
<td>3</td>
<td>4</td>
<td>25.0%</td>
</tr>
<tr>
<td>Senior lecturers</td>
<td>1</td>
<td>14</td>
<td>15</td>
<td>6.7%</td>
</tr>
<tr>
<td>Lecturers-permanent</td>
<td>4</td>
<td>9</td>
<td>13</td>
<td>30.8%</td>
</tr>
<tr>
<td>Lecturers-fixed term</td>
<td>6</td>
<td>13</td>
<td>19</td>
<td>31.6%</td>
</tr>
<tr>
<td>Senior researchers</td>
<td>20</td>
<td>38</td>
<td>58</td>
<td>34.5%</td>
</tr>
<tr>
<td>Researchers-permanent</td>
<td>0</td>
<td></td>
<td></td>
<td>0%</td>
</tr>
<tr>
<td>Researchers-fixed term</td>
<td>8</td>
<td>12</td>
<td>20</td>
<td>40.0%</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>45</td>
<td>148</td>
<td>193</td>
<td>23.3%</td>
</tr>
<tr>
<td><strong>Grand total</strong></td>
<td>459</td>
<td>1428</td>
<td>1877</td>
<td>23.9%</td>
</tr>
</tbody>
</table>

Source: RES Women’s Committee Survey 2012.

www.res.org.uk/view/resNewsletter.html
In aggregate, information is available for 1,877 people who work as economists in academic appointments in the UK, 449 (or 23.9 per cent) of these are women. The vast majority of these economists (85 per cent) are working in standard academic appointments (i.e. mixed teaching and research jobs as opposed to research-only appointments); this figure is lower for women than for men (77.7 per cent and 87.9 per cent, respectively). If the research-only categories are excluded from the calculation, women make up 21.8 per cent of the standard full-time academic workforce (or 349 out of 1,604 employees). Women are substantially more likely to be employed at lower academic grade levels, as is clearly seen in the final column of Table 1. Amongst full-time staff, the proportion female decreases from 29 per cent of the permanent lecturers, to 18.6 per cent of the readers and 11.4 per cent of the professors.

**Table 2. Main research discipline, by gender and RAE score in standard academic appointments (responding sample, 2012).**

<table>
<thead>
<tr>
<th>JEL research discipline</th>
<th>Female</th>
<th>Male</th>
<th>Total</th>
<th>% Male</th>
<th>% Female</th>
<th>% Total</th>
<th>% Male</th>
<th>% Female</th>
<th>% Male in RAE3</th>
</tr>
</thead>
<tbody>
<tr>
<td>A - General Economics and Teaching</td>
<td>11</td>
<td>27</td>
<td>38</td>
<td>2.3%</td>
<td>2.1%</td>
<td>1.0%</td>
<td>10.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B - History of Economic Thought, Methodology, and Historiography</td>
<td>3</td>
<td>21</td>
<td>24</td>
<td>1.4%</td>
<td>0.8%</td>
<td>1.0%</td>
<td>8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C - Mathematical and Quantitative Methods</td>
<td>35</td>
<td>189</td>
<td>224</td>
<td>13.3%</td>
<td>14.4%</td>
<td>9.3%</td>
<td>4.2%</td>
<td>40.6%</td>
<td></td>
</tr>
<tr>
<td>D - Microeconomics</td>
<td>56</td>
<td>177</td>
<td>233</td>
<td>13.9%</td>
<td>13.5%</td>
<td>10.5%</td>
<td>10.0%</td>
<td>44.3%</td>
<td></td>
</tr>
<tr>
<td>E - Macroeconomics and Monetary Economics</td>
<td>42</td>
<td>187</td>
<td>229</td>
<td>13.8%</td>
<td>14.3%</td>
<td>11.2%</td>
<td>13.0%</td>
<td>33.8%</td>
<td></td>
</tr>
<tr>
<td>F - International Economics</td>
<td>28</td>
<td>77</td>
<td>103</td>
<td>6.1%</td>
<td>5.9%</td>
<td>6.9%</td>
<td>5.8%</td>
<td>30.1%</td>
<td></td>
</tr>
<tr>
<td>G - Finance</td>
<td>39</td>
<td>118</td>
<td>157</td>
<td>9.3%</td>
<td>9.0%</td>
<td>10.4%</td>
<td>8.3%</td>
<td>25.6%</td>
<td></td>
</tr>
<tr>
<td>H - Public Economics</td>
<td>9</td>
<td>39</td>
<td>48</td>
<td>2.8%</td>
<td>2.0%</td>
<td>2.4%</td>
<td>3.3%</td>
<td>27.5%</td>
<td></td>
</tr>
<tr>
<td>I - Health, Education, and Welfare</td>
<td>30</td>
<td>45</td>
<td>75</td>
<td>4.4%</td>
<td>3.4%</td>
<td>8.0%</td>
<td>4.8%</td>
<td>22.7%</td>
<td></td>
</tr>
<tr>
<td>J - Labor and Demographic Economics</td>
<td>31</td>
<td>97</td>
<td>128</td>
<td>7.8%</td>
<td>7.4%</td>
<td>8.3%</td>
<td>9.9%</td>
<td>30.3%</td>
<td></td>
</tr>
<tr>
<td>K - Law and Economics</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>0.2%</td>
<td>0.15%</td>
<td>0.3%</td>
<td>0.00%</td>
<td>66.7%</td>
<td></td>
</tr>
<tr>
<td>L - Industrial Organization</td>
<td>18</td>
<td>87</td>
<td>105</td>
<td>6.2%</td>
<td>6.6%</td>
<td>4.8%</td>
<td>6.8%</td>
<td>22.4%</td>
<td></td>
</tr>
<tr>
<td>M - Business Administration and Business Economics, Marketing; Accounting</td>
<td>10</td>
<td>24</td>
<td>34</td>
<td>2.0%</td>
<td>1.8%</td>
<td>2.7%</td>
<td>1.7%</td>
<td>2.9%</td>
<td></td>
</tr>
<tr>
<td>N - Economic History</td>
<td>9</td>
<td>24</td>
<td>33</td>
<td>2.0%</td>
<td>1.6%</td>
<td>2.4%</td>
<td>1.7%</td>
<td>7.8%</td>
<td></td>
</tr>
<tr>
<td>O - Economic Development, Technological Change, and Growth</td>
<td>27</td>
<td>95</td>
<td>122</td>
<td>7.2%</td>
<td>7.2%</td>
<td>7.2%</td>
<td>7.4%</td>
<td>44.6%</td>
<td></td>
</tr>
<tr>
<td>P - Economic Systems</td>
<td>5</td>
<td>23</td>
<td>28</td>
<td>1.7%</td>
<td>1.8%</td>
<td>1.8%</td>
<td>1.8%</td>
<td>28.5%</td>
<td></td>
</tr>
<tr>
<td>Q - Agricultural and Natural Resource Economics, Environmental and Ecological</td>
<td>11</td>
<td>50</td>
<td>61</td>
<td>3.6%</td>
<td>3.8%</td>
<td>2.8%</td>
<td>3.3%</td>
<td>40.1%</td>
<td></td>
</tr>
<tr>
<td>R - Urban, Rural, Regional, Real Estate, and Transportation Economics</td>
<td>19</td>
<td>29</td>
<td>48</td>
<td>2.3%</td>
<td>2.2%</td>
<td>2.5%</td>
<td>2.5%</td>
<td>28.2%</td>
<td></td>
</tr>
<tr>
<td>S - Other Special Topics</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>375</td>
<td>1311</td>
<td>1686</td>
<td>100%</td>
<td>77.8%</td>
<td>22.2%</td>
<td>517</td>
<td>34.4%</td>
<td></td>
</tr>
</tbody>
</table>

Source: RES Women’s Committee Survey 2012.

**Part time employment**

The number of men working part-time is considerably larger than the number of women (see the lower panel of Table 1); although, their numbers relative to the total pool of male employees are similar with some 10 per cent of female and male economists in academia working part-time. Men working part-time are more likely to have a standard academic job whereas part time employment is more common for women in research only positions. (Of the economists in standard academic jobs, 4.9 per cent of the women work part-time whilst 7.8 per cent of the males do.) Women are particularly prevalent amongst the researchers and lecturers working part time.

**Considering a role model effect**

Departments with female professors may find it easier to recruit, promote and/or retain other women (a role model effect). Departments with a female professor were found to have an average of 15 per cent of female staff in non-professorial job ranks, in departments with no female professor this proportion was 22 per cent. Additionally, departments with at least one female professor are larger in size, as measured by the number of staff below professor (21 relative to 14). Taken in combination, the evidence presented in the report does not provide **prima facie** support for the role model hypothesis (a similar conclusion was reached for the 2006, 2008 and 2010 surveys).

**Analysis by RAE results**

It may be argued that there is a relationship between the presentation of women in a department and the department’s success in the Research Assessment Exercise (RAE). This is another issue that has been explored in the previous surveys and reports, without convincing results supporting the hypothesis. Whilst the full report provides more extensive analysis of this issue, on average, departments with lower RAE scores are found to have relatively more posts held by women. The relative number of female professors and readers is, however, larger in the higher RAE scoring departments.

**Research discipline**

For the first time, information was harvested on the research discipline of academic staff from the web pages (by Jonny Roman and Malgorzata Mitka) and was sent for verification with the survey returns. Table 2 presents results for economists in standard academic appointments (full time and part time) in CHUDE departments from the verified survey (additional information including discipline breakdown by rank and within research institutions is provided in the full report). Column 4 shows that the most popular research disciplines are unsurprisingly the core areas of microeconomics (13.9 per cent of all staff); macroeconomics and monetary economics (13.6 per cent); and mathematical and quantitative methods (13.3 per cent).
These are also the research areas which are the most common amongst the professors (see column 7 of Table 2), although the ordering is slightly different with more professors working in mathematical and quantitative methods (14.5 per cent); followed by macro and monetary economics (13.5 per cent); and then microeconomics (13 per cent). The distribution of research interests amongst professors is similar to that across the total staff (comparing columns 4 and 7) with the possible exceptions of labour economics (more popular amongst professors) and general economics and teaching (less popular).

Flows into and out of standard academic positions in the previous year
Changes in the stock of individuals in any job rank due to inflows from new hires, job separations (resignations and retirements), and promotions (within and across departments) can also be addressed. As the web based survey is now tracking individuals we can begin to calculate movements more accurately (for example, tracking those who left one department but were hired into another, and if they received a promotion in this move). In the past, our data on promotions only included promotions that were internal to departments and total staff movements were essentially gross rather than net.

Table 3 presents staff movements over the 2011/12 academic year (between Novembers 2011 and 2012), these were sent with the 2012 web survey results to institutions for verification. Columns 1 to 4 are those promotions internal to the department, columns 5 to 8 are those promoted from other UK departments. These numbers of promotions are obviously small so we should be cautious about how valid the implications of these flows for changes in relative employment stocks are. Nevertheless, comparing columns 4 and 8 (showing the percentage female by rank amongst the flows) with columns 21 (showing the percentage females amongst the stock by rank), suggests very small gains were made in the 2011/12 time period via promotions, especially amongst professors and readers.

Panel two of Table 3 provides information on hiring over the 12 month period. Columns 9 to 12 presents information on new staff hired in the last year (in the 12 months prior to the survey date), this is staff entering the sector. Columns 13 to 16 are for hires across UK departments. We can see that there were 50 professors hired from outside of the UK sector (column 11) in the 2011/12 academic year, and a further 15 professors hired from other UK departments (column 15). With the exception of senior lecturers (where females are less likely to move across departments), there is little gender difference across ranks for those being hired from other departments or from outside the sector comparing columns 12 and 16). The representation of women amongst the hiring inflow will do little to improve the overall representation of women in the stock by rank (column 21); with a very slight increase in the percentage of professors who are female but larger fall amongst the readers.

The third flow affecting the stock of academic economists is, of course, leavers. In aggregate, women make up a similar proportion of these separations as they do of the total pool of academic economists (24.9 per cent relative to 23.9 per cent) and such separations are rare for the most senior women (Professors and Senior Researchers). The most common destination employment for the job leavers is to an ‘unknown job’ (138 out of 361 leavers or 38 per cent of all job leavers) followed by to another academic appointment (36 per cent) implying considerable churning within the sector, with non-employment taking up a further 20 per cent. The 2012 survey also asks departments about the reasons for these separations. Women are slightly more likely than men to leave for a promotion and they are considerably more likely to be left without a job because they reached the end of their contract. Drawing together the information on inflows, separations and promotions allows us to consider the major sources of the

www.res.org.uk/view/resNewsletter.html
aggregate employment shifts in the sector.

**Staff changes over time.**

Figure 1 plots the percentage of women amongst the total academic economics workforce (including research grades) and amongst the standard academic workforce for each of the RES Women’s Committee surveys using unbalanced samples (reflecting the fullest sample information for each of the surveys). An overall growth trend in the percentage of women in the workforce can clearly be seen in Figure 1 (with or without the inclusion of the research grades).

The percentage of the women working in full-time standard academics jobs in CHUDE departments by rank (using unbalanced samples from the bicentennial surveys) is shown in Figure 2. We can clearly see the substantial improvement in the relative position of women over the time period. In 1996, approximately 5 per cent of the professors were female, 10 per cent of the senior lecturer/readers and 15 per cent of the lecturers. By 2012, these ratios had essentially doubled. However, Figure 2 also reveals only a very small change in the representation of women amongst the professors in recent years (especially post 2008).

The percentage of full-time female (male) UK academics in CHUDE departments by rank over time is plotted in Figure 3 (4); again using the unbalanced samples from each of the biennial surveys. In 1996, roughly one in every two males was a lecturer and one in four males a professor or senior lecturer/reader. By 2012 men had similar proportions in each of these three academic rank groupings. The opening position for women was vastly different with almost three quarters of female staff members being a lecturer and only one in sixteen a professor. These gaps have closed substantially for women over the years. Nevertheless, women finished the time period much less favorably (than did the males) with a roughly one in two chance of being a lecturer, one in three a senior lecturer/reader and only one in six of being a professor.

It is not obvious how the relative position of women in UK academia will change in the next few years. Figure 4 clearly reveals that the pool of men in each of the grade ranks is not in steady state over the time period. Consider the professors; it is exceptionally rare for Professors to be demoted and so they typically maintain this job rank until retirement. Increasing the pool of male professors (these have more than doubled in numbers between 1996 and 2012) will obviously result in a fall in the proportion of the job rank female, ceteris paribus. The number of female Professors has increased almost six fold over the time period but they are still only making up some 11 per cent of the total number of professors. The major source of growth in the pool of professors in the last two decades is due to higher inflows. Changing the retirement laws so that the exit rate (into retirement) falls would be expected to raise the average duration of those in the professorial pool.

....continued on p.
Degree Class Matters

A new study by Andy Feng and Georg Graetz, research students at the Centre for Economic Performance, London School of Economics, finds that university degree classification matters for initial job outcomes.1

The degree classification is a system of categorizing performance on university degree programmes. The highest distinction for an undergraduate is the First Class honours followed by the Upper Second and Lower Second degrees (we do not consider Third Class and below in this study). A sizeable fraction of employers in the UK report using the classification system in hiring decisions and universities often use degree class to screen applicants to postgraduate programmes. However, it is not obvious that the classification system is useful if degree transcripts provide more accurate information.

Using survey and administrative data from the London School of Economics and Political Science (LSE), we find significant effects of degree class on initial labour market outcomes (six months after graduation). An Upper Second earns 7 per cent higher wages compared to a Lower Second while a First Class earns 3 per cent higher wages compared to an Upper Second.

Identifying these effects is complicated by the fact that a naïve comparison of, say, students who received a First Class against students who received an Upper Second could be biased because the former have higher ability or worked harder for the degree. To isolate the pure ‘sheepskin effect’ we employ a regression discontinuity design. Essentially we mimic a randomized experiment by comparing two similar students one of whom was lucky on a critical exam and scored 70 (thereby receiving a First Class), while the unlucky student just missed by scoring 69 (thereby receiving an Upper Second). We attribute the difference in their initial labour market outcomes to the effects of degree class alone.

LSE degree classification rules

Undergraduates in the LSE take nine courses over three years. Every course is graded out of 100 marks and fixed thresholds are used to map the marks to degree class. For example, a First Class honours requires either 5 marks of 70 or 4 marks of 70 with aggregate marks of at least 590. This mapping applies across all departments and years (Table 1).

These rules mean that the fourth highest mark for any student is critical in determining the eventual degree class. A student whose fourth highest mark is 70 (60) is much more likely to receive a First Class (Upper Second), everything else equal. This can be seen by plotting a graph of the fraction of students who receive a given degree on the y-axis against the marks on the fourth highest mark on the x-axis (see Figure 1). There is a clear jump in the probability of receiving a First Class at the 70-mark threshold. A similar story is seen for the Upper Second at the 60-mark threshold.

This jump in degree class ‘treatment’ is ideal for a regression discontinuity (RD) design where the fourth highest mark plays the role of the assignment variable. We argue that whether a student receives a 70 or 69 on the critical exam is down to random luck and this generates randomized assignment to the First Class or Upper Second ‘treatment’. In practice we employ a fuzzy RD where a dummy variable indicating the crossing of the relevant marks threshold is an instrument for the degree class.
Data and empirical strategy
We use two datasets. First, LSE student records gives us (fully anonymised) administrative data on age, gender, nationality and country of domicile information. It also includes course history and eventual degree class. The course history information allows us to find the critical fourth highest exam for each student.

The second dataset is the Destination of Leavers from Higher Education Survey (DLHE) that reports employment circumstances of students six months after graduation. From the DLHE we construct the relevant labour market outcome variables. We have a dummy variable for full-time employment and two-digit SIC industry codes. To construct our wage measure we merge Labour Force Survey (LFS) data at the industry by year by gender level into the DLHE survey. One concern is that the industry average wage is not representative of the earnings facing undergraduates. To address this we also calculate mean log wages conditional on university education and various experience levels.

Our interpretation of the wage outcomes is that these measure the industry’s ‘rank’ compared to other industries. This is a relevant measure because students form expectations of future wages on the basis of industry differences. The unconditional and conditional (on education and experience) industry wage measures are highly correlated and our results are comparable across different outcomes.

Main results
Our first result compares the returns to receiving a First Class against an Upper Second degree. A First Class is ‘worth’ roughly 3 per cent in starting wages which translates into £1,000 per annum. An Upper Second is worth more — 7 per cent in starting wages which is roughly £2,040. When we look at men and women separately, men receive a statistically significant 6 per cent return to a First Class compared with a statistically insignificant — 2 per cent for women. For the Upper Second, men receive 8 per cent while women receive 5 per cent — however both effects are statistically insignificant.

These results are robust to a battery of specification checks. The combination of quasi-experimental variation and robustness of results strongly suggests that degree grades matter for labour market outcomes.

However there are important caveats. First, this is a highly selected sample because LSE is a specialized institution that consistently ranks within the top of the national distribution. Thus, the external validity of our results could be an issue. Second, we do not have data on students’ work experience during the course of their studies and this may affect their future wages regardless of degree class. Third, we cannot follow these graduates to see if the initial wage differences persist or fade. This is important because lifetime earnings are more relevant in welfare calculations.

Future work
We propose four areas for future work. First, replicating this methodology in other institutions to test the external validity of our results. Second, more work can be done to understand how employers make hiring decisions. It appears that informational frictions exist and employers use degree class in their decisions but it is less clear how exactly this is done. Third, on the supply side an interesting area of research would be to understand how students perceive the returns to degrees. To the extent that degree majors vary in their distribution of awards, the expected returns to degree class may influence programme choice. Finally, it would be interesting to see how these initial differences change over the careers of graduates.

Broader discussion and conclusion
Our results show that degree class matters for initial job outcomes. These results speak to the broader policy discussion regarding whether the UK should move to alternative award systems like the grade point average (GPA) system that is adopted in the US. To the extent that our findings show that degree class results in sharp differences in outcomes, a more graduated system of awards like the GPA may be attractive. On the other hand, if full transcripts (which provide greater detail on student achievement) are already available to employers, it is not clear that moving to any other system of awards would lead to an improvement. In the end, we think that more work in this area needs to be done to understand the process involved in hiring workers and in understanding the informational frictions that exist in the graduate labour market and hope that our contribution provides some insight into this under-studied field.

Notes:
1. A fuller version of this paper can be downloaded at: http://cep.lse.ac.uk/_new/publications/abstract.asp?index=4246
Quantitative Easing and the Quantity Theory of Credit

When the effects of QE continue to be debated, Richard Werner explains the origin of the term (and some misconceptions surrounding it).

‘Quantitative easing’ (QE), has received much publicity in the past five years. However, its effectiveness remains disputed. Moreover, there are different views about what constitutes QE. It is the purpose of this contribution to review the origins and varying applications of QE, using and thereby explaining the macroeconomic model that gave rise to the concept. Called the ‘Quantity Theory of Credit’, this is arguably the simplest empirically-grounded model that incorporates the key macroeconomic role of the banking sector — a task belatedly recognised as crucial by researchers in the aftermath of the 2008 crisis.

1. The Quantity Theory of Credit after 20 years
I presented the Quantity Theory of Credit in April 1993, at the RES Annual Conference at York. The central argument is a dichotomous equation of exchange distinguishing between money used for GDP-transactions (determining nominal GDP) and money used for non-GDP transactions (determining the value of asset transactions). Money is not defined as bank deposits or other aggregates of private sector savings. Banks are recognised as not being financial intermediaries that lend existing money, but creators of new money through the process of lending. Growth requires increased transactions that are part of GDP, which in turn requires a larger amount of money to be used for such transactions. The amount of money used for transactions can only rise if banks create more credit. Banks newly invent the money that they lend by pretending that the borrowers have deposited it and thus crediting their accounts without transferring any money from elsewhere. This expands the money supply and it suggests that the accurate way to measure this money is by bank credit. It can be disaggregated into credit for GDP transactions ($C_R$) and credit for non-GDP (i.e. asset) transactions ($C_F$). The former drives nominal GDP and the latter asset transaction values. Under further conditions, they determine consumer and asset prices:

$$ C = C_R + C_F $$

$$ \Delta (C_R V_X) = \Delta (P_R Y) $$

$$ \Delta (C_F V_F) = \Delta (P_F Q_F) $$

Another feature of the model is that it does not assume perfect information — a fundamental condition for market clearing. As a result, markets cannot be expected to be in equilibrium. Then the ‘short-side principle’ applies. Given steady demand for credit and rationing by banks (due to the issues identified in Stiglitz and Weiss, 1981), the supply of credit is the short side.

This simple model explains a number of empirical anomalies, including the often reported lack of empirical signifi-
the banks to clean up their balance sheets, that the successful system of ‘guidance’ of bank credit should be re-introduced, that capital adequacy rules should be loosened not tightened, and that the government could kick-start bank credit creation and thus trigger a rapid recovery by stopping the issuance of bonds and instead entering into loan contracts with the commercial banks (e.g. Werner, 1998).

My articles caused consternation among economists of diverging schools of thought. The Keynesians, such as Richard Koo, disputed that further monetary stimulation of any kind was needed and that fiscal policy on its own was going to be ineffective. The government listened to Mr Koo, and Japan continued to expand its national debt in massive spending programmes, while credit growth continued to stagnate. So did the economy. Monetarists, such as Peter Morgan or Alan Meltzer, likewise argued that a lack of bank credit was not a problem and ‘quantitative easing’ in the form of credit creation was not needed. Instead, they argued, an expansion in bank reserves at the central bank would do the job. But massive reserve expansions failed to make any impact and due to stagnating bank credit, economic growth remained well below its potential for most of the following decade and a half. Supply-side economists and proponents of real business cycle models argued that a lack of bank credit could not be the problem — after all, their models did not include banks! I warned during the 1990s that fiscal expansion funded by bond issuance was likely to crowd out private demand, that the expansion of bank reserves would have no impact as idle reserves do not translate into bank credit growth when banks are risk-averse, and that structural reform, if able to increase productivity (which is doubtful) would merely boost potential growth, while Japan’s economy had remained in recession due to a lack of demand.

While my recommendations were not heeded, the label I used caught on. Critics from both the Keynesian and monetarist camps began to redefine QE as an expansion in bank reserves — despite the fact that I had been arguing that such a policy would not work. A new name for an old policy was only likely to cause confusion.

Initially, the Bank of Japan refused to adopt this distorted definition of quantitative easing. It relented in 2002-3, adopting the expression QE to refer to bank reserve expansions and, despite arguing frequently and correctly that such a policy would not work, adopted it for five years, starting in March 2001. Bank reserve targeting had been tried by the Bank of England and the Federal Reserve in the early 1980s but was abandoned as a failure. The puzzle was why the Bank of Japan, despite seconding me in my argument that reserve expansion would not work, chose to adopt it, while giving it the label of a policy I argued would be successful. It certainly had the result of tarnishing the idea of QE. In 2006 the Bank of Japan announced that it abandoned ‘QE’ as, predictably, it had not been successful.

3. QE, QTC and how to end post-crisis recessions

This did not stop the Bank of England from adopting a similar policy in March 2009, with the variation that bond purchases would be made from the non-bank private sector (one of the conditions I had mentioned in the 1990s for central bank bond purchases). Better still would have been to boost bank credit by directing any central bank asset purchases to non-performing bank assets. As a result, UK-style QE also failed as bank credit growth continued to stagnate (Lyonnet and Werner, 2012). Meanwhile, Ben Bernanke, who participated in the debates on Japanese policy in the 1990s, seemed to have listened more carefully: In his January 2009 speech at the LSE he insisted that the Fed was not engaging in Bank of Japan-style QE, since reserve expansion would not work, and instead was pursuing a policy more directly targeting credit, which he called ‘credit easing’. This seemed to take us full circle to the original meaning of QE. And the US purchases of non-performing bank assets did seem to do the job of allowing banks to create credit again (with credit growth reaching over 5 per cent by early 2013, and the US economy recovering).

Meanwhile, the Bank of England and HM Treasury began to recognise that policies more directly targeting bank credit creation are more appropriate: the UK ‘Funding for Lending Scheme’ (FLS) cites a key concept from the Quantity Theory of Credit, namely that a successful quantitative monetary stimulation policy needs to be ‘designed to incentivise banks and building societies to boost their lending to UK households and private non-financial corporations — the “real economy”’ or \( C_R \) of equation (2). Further, for FLS the authorities had adopted almost the same definition of bank credit for the real economy that had been presented to the Bank of England in 2011, when the QTC was applied to the UK (published as Lyonnet and Werner, 2012). In this paper we showed that the Bank of England’s ‘quantitative easing’ had failed to make an impact on bank credit creation, although bank credit creation for GDP transactions remained the main determinant of nominal GDP growth. Unfortunately, it is not clear that FLS is going to work. Direct targeting of bank credit by the central bank, relaxation not tightening of capital adequacy rules and, most of all, switching the funding method of the public sector borrowing from bond issuance to borrowing from banks, remain surer bets.

The same applies to Europe. Nominal GDP contractions, record unemployment and widespread corporate bankruptcies in Ireland, Portugal, Spain and Greece are driven by credit contractions. Governments can end this by adopting true quantitative easing, easiest in the form of stopping bond issuance and instead borrowing from the banks in their countries. This should be particularly attractive since bond issuance yields have been pushed far beyond the prime lending rate for bank credit. But perhaps it needs to take Japanese leaders - the well-intentioned new prime minister and central bank governor - to finally show the world how true quantitative easing, suggested twenty years ago, can be made to work. For this, however, the continued emphasis on bank reserves needs to be ditched in favour of direct targeting of bank credit.

www.res.org.uk/view/resNewsletter.html
Notes:
1. Richard A. Werner, D.Phil. (Oxon), is Professor in International Banking at the University of Southampton Management School and Director of its Centre for Banking, Finance and Sustainable Development. He is also a member of the ECB Shadow Council and advises institutional investors. Email: werner@soton.ac.uk

2. Werner (1992). This was reviewed favourably by the Economist (Economics Focus, 19 June 1993) and published later as Werner (1997c). I toned down the title from 'quantity theory' to 'quantity theorem' in the bashfulness of my youth - possibly influenced by harsh comments from referees who hardly seemed ready for monetary models based on bank credit creation or the warnings I had been sounding since 1991 about the imminent collapse of the Japanese banking system (Werner, 1991).


5. See the Bank of England's Churm et al. (2012).

References:


Women’s Committee Survey ...continued from p17

As we might reasonably expect more elder male cohorts than female amongst the Professors, this may lead to lower relative numbers of women amongst the Professors in the next few years. As the Women’s Committee continues with its annual individual based web surveys, we will be able to monitor both inflow and outflow rates for each grade rank enabling us to more insightfully address concerns including why the relative proportion of female Professors has shown little change since 2008.

Notes:
1. Chair of the Women’s Committee (and Professor at the University of York).

A full version of the report can be found on the Women’s Committee webpages:

RES notice to members

Updating membership details

The Society is increasingly using online facilities via its website to contact and publicise its activities to members. You can now update membership details directly, including your email address by registering on the website at www.res.org.uk.

- Members joining or renewing online are automatically registered with login access to the RES website. Login is based on the email address and password you supplied in your membership application.

- Members who have joined by post will need to register online at www.res.org.uk.

Could we ask all members to please ensure that you have a current email address registered so that you can be contacted by the Society for the election of Council members which will take place online this autumn? If you receive the message that your email address is already registered please use the forgotten password facility which will allow you to reset your password for the email address. You should also soon receive your renewal letter from Wiley Membership Services and this might also prompt you to check that your email address is registered correctly with us. If you prefer to speak to someone please call Membership Services on +44 (0)1865 476038.
A tax on financialisation

At a time when taxing financial transactions is widely promoted (at least in the eurozone), Janek Toporowski discusses the advantages of a tax on financial holdings.

A ll crises challenge the received ideas that validate, but do not inform, routine and unthinking behaviour, policy and decisions. Those who think, use their imaginations to find new solutions to the urgent problems that beset us. Those who do not, reach back to the dogmas that comforted them in the past, in the hope of finding such comfort in a world that will not conform to old ideas.

After half a century of debate about the perniciousness of state welfare and the odiousness of taxation, the present crisis appears as a crisis of state finances, soluble only by higher taxation of citizens, or lower welfare provision for them. The policy debate is caught up in a largely formal exchange between peddlers of austerity, who play on citizens’ fears of debt, taxes and inflation, and ‘Keynesians’ who see no end to the possibilities of fiscal stimulus. In the process we have lost the insights into the incidence and effects of taxation and government expenditure that were common currency in the mid-twentieth century discussions on public finance.

In this situation therefore it is worth re-reading Kalecki’s paper ‘A Theory of Commodity, Income and Capital Taxation’, published in 1937 in the Economic Journal, a short paper of remarkable clarity and reason. By ‘commodity’ taxation, Kalecki meant sales taxes, like the Value Added Taxes that are so widespread today. Kalecki argued that this simply redistributes income from those in employment to recipients of welfare payments and government employees. In the case of income tax, this also largely redistributes existing consumption. However, he showed that government expenditure financed by a tax on capital, because it is not paid out of income and has no effect on costs, would tend to raise incomes, employment and business investment. He concluded that ‘capital taxation is perhaps the best way to stimulate business and reduce unemployment. It has all the merits of financing the state expenditure by borrowing, but it is distinguished from borrowing by the advantage of the state not becoming indebted.’

Kalecki was arguing about a tax on capital that is used to finance additional government expenditure. However, a tax on capital may also be used to repay government debt. An early advocate of this kind of financial operation was David Ricardo. In 1819, in speeches to the House of Commons, when he was a Member of Parliament, and in an article on ‘The Funding System’ which he wrote for the Encyclopaedia Britannica, Ricardo alluded to the benefits of taxing wealth in order to pay off the national debt. This would, in his view, stimulate business by making the wealthy more liquid (having their holdings of government debt exchanged for money). Similar arguments were made a century later, in Vienna, in a discussion between the veteran Austrian Marxist Otto Bauer and Joseph Schumpeter. In 1919 they were in a Socialist government that had inherited the responsibility for Austria’s war-time debts, in a country that had been hugely reduced by the Versailles and Trianon settlements, and whose economy had not only been correspondingly reduced, but also thrown by political circumstances into a state of chaos and depression. Bauer and Schumpeter, who were both in the Austrian Government’s Committee on Socialisation, were in agreement that the fiscal situation could be alleviated by a levy on bank capital. Bauer wanted to use the levy to drive the banks into insolvency, whereupon they would be taken over by the state. Because of the banks’ large holdings of company stock, this would be an effective way of bringing Austrian business under state control, fulfilling the destiny that Hilferding and Lenin had prescribed for ‘finance capital’. Schumpeter, who had no enthusiasm for socialisation and appears to have been intriguing with conservative circles in Bavaria and Hungary to overthrow Soviet Governments in those countries, had other ideas. With the government in serious financial difficulties, he recommended that the capital levy be used to buy in War bonds, effectively cancelling them. In the end, the socialisation drive, and the capital levy that was to finance it, petered out in acrimonious parliamentary procedure.

A tax on financialisation

These historical considerations point to a simple and practical way of alleviating the crisis in Europe. This could be done by indebted government’s imposing a small annual tax of 1 or 2 per cent on the balance sheets of all registered companies above some minimum size that would exclude small businesses. The tax would be in proportion to the total value of all assets or liabilities, with deductions for industrial or commercial assets and equipment. In effect the tax would fall mostly on financial intermediaries, and on non-financial companies holding financial assets. This would therefore be a tax on ‘financialisation’, that is on the financial balance sheets that have proliferated with credit innovation and deregulation. The tax could be used by the Debt Management Offices of indebted governments to buy in, at full value, the government debt held by banks. This would support the government bond market, causing yields to fall in the market, and thereby easing financing pressure on governments. By concentrating buying on bonds of particular maturities, the fiscal authorities could manage the yield curve...
for government bonds. By improving the price and liquidity of government bonds, the tax and bond buy-back would improve the balance sheets of banks as well as the balance sheet of the government.

A number of possible objections may be easily shown to be groundless. First of all, it may be objected that this kind of tax would discourage the holding of government bonds. On the contrary, far from discouraging the holding of government bonds, the buy-back part of the scheme would actually encourage the holding of government bonds, because these would have a more assured liquidity and a higher value. If anything, the tax would discourage the holding of financial assets that are not liabilities of the government. But by allowing deductions for industrial and commercial assets, the tax would increase the incentive to invest in the real economy, as opposed to the financial markets.

A second objection is that the tax would be passed on to bank borrowers, and would thereby discourage financing for productive purposes. As previously mentioned, the greater inducement to invest of deductions for productive assets, would more than off-set this discouragement, since any increase in the cost of borrowing would not affect investment financed by drawing on reserves. In any case, strictly speaking such a tax could only affect banks’ margin between deposit and lending rates. There is no convincing empirical evidence to show that this margin, let alone the absolute cost of borrowing, affects investment in any way. Moreover, as financial assets and liabilities proliferate with financial development, more and more borrowing is done by banks themselves in the inter-bank market. If banks pass on the tax to their borrowers, they would increasingly be passing it on to each other and a growing proportion of this tax would be paid by financial intermediaries. In this way a tax on financial balance sheets would truly be a tax on ‘financialisation’.

A third objection might be that such a tax would make financial intermediaries less liquid. On the contrary, it would make those intermediaries holding government bonds more liquid, because those bonds would be repaid. Those intermediaries that do not hold bonds that are bought back by the government, would of course be paying taxes and not receiving the liquidity benefits of having long-term bonds repaid. In effect the scheme would recycle intermediaries’ own liquidity towards those banks holding government bonds. Insofar as this would stabilise government finances there would be social benefits in a scheme that improves government and bank balance sheets. In extreme cases, banks may have to reach into their reserves to pay the tax. But this should not affect their solvency as long as banks can borrow and lend among themselves and the central bank is prepared to accept non-government collateral.

A fourth objection is that the tax may be evaded. This is certainly true of taxes on profits where profits may be easily manipulated by transfer pricing, but also, with financial development, by management of debt liabilities, payments on which are treated as costs, rather than as taxable profits. However, it is less possible to do this with balance sheet totals. If anything, tax avoidance by debt management tends to increase the size of financial balance sheets. Some of the tax lost due to debt management could therefore be recouped by a balance sheet tax. Emigration is also less of a threat to balance sheets. A bank may transfer its country of domicile, as the Hong Kong and Shanghai Bank did in the early 1990s. But it cannot transfer its balance sheet unless it liquidates its business in a given country. As long as financial markets have the prospects of future profits, financial intermediaries will keep the balance sheets that they hope will capture those profits.

How it might work in Europe

A tax on financial balance sheets dedicated to buying in government bonds has the advantage that it can be applied within the European Monetary Union without changing the Maastricht Treaty, whose inflexible provisions contribute to the present revulsion against government debt. Governments within the European Monetary Union have debt management offices within finance ministries that can, with national parliamentary authority, levy a balance sheet tax, handing over the proceeds of the tax to the DMO to use to buy in bonds issued by that office. No supranational fiscal authority would be required and many governments, including that of the UK, already impose taxes on bank balance sheets. But these are only a tiny fraction of the taxes that could be raised. The tax and buy-back scheme would have to operate at a national level, because it is only the national government that could buy back and cancel its own debt. A Europe-wide fiscal authority, taxing all financial balance sheets across Europe and buying in government bonds would be able to buy in governments bonds and then forgive them. But it is likely that depositors and shareholders of banks in a country with a low level of government debt would object to their financial balance sheets being taxed in order to cancel the debt of a more highly-indebted government of another country in the European Union. This political objection would not apply at a national level.

But there is another reason why a scheme like this is not only necessary, but essential to the future of Europe. When the monetary institutions for the European Union were being planned and established in the 1990s and at the turn of the century, it was believed that the only function of a central bank should be the conduct of monetary policy, and the issuing of money. The other functions of central banks were believed to be either unnecessary, in the case of the original function of central banks to manage government debt markets, or were transferred elsewhere, in the case of bank regulation. The resulting institutional set-up means that Europe now has a central bank without a government, and governments without central banks. The function of managing government debt markets could be effectively recovered by extending the responsibilities of national debt management offices to include ensuring the liquidity of the secondary markets in government bonds.
Indeed, it is most efficient for the institution that sells government bonds into the primary market to have responsibility for managing the secondary market, because that institution is best placed to cancel, on buying back, the bonds that it issues.

The European economy, and the institutions that are supposed to regulate it, are in a mess. A capital levy on financial balance sheets, used to buy back and cancel government debt, would not get Europe out of this mess. But it would buy time for more effective measures to be introduced, measures that are currently held back because of what has been made to look like a financial crisis of the state that need not be so critical. In the present circumstances, a financial balance sheet tax, should be welcomed by financial intermediaries and corporations as a small price to pay for improving the balance sheets of banks and governments.

Notes:
4. Christian Seidl ‘The Bauer-Schumpeter Controversy on Socialization’, History of Economic Ideas II/1992/2, pp. 41-69. I am grateful to Riccardo Bellofiore who has made available to me his copy of this article.
• find articles that are part of the JSTOR ‘Register & Read’ initiative;
• get access, register for a free MyJSTOR account and add article content to your ‘shelf’ in your JSTOR account;
• read the full text online for up to 14 days. After this time you may remove it and add other items to your shelf;
• purchase and download some articles that will also be available in pdf version for access at any time.

Please go to www.res.org.uk Membership Benefits for details and links.

AGM

Papers, the Secretary-General’s Report and the Accounts of the Society can be found at www.res.org.uk or on request from the RES Office (royaleconsoc@st-andrews.ac.uk)

New members of Council

The AGM ratified the following as members of the RES Council from April 2013 until 2018: Oriana Bandiera, V Bhaskar, Sarah Brown, Vince Crawford, Andrew Haldane, Jonathan Portes.

Nominations for RES Council

Nominations for the next cohort of the RES Council (2014-2019) have been received and reviewed by the Nominations Committee. An online ballot will be taken of all RES members in the Autumn and the results declared to the Executive and Council.

The election will be ratified at the AGM in 2014 after which the new members will take their place on the RES Council. For a full list of members of the RES Council please see the RES website or contact the RES office.

Conference Diary

2013

august

26-30 August Gothenburg, Sweden
The European Economic Association and the Econometric Society European meeting (EEA-ESEM) will feature the work and findings of the leading scholars in economics, econometrics and related fields, and will provide an excellent forum to present one’s own research results.

Further information: 2013 EEA-ESEM joint meeting (http://www.eea-esem-congresses.org/)

Mobile

September 5-7 Ljubljana, Slovenia
Sixth European Workshop on Applied Cultural Economics (EWACE). The workshop is to provide a forum for the development and dissemination of applications of quantitative methods in cultural economics, as well as cultural-related applications of mathematical economics, experimental economics and other quantitative approaches.

Further information from: Antonello.scorcu@unibo.it

5-6 September 2013 Denmark
13th OxMetrics User Conference. This conference provides a forum for the presentation and exchange of research results and practical experiences within the fields of computational and financial econometrics, empirical economics, time series and cross-section statistics and applied mathematics. The conference programme will feature keynote presentations, contributed paper sessions, poster sessions, and a panel discussion with the OxMetrics developers. This year the Ana Timberlake Memorial Lecture will be delivered by Professor Russell Davidson, McGill University.

Further information from: Conference website.

5-6 September Exeter, UK
Economics Network Biennial international conference, ‘Developments in Economics Education’ (DEE) supported by the RES. DEE 2013 will have a particular focus on the recent changes in higher education, including increased fees and consequently student expectations. We are interested in how economics can tackle these challenges and how teaching staff can integrate skills development into the classroom. The keynote address will be given by John Kay.

Further information from: www.economicsnetwork.ac.uk/dee2013

6-7 September 2013 London
The biennial European Historical Economics Society Conference will take place at the London School of Economics on 6th and 7th September 2013, with financial support from the RES. Registration closes: 31st August.

Further information from: http://ehes.org/ehes2013.html

11 - 13 September London
Money, Macro and Finance Research Group 45th Annual Conference at Queen Mary University of London. Keynote speakers include: Harris Dellas (Bern), Stephanie Schmitt-Grohe (Columbia), Axel Weber (UBS) Special sessions include ‘The Future of the Euro’ with Paul De Grauwe (LSE).

Further information from: www.mmf2013.org/home

25-26 September Cardiff
Urban and Regional Economics Seminar Group This meeting will have as its theme: ‘What Constitutes a Regional Economy?’ and will be based on a series of invited presentations.

Further information from: Leslie Budd (Leslie.Budd@open.ac.uk)
26-27 September Blomfentein, South Africa

26-27 September Le Mans, France
TEPP conference on Research in Health and Labour Economics at University of Le Mans. The conference aims at bringing together researchers working on labour, health and public policy. The conference will include invited lectures, parallel sessions and poster sessions for PhD and junior researchers.
Further information from: Sylvie Blasco (sylvie.blasco@univ-lemans.fr) and http://tepp2013.org/home.html

October

October 2-4 Rome, Italy
CALL FOR PAPERS
Advances in Business-Related Scientific Research Conference. ABSRC 2013 Rome is an important international gathering of business and business-related sciences scholars and educators. In addition to scientific papers, the focus is on various best practices and solutions, which are important for business-related policies and activities at the individual, organizational, group, network, local, regional, national, international, and global level. The deadline for submissions of papers is August 8, 2013.
Further information from: www.absrc.org/

November

November 18-19 Mannheim
CALL FOR PAPERS
You are invited to submit individual proposals for a Conference on Taxing Multinational Firms organised by Centre for European Economic Research (ZEW), University of Mannheim and Oxford University Centre for Business Taxation (CBT). Submissions should be e-mailed as PDF file to taxation2013@zew.de by August 31, 2013.

24-26 November Tunisia
The International Conference on Business, Economics, Marketing & Management Research (BEMM'13) is to bring together innovative academics and industrial experts in the field of Economics Business and Marketing Management to a common forum. The primary goal of the conference is to promote research and developmental activities in Economics Business and Marketing Management. Organised by International Center for Science & Cultural Development (CSCD) bemm-conf@ciert-pub.com

december

December 9-10 London
The Bank of England and London School of Economics (LSE) organised their first joint conference on Macroeconomics in 2012. Since then the Centre for Macroeconomics has been launched, and we will be holding the second on 9-10 December 2013 at the Bank of England in London on Understanding Low Growth. Western economies have now suffered from five years of stagnation. Is this just another recession, albeit unusually severe, or has it been characterised by self-sustaining low-level equilibria or traps? We invite papers that may shed light on this question. The keynote speakers will be Paul Beaudry (UBC), Roger Farmer (UCLA) and Jaume Ventura (CREI and Universitat Pompeu Fabra).
Further information from: Claire Scott (claire.scott@bankofengland.co.uk)

2014

January 16-17 Frankfurt, Germany
CALL FOR PAPERS
Conference on The Challenges of International Banking Regulation and Supervision after 1945, Jointly organised event by University of Glasgow (www.bank-reg.co.uk) and EABH e.V. Conference organisers welcome proposals investigating the obstacles and challenges to international banking regulation and supervision after 1945. The aim of the conference is to bring together different approaches—legal, economic, political science / political economy, historical — in order to enrich and widen the debate about international regulation and supervision. Submission deadline: 30th September 2013
Further information from: Dr Emmanuel Mourlon-Druol (Emmanuel.Mourlon-Druol@glasgow.ac.uk) or Carmen Hofmann (c.hofmann@bankinghistory.de)

21-22 March Munich, Germany
CALL FOR PAPERS
Conference on Social Economics, organised by (Center for Economic Studies and Ifo Institute for Economic Research) CESifo. The purpose of the conference is to bring together international scholars working in this field and to stimulate research on this theme. Deadline for submission of complete papers 31 October 2013.
Further information from: office@cesifo.de. or Senta Huber (huber@cesifo.de)
Membership of the Royal Economic Society

Membership is open to anyone with an active interest in economic matters. The benefits of membership include:

- Copies of the Economic Journal, the journal of the society, eight times a year.

  The Economic Journal is one of the oldest and most distinguished of the economic journals and a key source for professional economists in higher education, business, government service and the financial sector. It represents unbeatable value for those who want to keep abreast of current thinking in economics. Issues are divided into those containing ‘Articles’ - the best new refereed work in the discipline — and ‘Features’ including symposia and regular features on data, policy and technology.

- On-line access to The Econometrics Journal, an electronic journal published by the Royal Economic Society and Wiley Publishers. The journal seeks particularly to encourage reporting of new developments in the context of important applied problems and to promote a focus for debate about alternative approaches.

- Copies of the Society’s Newsletter. This is published four times a year and offers an invaluable information service on conferences, visiting scholars, and other professional news as well as feature articles, letters and reports.

- The right to submit articles to the Economic Journal without payment of a submission fee.

- Discounts on registration fees for the Society’s annual conference.

- Discounted prices for copies (for personal use only) of scholarly publications.

- The opportunity to take advantage of the grants, bursaries and scholarships offered to members of the Society.

Details and application form are available from: The Membership Secretary, Royal Economic Society, University of York, Heslington, York, YO10 5DD.

Membership rates for print and online for 2013 are £48 ($82, €57)*

‘online only’ membership for 2013 is £38 ($65, €45)

There is a reduced rate of £23 ($42, €28) for members who reside in developing countries (with per capita incomes below US$500) and for retired members.

A special ‘online only’ offer of three years membership (2013-2015 incl.) for the price of $29/€20/£17 or one-year online only for £10/$14/€12 is available to full-time students.

* All ‘hardcopy’ customers in the UK should add 10 per cent and ‘online only’ customers 20% VAT to these prices or provide a VAT registration number or evidence of entitlement to exemption. Canadian customers please add 5 per cent GST or provide evidence of exemption. For EU members, please add VAT at the appropriate rate.

If you would like to join the Society, complete the adjacent application form and return it to the Membership Secretary at the address above.

Please enter my name as an applicant for membership of the Royal Economic Society. I enclose a cheque for

............... in payment of my subscription for 2013.

Name:

.................................................................

Address:

.................................................................

.................................................................

.................................................................

.................................................................

.................................................................

Occupation...............................................

Date..........