A new look

As promised in the last issue we have taken the opportunity of the re-design of the Society’s website to give a facelift to the print version of the Newsletter. This brings it closer in design to the website, by using the website colours for example. But the layout and classification of items now follows the terminology of the website and should make it easier for readers to find both electronic and print versions of material they may want.

In the last issue, we said that we would let evidence speak for itself while taking a break from major features on the great austerity debate. Three months on, it does not look any brighter with the UK now officially returned to recession. This issue carries a shortened version of the Krugman/Layard manifesto, with an invitation to readers to send comments to the Newsletter (in the form of brief correspondence).

In addition to Ray Rees’s regular ‘letter from Germany’ (putting the German view of the Euro crisis) we are all but overwhelmed by features. These include the report of the Society’s Annual Conference, written by Sam Fleming, the Economics Editor of The Times. Given the seasonal anxiety about the effect of university fees on UK students, and the attractions of studying abroad, we have a timely and interesting piece on economics in Dutch universities and life as a postgraduate economics student in Rotterdam.

All this and much more...
ROYAL ECONOMIC SOCIETY

NEWSLETTER

Editor

Prof Peter Howells,
Centre for Global Finance,
Bristol Business School,
UWE Bristol,
Coldharbour Lane,
Bristol BS16 1QY

Fax: (44) (0)1722 501907
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

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

Next issue

Newsletter No. 159 - October 2012

Articles, features, news items, letters, reports etc. should be sent to the Editor by:

15 September 2012

Items concerning conferences, visiting scholars and appointments should be sent to the Information Secretary by:

16 September 2012

Contributions from readers

The Newsletter is first and foremost a vehicle for the dissemination 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 correspondence 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 the RES website at:
www.res.org.uk

and the Newsletter website at:
www.res.org.uk/view/resNewsletter.html
Letter from Germany

The Euro Crisis: A View from Germany

In this letter, Ray Rees\(^1\) argues that Germany has made substantial, but unrecognised, transfers to some members of the eurozone and that the country’s caution about fiscal co-ordination should be supported.

A view of the historical causes of the current crisis in the Eurozone which would find wide agreement in Germany was recently put forward by Charles Blankart, a specialist in political economy at the Humboldt University, Berlin. He identifies two kinds of countries in Europe, those which espouse a ‘stability regime’, such as Germany, Austria and the Netherlands, and those believing that inflation can be used as a stimulus for growth, implying an ‘inflation regime’, exemplified by countries such as France, Italy and Spain.

Germany: a victim of the euro?
Blankart argues that the foundation and subsequent development of the euro represented a clear victory for the latter group. In exchange for support of German reunification, a Bundesbank type of regime for the new European Central Bank (ECB), and the 1991 Maastricht Treaty that was supposed to ensure an appropriate degree of convergence of the economies of the member states, Chancellor Helmut Kohl agreed to January 1 1999 as the starting date for the Currency Union. German misgivings led subsequently to conditions on the values of the ratios of government debt and the current public deficit to GDP being added as a requirement for membership, and these were further consolidated in 1997 in the Stability and Growth Pact, that was supposed to ensure continued adherence to these criteria of fiscal responsibility. In fact however countries such as Italy, Spain and Portugal were accepted into the eurozone members even though they did not satisfy the criteria, and no-one was really surprised when it turned out that Greece had falsified the statistics on which its claim for membership was based.

There are good reasons for seeing Blankart’s view as overly simplistic. Despite the fact that a majority of its governing body is made up of ‘inflation countries’, the ECB’s control of monetary policy as such cannot be said to have been inflationary. A further difficulty with the ‘inflation countries vs. stability countries’ story is that a central problem has been the ineffectiveness of the Stability and Growth Pact, with above all Germany and France responsible for its early demise. For a time at least, Germany would have to have been reclassified as an ‘inflation country’. Nevertheless, Blankart expresses the fears of many Germans when he pictures a future in which Germany, outvoted not only at the ECB but in other major decision bodies of the EU, is trapped in a ‘Transfer Union, a system in which Germany has to transfer its wealth to the ‘inflation countries’ to meet the consequences of their profligate policies.

Indeed, the ECB is seen as having already instituted such a system, not only explicitly, in its large purchases of government bonds of the countries in dire straits and issuance of loans against junk bonds as collateral, but also implicitly and perhaps even unknowingly, in its operation of the so-called Target2 system.

The problem with Target2
My colleague at Munich, Hans-Werner Sinn, with his co-workers, has been responsible for identifying and quantifying the scale of the problem associated with the Target2 system, and despite criticism from some quarters, which he seems to have been well able to deal with, has gained the support of most German monetary and macroeconomists outside the Bundesbank and ECB. In some ways it is a remarkable story. The name is quite misleading, it has nothing to do with targets,
but is simply an acronym derived from its ugly bureaucratic title: Trans-European Automated Real-time Gross Settlement Express Transfer System. Target2 is as this name suggests a payments settlement system through which the central banks of eurozone countries (as well as private institutions) transfer payments arising out of transactions between economic agents in their respective countries. A seller of goods effectively generates a credit for the value of the goods sold in his country’s central bank account with the ECB, the buyer (if in the eurozone) generates a debit of the same amount in his country’s central bank account, and the clearing system simply processes these debits and credits, with of course at any one time the total across all countries netting out at zero.

It seems to have been envisaged that these transactions would, over relatively short periods of time, also net out to zero for each central bank involved, but it appears that instead some central banks, for example the Bundesbank, have accumulated very large credit balances, while other countries, in particular Greece, France and Italy, have accumulated large deficits. These are however nowhere reported by the ECB and have to be extracted from the reports of the individual central banks. It is almost as if the ECB were unaware of their existence. The worrying problem lies in the fact that individual central banks, by creating credits for their domestic banks, are able to add to the total stock of euros in existence. Indeed, as Sinn argues, it is as if individual country central banks can print euros to fund their national payments deficits, effectively creating their own overdrafts at minimal interest rates, and there is strong evidence to suggest that Greece has indeed been doing that since the onset of the crisis in 2007, thus avoiding the need to take the painful and unpopular steps required to put its finances in order. The solution he proposes is that this should only be possible against the backing of first class financial assets as collateral, thus of course raising its cost. At the very least, Sinn seems to have established the existence of a serious design fault within the eurozone banking system.

Although there is room for debate about the exact extent to which the deficits of the debtor countries can be said to be funded by the surpluses of the creditor countries (Germany, Luxembourg and Finland), there is certainly a strong case for arguing that the existence of these balances implies a significant increase, in the order of well over 300 billion euros, in the already very large amount that Germany has at risk, given the possibilities of default in the deficit countries.

Invisible integration
In the light of all this, it is surely not surprising that German economists, and the German public generally, oppose the immediate introduction of Eurobonds as a solution to the current crisis. In a certain sense, eurobonds already came into existence when, following the introduction of the euro, the borrowing rates of the eurozone countries converged. Capital markets obviously believed that defaults on sovereign debt by eurozone countries would not be allowed to happen, and so the interest costs on debt issued by countries such as Greece, Spain, Portugal, Ireland and Italy, previously at times at least as high as those they have been paying in the last few years, fell to German levels and remained there until the financial crisis hit in 2007. There is a strong case for arguing that the sources of the current crisis, the housing bubbles in Spain and Ireland and the public sector deficits in Greece, Portugal and Italy, have their roots in this failure of interest rates to reflect the risks of lending to the countries concerned. The opposition in Germany to institutionalising the moral hazard involved in bundling the debt of all eurozone countries into a single instrument is surely fully justified, as is the argument that any steps toward an explicit fiscal union must wait until the public finances of the problem countries have been put in order.

The current ‘austerity regime’ in place in the UK suggests that, in Blankart’s dichotomy, we would be placed among the ‘stability countries’. Moreover, whatever the outcome of the debate about the UK’s long term future in Europe, it is surely undeniable, and is at last becoming generally perceived, that this country can only lose from the existence of a eurozone characterised by fiscal disorder and recurrent crises. The original decision not to join the euro system looks an even better one from today’s perspective, but this should not induce smugness and schadenfreude. On the European political stage Angela Merkel often looks isolated as she obstinately insists that sound, coordinated fiscal policies and labour market reforms have to precede any steps toward fiscal union, but anything less would be political suicide for her in Germany. She deserves the UK’s support.

International Finance and Economics Society
Local chapter — call for members

IEFS UK Chapter (www.iefs.org.uk) is keen to recruit new members and suggestions for conferences and workshops from UK universities please contact Professor Keith Pilbeam at k.s.pilbeam@city.ac.uk

www.res.org.uk/view/resNewsletter.html
Letter of support for the new central bank law in Argentina

The prevailing ideology over the last thirty years has been that the only legitimate task of central banks everywhere is control of inflation. This has frequently been through the application of an ‘inflation target’, a maximum rate of increase of some measure of aggregate price changes. The practical consequence of setting the ‘fight against inflation’ as the primary objective has been to reduce substantially the policy options of central banks. Even more, this narrow approach prevents the coordination of monetary policy and fiscal policy, essential to successful countercyclical interventions.

In Argentina in the 1990s economic policy operated under the burden of an extreme form of this narrow approach, a ‘currency board’ regime, involving a fixed exchange rate to the dollar and a monetary base strictly linked to foreign exchange reserves. During 1997-2002 the weaknesses inherent in this monetary policy created disaster, economic collapse and high inflation.

In March of this year, the Argentine government proposed a new central bank mandate, that would repeal the currency board rules and broaden the institution’s mandate to multiple objectives including growth, more equitable distribution, sectoral credit allocation, and price stability. The Congress passed and President Cristina Fernandez signed it into law the new mandate.

We, economists working in the United Kingdom, applaud the Argentine government and the Congress for this farsighted approach to monetary policy. The new mandate allows the current and future governments to choose between wise and foolish economic policies, while the previous law institutionalized the latter.

George Irvin
Costas Lapavitsas
Terry McKinley
Jan Toporowski
John Weeks
SOAS, University of London
Anne Pettifor
Prime Economics
G C Harcourt
Ha-Joon Chang
Gabriel Palma
University of Cambridge
Malcolm Sawyer
Gary Dymski
Anna Kaltenbrunner
University of Leeds
Guy Standing
University of Bath
Engelbert Stockhammer
University of Kingston
Ozlem Onaran
University of Westminster
John Grahl
University of Middlesex
Sarah Bracking
University of Manchester
Kalim Siddiqui
University of Huddersfield
Hulya Dagdeviren
University of Hertfordshire
Michael Burke
Socialist Economic Bulletin

Economists’ ‘Manifesto’ questions wisdom of austerity

As the European Union summit got underway in late June 2012, Nobel laureate Paul Krugman and LSE professor Richard Layard lay down a challenge to the seeming orthodoxy which says that public deficits are the main cause of the present economic stagnation.

In their ‘A Manifesto for Economic Sense’, published in the Financial Times on Thursday 28 June 2012, they invited all economists to join on the manifesto’s website in condemning excessive fiscal austerity.

They review the main arguments put forward in favour of austerity and find them contradicted by the evidence:

• Previous fiscal contractions have not stimulated recovery but have undermined confidence and productive investment, rather than restoring it.

• Structural issues are not a central cause of today’s unemployment, since it pervades all sectors of the economy.

• High deficits need not cause high interest rates. Rates of interest in the United States and the UK are extremely low despite high deficits and debt, and high rates in Spain and Italy are due to the absence of a normal central bank.

The manifesto is available on the FT website (www.ft.com) and here: www.manifestoforeconomicsense.org

Comments can be sent for publication as correspondence to Peter Howells (Peter.Howells@uwe.ac.uk), editor of this Newsletter. (http://www.res.org.uk/view/resNewsletter.html).
RES Conference Report

The Society’s Annual Conference took place this year at the University of Cambridge from 26th-28th March. This report was compiled by Sam Fleming, Economics Editor of The Times.

The ducks are back from their winter retreat, the daffodils are rampant, and punts filled with gaggles of Italian school children are gliding along the chilly river. It must be Cambridge in the springtime. But along with the city’s customary visitors, for three days in March the Backs teamed with flocks of a more exotic feather: economists, gathered for the Royal Economic Society’s annual conference.

Having tired the newspaper’s readers with several weeks of Budget coverage, I was eager to escape London and delve into realms of economics that the national media normally neglect. The RES conference certainly fits that bill: delegates packed into the conference rooms of Robinson and Clare colleges between March 26 and 28 were offered a smorgasbord of presentations ranging from local corruption and coal mining deaths in China, to the impact of cashless systems on free school meal take-up in Essex; from examinations of the impact of the 1918 Spanish flu epidemic, to the de-penalisation of cannabis in the London Borough of Lambeth.

Familiar themes also reared their heads: how do we get the UK growing again? What do we do about the transmission of sovereign debt shocks across the euro area? How do we regulate the banking system in the future? Conveying the full contents of a conference jammed with so much content is — needless to say — impossible. So my account offers a selective and highly biased account reflecting one journalist’s attempt to pick his way through scores of presentations and debates.

One feature that immediately became apparent scanning the programme on the first day was the Society’s pulling power. Delegates were able to listen to some of the super-heavyweights of the economics world, among them Kenneth Rogoff of Harvard, Lorenzo Bini Smaghi, lately of the European Central Bank’s executive committee, and Guillermo Calvo of Columbia University.

The three economists joined for one of the big set piece events of the conference, a debate in the West Road concert hall about the sovereign debt crisis. Bini Smaghi struck the most optimistic tone of the three, perhaps unsurprisingly given his recent position, as he argued that crises such as the one afflicting euroland are a painful but necessary force for change in democracies. Progress in this case will require among other things a recognition that the region’s imbalances were driven by the private sector, rather than purely being a fiscal matter. One key vulnerability is that the region’s banking systems remain strongly national in nature. The contrast with the US is clear: if a state there goes bankrupt the banking system itself doesn’t go bankrupt as well, because there is no inextricable link between the lenders and the individual state itself. What is needed in euroland is a truly European banking system and resolution system — something that the region’s politicians have belatedly been coming round to in recent months.

A rather more gloomy Professor Rogoff dwelled on the classic critique of the euro — namely it has never been an optimal currency area — before comparing the situation to that of a couple who can’t decide whether to get married. They decide to open a joint account at the local bank, as a way of seeing how things would work out financially. Then they decide to bring in their siblings to share the account too, then cousins, and then second and third cousins they’ve never even met.

Eventually everyone begins to fall out, triggering a barrage of lawsuits. What do they do? The upshot is they have little choice but to get married, solemnizing their commitments in a far more tangible union, and that, according to Professor Rogoff, is what the euro needs to do now. The alternative — a break-up — is simply too painful and expensive to contemplate.

The growth and investment conundrum

Asked in the Q&A about the worries of the US, Professor Rogoff acknowledged that a debt default by the world’s biggest sovereign creditor would be great for sales of his and Carmen Reinhart’s book — This Time Is Different — but was unlikely to happen. One question in the meantime is to consider what damage uncertainty over how America will get to grips with its fiscal woes is doing to the real economy.

In the Hahn lecture, Nance L Stokey of the University of Chicago sketched out a simple model examining the damage that may be resulting. This looked at the impact of uncertainty over the potential for future tax rises, which prompts businesses to delay investment decisions.

A high degree of uncertainty about tax changes increases the option value of waiting to make investments,
given they are expensive to reverse. When the uncertainty over tax is resolved, a boom results as companies eagerly pull projects off the shelf. The size of the boom will depend on the ultimate tax rate, with lower rates generating a bigger boom.

The goal is to build a model in which markets in the short term ‘dislike’ uncertainty. The concept could equally be applied to hiring decisions, or to consumers’ decisions on whether to buy a new house, as well as to uncertainty over future financial regulation or energy policy changes. Look at present-day US and the value is clear. Investment plunged in 2009 and has remained low since, despite the large cash surpluses of companies such as Apple.

Meanwhile US deficits have been rising, and the costs of social security and Medicare will only increase in the future as more baby boomers retire. The question marks over how the country’s swelling debt mountain will be tackled may well be short-circuiting an investment-led recovery.

Britain’s own investment outlook is also one of the big disappointments of recent history — and its own fiscal woes may well be part of the picture. A special session on the first day of the conference looked at ways of engineering a growth pickup.

This involved firstly drawing lessons from the Great Depression era. Nick Crafts of the University of Warwick told delegates that the growth strategy of the 1930s was initially driven by efforts to raise the price level, while fiscal policy was tightened. Fiscal policy only became Keynesian in the UK from the mid-1930s onwards, with expansion driven by re-armament. The Defence Loans Act in 1937, under which £400 million was borrowed over five years, may have had a significant effect on GDP, pointing to a high fiscal multiplier.

John Van Reenen, Director of the Centre for Economic Performance at the London School of Economics, looked at more recent history, arguing that the claim that Britain’s pre-2007 growth was all down to a finance boom was simplistic. The UK saw strong productivity growth, with improvements in a range of sectors including business services, distribution and manufacturing. This was thanks in part at least to continued reforms by the Labour government, not just a Thatcherite inheritance.

There are therefore reasons to take a more optimistic view of the evolution of productivity from here too, rather than assuming that massive capacity destruction has left little by way of an output gap. This could lead to the conclusion that there is room for more of a fiscal stimulus by the Government today. It is not, for instance, clear why more investment in schools and roads would terrify the bond markets.

The race to the bottom in tax
As it pursues its austerity agenda, the present Government’s reform efforts have focused on making Britain a more attractive destination for global enterprise — for example with plans to lower the Corporation Tax rate to 22 pence.

Another initiative is the so-called ‘Patent Box’ regime for innovative companies. A lucid presentation from Helen Miller of the Institute for Fiscal Studies left me in little doubt as to how wrongheaded the policy is. The measure (which originates from the last Labour government and has always been looked upon sceptically within the Treasury) will offer a reduced 10 per cent rate of corporation tax for income derived from patents, as Britain follows in the footsteps of Belgium, the Netherlands and Luxembourg.

The trouble with the scheme is that it is poorly target- ed, being focused on the income from ideas, not the activity that generates the ideas, so that the research can be located separately from the income. There could of course be other benefits from having a patent filed in the UK, but the patent box structure does not guarantee that the innovation will necessarily happen here.

The research by Miller and her colleagues into firm behaviour shows that introducing a patent box does affect the likelihood of a country clinching more patent holdings, but revenue from that income is likely to fall sharply because the lower tax rate more than offsets the higher number of patents. The Treasury itself has estimated a £1.1 billion revenue loss from the policy.

That does not mean the patent box is bad news all round: a handful of companies are extremely heavy users of patents — including the UK’s top five filers Unilever, GlaxoSmithKline, BT Group, Rolls-Royce and QinetiQ. For some of them, this will no doubt prove to be an extremely welcome innovation.

Perhaps the regime will help convince them to keep some related research activities in Britain. The trouble, of course, is that the UK can’t patent the box itself: Even more countries may feel compelled to follow suit exacerbating the race to the bottom in the corporate tax system.

Crime and punishment
Government policy failures and successes loomed large in a fascinating session on the economics of crime, chaired by Stephen Machin of University College London. This is a growing field of empirical research examining issues such as the costs and benefits of partaking in crime and links with unemployment, wages, age and police practices.

Imran Rasul of University College London presented the results of an examination of the effects of the London Borough of Lambeth’s temporary and unilateral experiment with depenalising possession of small
quantities of cannabis between 2001 and 2002. The policy was championed by local police commander Brian Paddick in the hopes that it would free up the police to deal with more serious forms of crime.

The research involved building a data set looking at crime rates for eight types of crime including drugs offenses between 1998 and 2006 spanning the London boroughs. To interpret the evidence, the researchers developed a hotelling-style model of two boroughs, emphasizing the importance of behavioural responses by the police, suppliers and consumers.

Paddick’s initiative didn’t have much of an effect immediately after it was introduced in July 2001. But six months after it began it was announced that it would be extended, and at that point there was a sharp, 18 per cent increase in cannabis possession offenses. The research suggests about half of this surge could be accounted for by individuals moving into Lambeth from neighbouring boroughs, perhaps in response to signals that suggested (wrongly) that the policy would be permanent.

The researchers found little evidence that the policy caused the police to tackle crimes involving harder, Class A drugs such as heroin, crack and cocaine, but there were long-run reductions in five non-drug types of crimes as police attention was diverted away from the world of narcotics.

A year after it was started the policy was reversed amid reports of increased drug tourism into Lambeth and children turning up for school under the influence. Did local people value the policy, however short-lived as it ended up being? The research shows that house prices within the area were 6 per cent lower than might have been expected, suggesting that people put disproportionate negative weight on the increase in cannabis-related crime — despite the concomitant decline in non-drugs offenses.

While the Lambeth research looked at the effect of relaxing the law, a presentation from Rodrigo Soares examined the result of prohibition. This research took us across the Atlantic to Brazil, where the government decided in the 1990s to heavily restrict and then, in 2001, to ban the trade in the rare tropical wood mahogany.

Few outside the furniture and forestry trade would object to the decision in principle: mahogany takes 30 years to mature and its production was doing terrible damage to the rainforests. But the policy was thinly policed and proved to be a disaster. While officially mahogany exports fell, there was an 1,800 per cent spike in exports of a miscellaneous category called ‘other tropical timber specie’ in a single month in 1999, pointing to rampant mis-classification by producers attempting to circumvent government restrictions.

Prohibition also appears to have led to higher deforestation, and, alarmingly, a rise in homicides in regions with a natural occurrence or trade in mahogany as the business was driven underground. From 1995 to 2007, the effect for the state of Para, centre for production of the wood, added up to 1,998 additional deaths due to illegal mahogany activity.

This underscores the dangers of implementing loosely enforced prohibition, which may lead to high levels of illegal activity and violence. When agents operating in illegal markets cannot resort to the regular system of justice to uphold agreements and seek protection from competitors, the result can be violence. As Mr Soares put it, ‘the medicine is much worse than the disease.’ The potential lessons for other countries, including the US with its heavy-handed ‘war on drugs’ are clear to see.

Frontier economics

One of the more newfangled niches in economics goes by the clodhopping name ‘macroprudential regulation’. The Bank of England is trying to establish itself as one of the leading exponents, championing the use of ‘macropru’ via its new Financial Policy Committee in the hopes of preventing a re-run of the banking crash of 2007-09.

The problem is that while the merits of crisis-prevention tools are obvious, the theoretical underpinnings for this branch of central banking are at the seedling stage. To help address that problem, the Bank of England sponsored a session on the final day of the conference to examine the academic state of play.

Javier Suarez of CEMFI led the charge with a discussion of research into the calibration of capital requirements imposed on banks. These may well reduce credit and output in normal times, but they also reduce banks’ systemic risk-taking and therefore the losses caused by systemic shocks.

Getting the requirements right is clearly a hugely complex problem. Suarez’s research with David Martinez-Miera of Universidad Carlos III examines risk-taking in a simple dynamic general equilibrium model. Under their model, optimal capital requirements are quite high, at 14 per cent, and do not need much cyclical adjustment.

Such high capital requirements may well have a sizeable negative impact on GDP, but that is just one yardstick. The social welfare gain from having a 14 per cent requirement rather than 7 per cent is equivalent to a perpetual increase of 0.9 per cent in aggregate net consumption. To account for transitional costs, higher capital requirements should be introduced gradually, according to Suarez.

Charles Goodhart, emeritus professor at the London School of Economics and part-time sheep farmer, fol-
lowed. Humans, he argued in an entertaining lecture, are rather similar to sheep: they have a tendency to follow a path for no particular reason, and once they are on it they will carry on even if it was not well chosen. That is what regulators did when they set capital ratios under the Basel I and II capital accords. There was no theoretical underpinning for the ratios they demanded at all, nor was there any discussion of sanctions or penalties. But the regulators still gamely plodded along that same path for years.

The world has moved on, having recognized the inadequacy of the old Basel regime, and Basel III has been born. Prof Goodhart argues there is still work to be done. In his view there should be two capital ratios, with a sliding scale of sanctions. The lower ratio would be the point where a bank becomes too dangerous to continue and needs to be taken over. The higher one is a form of holiness—something to which we should all aspire, while accepting we inevitably fall short from time to time. We may want banks to hold a much higher level of capital in general, but we can’t expect them to hold it at all times, Prof Goodhart observes.

Basel III has taken a useful step in the right direction by setting a Conservation Range when the equity ratio falls below 7 per cent but above 4.5 per cent, but Prof Goodhart argues that 7 per cent is too low, while the 4.5 per cent minimum is too high. He also argues that a more sophisticated ladder of sanctions is needed, potentially including Pigovian taxes.

Young talent
Alongside veterans such as Prof Goodhart, the conference was populated with dozens of up-and-coming economists vying for delegates’ attention. In a session called Young Talent, Dutch economist Vincent Sterk put forward research into the impact of house prices on geographic mobility. A decline in home equity reduces the funds available to homeowners for deposits on new houses, and if the homeowner is in negative equity funds will be needed to pay off the existing home loan. The result is that unemployed homeowners may turn down job offers that require them to move, leading to a higher unemployment rate.

In a separate session exploring African growth and development, two compelling presentations examined the long shadow cast by slavery. The first of these, by Luis Angeles of the University of Glasgow, discussed why Europeans made Africa such a massive exporter of slaves to the Americas, with 12.5 million people displaced by the barbaric trade. The answer, he said, is in part the high price technologically advanced Europeans were able to offer for slaves. On top of this, it was relatively cheap to obtain slaves within the continent: enslaving your people was taboo, but Africa’s cultural fragmentation meant raiders did not have to go far to find villagers from a different background whom they could seize.

Such was the interest in the Africa presentations that it was standing room only in the stuffy little seminar room. Indeed, while previous writers have complained about a large number of nearly empty sessions in past conferences, I found little evidence of this in March. Maybe I was lucky in my choice of presentations, but all of the sessions I attended were both engaging and amply populated—despite the sunny spring sunshine tempting us to decamp to the Backs.

Relaunch of Economic Affairs
From the first issue of 2013, Economic Affairs, the journal of the Institute of Economic Affairs, is being relaunched as a fully refereed academic journal jointly published by the IEA and the University of Buckingham. Some of the commentary and opinion material previously carried by the journal will now appear in a new IEA print and online magazine which will appear in the new year.

The revamped journal aims to improve understanding of the role of markets in the economy and society. While, like most economists, we are broadly inspired by a classical liberal approach, we welcome a variety of analytical and empirical methodologies. These include neoclassical, Austrian and public choice economics. We also encourage submissions from people working at the margin of economics in such disciplines as (for example) political science, sociology and psychology, although all papers should contain economic arguments.

The editorial board encourages the submission of original empirical research and scholarly literature reviews. All submissions should have clear and explicit policy conclusions. The editorial board welcomes submissions from authors at all stages of their careers, but is keen to encourage newer authors to submit work.

Recognising the increasing integration of the world economy, Economic Affairs particularly welcomes contributions from non-UK authors and aims to heighten awareness of the experience of policy towards the market across Europe and the wider world.

Main articles should normally be of around 7000 words in length: responses and rejoinders, which are encouraged, should not exceed 2000 words. In addition authors may wish to submit short articles, of no more than 3500 words, reporting on larger studies which may be published in full elsewhere.

Potential authors are advised to contact the editor, Professor J R Shackleton (len.shackleton@buckingham.ac.uk) to obtain guidelines and a stylesheet.
It hardly needs saying why we may be interested in this topic. Charts 1 and 2 show the recent history of broad commodity indices, the real level and volatility (12 month moving SD). Commodity prices have always been volatile and consequently have a large impact on the economy — in terms of the direct impact on inflation, on exchange rates and on supply. And to some degree commodity prices have tended to move up and down together. Some have argued that this can in part be explained by the increase in financialisation of commodity prices ie, the increase in trading of financial products based on commodity prices. Others have argued that no, it is simply that the shocks driving everything are inevitably common. The workshop managed to shed light on these views.

First though, notwithstanding what the fundamental drivers are, many players, whether policymakers or market participants, would like to be able to forecast movements in commodity prices.

**Forecasting price movements**

The workshop opened with a paper presented by Ron Alquist of the Reserve Bank of Canada, entitled ‘Forecasting the Price of Oil’. This is a chapter in the forthcoming 2nd volume of the *Handbook of Forecasting*. There is a view that the efficient markets hypothesis implies that because all information is summarised in the spot price, oil prices are unforecastable (they follow a random walk). Ron presented convincing evidence that it is in fact possible to beat that by large margins and forecast oil prices in real and nominal terms at short horizons using various methods. Interestingly, using the futures price is not among them. Is this contrary to efficient markets? No. The current price probably aggregates all information, including — especially, in fact — expectations about where the price will go next. Otherwise there would be arbitrage possibilities in the two markets (traders in future prices, and holders of current inventories). But that doesn’t mean that the price is necessarily expected to remain constant. Financial arbitrage implies that the futures price is affected by not only the expected future price but also by risk premia. However risk premia are unobservable and we may not know what drives them. So the futures curve alone is not necessarily informative about where the future spot price will go — you need to understand risk premia, and that’s a tough call. The physical spot market is equilibrated by the arbitrage condition that the price of a barrel today must equal the future price less the interest foregone plus the convenience yield (benefits of holding a physical stock less storage costs). And that convenience yield can change over time (for instance if inventories are low the yield is likely to be high).

So although it’s widely believed as an empirical fact that you can’t beat a random walk forecast, that isn’t implied by the theory. And in fact it is now well understood that this does not follow, even for purely financial variables (even if markets are efficient, future movements can be forecastable). Likewise the fact that futures alone don’t forecast the spot better is not evidence against market efficiency. It’s now easy to see that publicly available information — for example, about inventories — can be used to forecast future oil prices. So in related work Kilian and Murphy (2010) find that global activity and inventories help forecast the real price of oil at short horizons, while Baumeister and Kilian (2011) find this would have worked in real time.

In the same forecasting session, Francesco Ravazzolo (Norges Bank) presented work in progress on ‘Oil Price Density Forecasts: Exploring the Linkages with Stock Markets’ (with Marco Lombardi, ex ECB and...
now BIS). Increasingly, attention among forecasters has been focusing on density rather than point forecasts. The Norges Bank is in the forefront of this. One rationale is that a particular class of point estimate is only optimal conditional on a particular loss function — eg, the mean for quadratic loss. But if we know the density then that is sufficient no matter what the loss. And in general densities communicate useful information — as the bank of England’s forecast ‘fancharts’ reveal. In this case the question arises from comovements between oil price and equity volatilities, where there is plenty of evidence of increasing and time varying correlation. A VAR turns out to produce forecast densities that are marginally superior to the unconditional densities. And moreover, that predictability could have been used profitably for an investor with power utility (parameterised at relative risk aversion equal to two) and reasonable transaction costs. The money would have been largely made between September and November 2008, in the commodity price boom.

**The effect of system-wide shocks**

The question then might be where those correlations come from. For the macroeconomist, the natural answer is a set of fundamental shocks hitting all sectors of the economy. This was explored by Tamarah Shakir, Bank of England in ‘The impact of oil shocks on the UK economy’ (with Stephen Millard). It is now totally uncontroversial that the impact of oil price movements on any economy differs depending on the underlying source of the shock. In particular, whether the driver is a supply, or demand, disturbance. Originally put forward as a proposition by Jim Hamilton (1983), it has subsequently been explored by several authors, most recently with Lutz Kilian to the fore. In this current paper, the empirical framework has time-varying parameters, which may be particularly relevant for the UK (given the changes in the structure of oil production and labour markets over recent decades). In line with earlier studies on larger economies, they find that that the source of the shock does indeed affect the size and nature of the eventual impact on the UK economy. Oil supply shocks typically lead to larger negative impacts on output and slightly higher increases in inflation relative to oil shocks stemming from shocks to world demand, which typically have small and frequently positive impacts on UK output. The nature of shocks in the world oil market has changed over time, with the oil price becoming more sensitive to changes in oil production, consistent with evidence from Gert Peersman (Ghent, also at this workshop) in Baumeister and Peersman (2011) that demand and supply elasticities have become smaller over time. There is also evidence that the impact of oil shocks became much smaller from the mid-1980s onwards, although the impact has risen slightly since around 2004.

Gert himself presented work in progress on ‘The US dollar exchange rate and the demand for oil’ (with Selien De Schryder). Most recent structural work on oil prices approaches the problem from an SVAR, identifying shocks. From these, it is possible to infer demand and other elasticities. But in this paper an older structural tradition is adopted, identifying elasticities from the conventional identification approach. They are able to do this because in their 65 country panel data set the price might be legitimately considered to be exogenous to the country. Macro panels are characteristically roughly square — the cross-section N and time period T the same order of magnitude — and characterised by dynamics. Under these circumstances conventional techniques designed for large N and small T are inappropriate, and indeed unnecessary. Instead, the problems arise from cross sectional heterogeneity and dependence. There are well-known solutions to these problems (eg Pesaran, Shin and Smith, 1999 and Pesaran, 2006). Remarkably, there are no published panel studies that apply these well known techniques. Apart from this, the novel aspect is that rather than use a domestic currency real price, the price drivers are the real dollar price and a world effective dollar rate. In the long run one might expect equal coefficients, but the short run elasticities examined here differ — the exchange rate elasticity is more than three times the price elasticity.

**Financialisation of commodities trading**

In the afternoon attention turned to aspects of financialisation, meaning the process whereby commodities and derivative products have become increasingly widely traded on financial markets. The session began with an examination of the evidence for bubbles in commodity prices: ‘The recent behaviour of commodity prices: fundamentals, speculative bubbles and relation to the global economic environment’ by Rod McCorrie, St Andrews (with Isabel Figuerola-Ferretti Garrigues and Christopher L Gilbert, Trento). A bubble here is defined as explosive behaviour. They test key commodities — crude oil, gold, silver, aluminium and copper — over the last decade or so. They use the ADF-type tests of Phillips, Wu and Yu (2011) and Phillips and Yu (2011), but modified so that critical values are made robust to allow for possibly different data spans and sampling frequencies. There is evidence of bubble behaviour in the copper, gold and silver markets in the first half of 2006. Results are less conclusive for the aluminium market, and there was no evidence for a 2007-08 crude oil bubble.

Speculative bubbles are one aspect of financialisation that may exist at medium frequencies, but Nicholas Maystre (UNCTAD) presented some evidence about very high frequency behaviour. In ‘The Synchronized and Long-Lasting Structural Change on Commodity Markets: Evidence from High Frequency Data’ (with David Bicchetti), he examined intraday co-movements
between returns on several commodity markets and the stock market in the United States between 1997 and 2011. He computed various rolling correlations at 1-hour, 5-minute, 10-second and 1-second frequencies. It seems there was a clear synchronized break which starts in the course of 2008 and continues thereafter. This is consistent with the idea that recent financial innovations on commodity futures exchanges, in particular the high frequency trading activities and algorithm strategies have an impact on these correlations. So this is a call for research into the causes of this break. These two papers were essentially presenting evidence of phenomena requiring explanations. Moving back to identifying causes, Claudio Morana (University of Milan - Bicocca) presented ‘Oil Price Dynamics, Macro-Finance Interactions and the Role of Financial Speculation.’ The issue was the extent of the role of financial speculation in determining the real oil price. He explored this using a novel framework that allowed many variables to enter a multi-country model, partly by blocks of country variables and partly through factor augmentation, and with an usually large number of shocks. As ever, identification is the key, and in this case a Cholesky structure is used, ordering by blocks of shocks and within blocks. Subject to this, the paper concludes that while macroeconomic shocks were the major upward driver of the real oil price since the mid 1980s, financial shocks also sizably contributed since the early 2000s, and to a much larger extent since the mid 2000s. The third oil price shock was a macro-financial episode: macroeconomic shocks largely accounted for the 2007-2008 oil price swing. Ivan (Petrella, Birkbeck) also explored speculation, although in a different concept, in ‘Speculation in the Oil Market’ (with Luciana Juvenal). The paper was motivated by the fact that the run-up in oil prices since 2004 coincided with growing investment in commodity markets and increased price comovement among different commodities, and then asking whether speculation in the oil market played a role in driving this. However, in this context, following Kilian and Murphy (2011) a ‘speculative’ shock is not so much to do with financialisation as with beliefs about future demand which affect inventory holdings. From an econometric point of view, this enables identification by sign restrictions on impulse responses, including on inventories. The novelty in this paper is to augment the VAR with factors, a useful way of incorporating large amounts of information while still restricting the dimensionality of the problem. In other applications, augmenting VARs in this way is often argued to improve dynamic properties, for example by removing well-known ‘puzzles’ in VAR impulse responses. The main results were: that while global demand shocks account for the largest share of oil price fluctuations, speculation is the second most important driver; the comovement between oil prices and the prices of other commodities is explained by global demand and speculative shocks; and the increase in oil prices over the last decade is mainly driven by the strength of global demand. However, speculation played a significant role in the oil price increase between 2004 and 2008 and its subsequent collapse. In the final paper, 'Index Funds Do Impact Agricultural Prices' Simone Pfuderer and Christopher L Gilbert (both from Trento) performed a simple exercise using Granger-causality to re-examine the data analyzed in Sanders and Irwin (2011), who concluded there was no effect from the rise in commodity index trading. They found support for Sanders and Irwin's conclusion that no impacts are discernible for the four grains markets they consider. However, Granger-causality is established in the less liquid soybean oil and livestock markets. That seems to suggest that index investment does also have price impact in liquid markets but that market efficiency prevents the detection of this impact using Granger-causality tests.

References


Note:

Features

HMRC/HMT/ESRC Joint Research Programme

Tax Policy and Operations in the Context of Economic and Societal Change

About 18 months ago the ESRC/HMRC/HMT jointly funded seven research projects on tax administration. Gareth Miles,1 reports on the results.

In 2010 the Economic and Social Research Council, HM Revenue and Customs, and HM Treasury jointly issued a call for research projects ‘focusing on tax policy and operations covering business and personal tax, benefits and credits, compliance and enforcement’. Seven projects were eventually chosen to receive financial support and papers from three of the projects were presented at the 2012 Royal Economic Society conference held in Cambridge. These papers gave a good insight into the variety and quality of the research funded by the joint ESRC/HMRC/HMT programme.

Richard Disney’s project ‘Household responses to complex tax initiatives’ involves researchers from the Institute for Fiscal Studies and the University of Nottingham. The project examines how tax schedules give strong incentives for households to arrange their tax affairs so as to minimise their tax burden, but introduce complexities that forestall full optimisation. Consequently, individuals and households may respond to tax regimes and to tax reforms by approximations (for example, estimating marginal tax rates off estimates of annual earnings rather than total income in the tax year). Using both econometric analysis and a laboratory experimental, the research investigates whether individuals and households respond to non-linear tax structures and to tax reforms that change incentives, through retirement saving and labour supply decisions.

In a paper stemming from this research project, Rowena Crawford, Richard Disney, and Carl Emmerson looked at the effect of marginal tax rates on retirement saving. Given that reliefs on retirement saving are given at the marginal rate, there is obviously a stronger incentive for individuals on higher rates of income tax to engage in greater retirement saving. Less well understood is that individuals in receipt of tax credits could also engage in retirement saving as a means of increasing their eligibility for tax credits, since these are assessed on income net of pension contributions. Finally, couples can optimise their tax affairs by the individual with the higher marginal rate taking on the bulk of pension contributions.

Given the importance of these policy issues, it is something of a surprise to find that there is little previous literature in Britain on these policy concerns. One reason is the lack of good data on consumption and saving matched to asset holdings and pension contributions with which to pin down the effects of tax schedules and policy reforms. In the context of income tax rates, a further issue is that, while it is well-established that individuals with high average tax rates save a greater share of income, this may simply reflect differences in time preference and access to employer-provided pension plans rather than the impact of the tax regime per se.

The authors therefore looked for discontinuities in saving behaviour at marginal tax rate thresholds. This involved computing original (i.e. pre-tax and pre-pension contribution) income and earnings relative to taxable income and then looking for changes in behaviour across households at changes in predicted marginal tax rates. An example of the effect is given in Figure 1: it should be noted that the (relatively small) discontinuity in the probability of contributing to a pension around the threshold of the 40 per cent tax rate appears to take place based only on a measure of earnings rather than full income in the year until the end of the tax year, or approximating behaviour among households.

The research found that, if anything, the probability of contributing to a pension increases among both partners when one or other is at the high rate threshold — this may reflect some form of ‘signal’ by which a high rate of tax on one or other family member induces both members to plan their saving strategy more carefully — bearing in mind that there is an incentive to reduce tax liabilities by retirement saving at any positive rate of income tax. Finally, the research found no evidence that people understand the interaction between tax credit eligibility and tax reliefs on retirement saving, although the lack of response may also reflect liquidity.

www.res.org.uk/view/resNewsletter.html
The second paper from the Joint Research Programme summarised results from the project ‘A lifetime perspective on the distributional and incentive effects of the tax system’ led by Monica Costa Dias from the Institute for Fiscal Studies. The project seeks to increase understanding of the mechanisms driving individuals’ decisions to study and to work, and how the tax and benefit system influences these decisions. It aims to answer questions such as: how financial incentives to work change over the lifecycle; how the tax burden shared over the population and over the lifecycle; and what impact would changes to taxes and benefits have on the distribution of lifetime income and the incentives to work and invest in human capital?

The paper was joint work with Richard Blundell, Costas Meghir and Jonathan Shaw. It considered the long-term effects of in-work benefits in a life-cycle model designed for policy evaluation. In-work benefits have gained attention over the past 20 years as a number of countries have allocated gradually increasing resources to such schemes. The basis of in-work benefits are that they provide a method of transferring income towards low-income families provided that members of the family are in work. Their objective is to alleviate poverty whilst simultaneously mitigating some of the adverse effects other benefits have on the incentives to work.

The basis of the paper is that the generosity of in-work benefits may affect life-cycle decisions other than just employment. For example, the value of additional education may be affected by an increase in the value of employment through the insurance effect of in-work benefits. The insurance effect may be substantial, with partial protection against bad income shocks, which encourages individuals to remain in work and increase labour market attachment. This can have dynamic consequences on future employment and earnings through the effect on work choices and experience. These dynamic links may be of great importance in welfare evaluation. Responses in anticipation of being (directly) affected by a policy in the future may enhance its effects. For example, education decisions may be responsive to an expected change in the return to education caused by future policy.

The paper analysed these effects in a life-cycle model of women’s labour supply which incorporated human capital formation. Household decisions were taken in an uncertain dynamic environment with constraints on the availability of credit. The model included important features not previously considered in a single model. First, the dynamic process of family formation was explicitly accounted for. Second, a detailed description of the policy environment was used to accurately determine net earnings by employment status. The model was applied to assess the impact of UK in-work benefits. In-work (i.e. work-contingent) benefits were first introduced in the UK in 1971 with the Family Income Supplement. Several changes have occurred over time, with the scheme being re-labelled as Family Credit in 1988 and Working Families’ Tax Credit (WFTC) in 1999, and then split into the Child Tax Credit (CTC) and Working Tax Credit (WTC) in 2003 (Child Tax Credit can be claimed by those not working).

The model was calibrated on a large set of data moments from the nineties under a policy environment reproducing the April 1999 regime. Many important empirical features were closely reproduced, including the empirically estimated short-run effects of the WFTC reform on employment rates. Simulations were then used to study the impact of WFTC and WTC/CTC on women employment, family income, and education decisions. The results show a small but non-negligible anticipation effects on employment and education. There was a substantial employment effect for lone mothers and mothers in couples but a small impact on education choices. The employment effect was due mainly to reallocation of hours across the lifecycle rather than changes in the nature of employment. The results identified some anticipation effect, but this had little impact on employment during eligibility.

The third of the papers was ‘Distortionary Taxation, Debt, and Immigration’ Michael Ben-Gad from City University addressed the extent to which governments can shift the cost of government expenditure from today’s voters to future generations of immigrants without resorting to taxation that is explicitly discriminatory between the groups. A government that can shift the cost onto future immigrants is able to buy current popularity by financing current expenditure without placing the burden of debt service on current voters or their descendants.

The analysis investigated the behaviour of an optimal growth model with overlapping dynasties. This allowed quantification of how much the government could shift the burden of taxation between the present-day inhabitants of a country and the future immigrants. The policy tools at the disposal of the government were the rates of distortionary factor taxation and level of deficit finance. The best perspective from which to judge the finding of the paper is relative to the results for a standard macroeconomic model with representative agents and inelastic labour supply. In such a model, if government expenditure is a fixed share of net national product, the government can minimize the deadweight loss of factor taxation by holding the tax rate on capital constant over time and equalizing the long-run tax rates on capital and labour income.

In contrast, in a model of an economy without representative agents, in this case one that is absorbing a continuous stream of immigrants, debt is not neutral. This creates the potential for redistributing resources from future immigrants to natives by deviating from
The adjacent words, written in the New York Times by a departing Goldman Sachs executive, confirmed what many people already believed about the financial markets, if not before the crisis that started in 2008, then certainly afterwards. These markets are widely seen as having become fundamentally anti-social. So too, by extension, all markets, and economists in general as the principal advocates of markets as the organising structure of modern society. While this is an exaggeration of popular views, evidence from opinion surveys suggests there has been a reappraisal of the pro-market philosophy dominant in public policy since the early 1980s. Although majority public opinion continues to support a market-based economy, there is little popular enthusiasm for how actual markets have been behaving. Markets have brought inequality, unemployment, and austerity. Dissatisfaction with actually existing capitalism has been strong enough to get a fair number of people out onto the streets to ‘Occupy’ the commanding heights of the global economy in the City and on Wall Street. Liberal intellectual opinion has become shrill in its denunciations of economics. In fact, there is a long tradition of writers seeing economics as conflicting with more important values or cultural traditions.

It is no surprise that the deepest and longest economic downturn since the Great Depression has encouraged a revival of this kind of criticism. If economists are supposed to help prevent or alleviate economic crises, we have obviously not been doing a good job. While plenty of economists insist there is no fundamental problem with the subject, many more would reject the hyperbolic attacks from novelists and protestors, many other economists are reflecting seriously on the lessons of the crisis for their intellectual framework and for the practical role they play in the world of public policy. Keynes famously said economists should be ‘humble, competent people’ like dentists, fixing things that go wrong and making modest improvements in people’s lives. Instead we have turned out to look more like Dr Frankenstein, unleashing an idealistic experiment that has run monstrously amok, causing devastation.

These days, the most common question I get from junior analysts about derivatives is, ‘How much money did we make off the client?’ ….. I attend derivatives sales meetings where not one single minute is spent asking questions about how we can help clients. It’s purely about how we can make the most possible money off of them. It astounds me how little senior management gets a basic truth: If clients don’t trust you they will eventually stop doing business with you.

Have economists created a monster?
I am going to start by looking at the case that economists have created a monster, and that economics has shaped the world in its own dysfunctional image. There is some truth in this, in my view, especially when you get beyond the literary exaggerations. My profession does bear some responsibility for what has happened, in a way I will explain below. But I will go on to argue that this is most true of a particular approach to economics, one which has been in retreat for some time and will turn out to have been finally discredited by the great crisis. The economic catastrophe could indeed be the making of a stronger economic science, re-rooted in the natural sciences, as it was at its birth in the Enlightenment.

It should not really be controversial among economists — although it will be — to suggest that economics as an intellectual discipline and professional practice has actually helped shape the economy. Beliefs about the way the economy works and expectations about the future have a central role in every approach to the theorising, or modelling as it is referred to in our jargon. In particular, the orthodox macroeconomic models — algebraic summaries of the whole economy at an aggregate level — assume that agents (as we call people) have more or less correct beliefs or ‘rational expectations’ about the economy. At one level this is a reasonable assumption that you can’t fool all of the people all
of the time: if they are systematically proven wrong, they will change their beliefs. In practice, it becomes a strong assumption about the information and powers of calculation that millions of real people actually have. However, the key point about the assumption that behaviour today depends on more or less correct beliefs about tomorrow is that it opens the door to self-fulfilling outcomes. Whenever expectations matter, ideas have the power to shape reality. Keynes’s insistence on the importance of ‘animal spirits’ for investment and consumer spending is captured and pinned down in these formal rational expectations models, albeit not in a way he would appreciate. Even asset price bubbles can be rational in this way: as long as most investors expect the price to continue rising, it will do so.

Economics owes the terminology of the self-fulfilling outcome to the sociologist Robert K Merton, although there are many earlier examples of the idea. One classical self-fulfilling prophecy is found in the Oedipal myth; Laius’ reaction to the prophecy is what brings about the tragedy it foretells. As soon as the formal economic models that were developed from the late 1970s on incorporated a central role for expectations in decisions, almost everything became self-fulfilling — indeed, instantaneously so in economists’ unearthly world of perfect information and no frictions. However, economists have never given much thought to the theoretical possibility this opens up, namely, that the way economics thinks about the economy can become self-fulfilling too, that the principle works outside the models as well as inside them. If mainstream global economics models the economy or the financial markets in a certain way, and that enters the thoughts of public officials or financial market traders and shapes their beliefs and expectations, couldn’t reality change to reflect the model?

This is the strong version of self-fulfilling prophecy, now often described as ‘performativity’. The canonical example is the model for pricing financial options. Robert K Merton’s son, Robert C Merton, was jointly awarded the Nobel Memorial Prize in Economics in 1997 for devising this model (with Myron Scholes - Fisher Black, the other co-author of the original Black-Scholes model, having died earlier). The investment company he co-founded to put it into practice, Long Term Capital Management, went bankrupt with losses of $4.6 billion in 2000, in a kind of practice run for the later financial crisis. It is hard not to see some strange echo of the Oedipal story in this, especially as his father is rumoured to have invested in LTCM.

How did the options pricing model of Merton filiis alter financial reality in its own image, ultimately bringing about his catastrophic financial downfall? The sociologist Donald MacKenzie has traced the massive growth of derivatives markets since the 1970s to the availability of a practical model for pricing these financial instruments. Merton’s contribution was to provide a simple version of the pricing formula for options, one that was more intuitive for traders in the markets than competing approaches because it related the option price to the volatility of the price of the underlying asset from which it was derived. What’s more, Fisher Black, a co-inventor of option pricing along with Merton and Myron Scholes, also provided a commercial service to the financial markets in Chicago. His business calculated various options prices using the Black-Scholes-Merton model on computers away from the market and circulated as single sheets of paper that a trader could roll up into a cylinder for ease of reading a specific column. MacKenzie presents evidence that over a few years options prices observed in the US financial markets converged to those predicted by the model, the discrepancies between the model and the reality declining decade by decade as an ever-larger proportion of traders in the market used the same model for pricing their transactions. He also argues that the intellectual status of an economic theory born in the University of Chicago helped encourage the regulatory authorities not to ban options trading as a form of gambling. The combination of a trader-friendly model (subsequently greatly extended as the computer revolution made it easier for others to calculate prices according to the model), the successful commercial provision of pricing sheets, and sympathetic regulators brought into being a global derivatives market from almost nothing in 1970 to a notional value of $1.200 trillion by 2010.

There is clearly more to this story than the intellectual act of creating and publishing an economic model. However, the argument that the Black-Scholes-Merton model played the Dr Frankenstein role in creating modern derivatives markets seems quite strong, although it is only with hindsight that the case for regulatory prohibition in the early years seems so strong.

Important as they are, culpable as they are in causing the crash, financial markets are not the whole of the economy, and the Efficient Markets Hypothesis is not the whole of economics. The computers trading in financial markets are not economists, nor embodiments of economics in any way. Many, probably most, economists would not regard finance theory and the Efficient Markets Hypothesis as the pinnacle of their subject, to say the least. The out-of-control financial markets need to be tackled, but to do so will do no violence to economics.

A number of economists have objected to my suggestion that the excesses of the financial markets have anything to do with economics at all. They note that many economists were in fact warning of unsustainable asset bubbles in the run-up to the Crash (albeit that few specifically predicted a major banking crisis). This is absolutely correct. Political philosophy, the power of financial institutions, their lobbying of government, and sheer greed all bear much greater responsibility than
does economics, or even options markets. If politicians and regulators had really been listening to economists, the crisis might have been averted. There is also a strong defence of the potential for financial markets to improve society. A well-ordered financial system helps individuals and businesses manage risk, and channels savings to the most productive investments. Robert Shiller, famous as one of the economists who predicted the crash, has also argued for an example, to help countries insure each other against the costs of natural disasters.11

But those offering these defences overlook two points. First, other people believe financial markets and economics are the same thing. Secondly, economics did play a fundamental role in giving birth to the modern financial markets. Economists cannot plausibly disinherit the financial monster without a clearer account of the separation.

There are some other examples of economics shaping the world, although I do not think the claim of ‘performativity’ has nearly the same force outside finance. Indeed, there are some areas of economics

“The neoclassical approach does tend to dictate a particular regulatory philosophy, in which policymakers ideally seek to identify the specific market imperfections preventing the attainment of complete and efficient markets, and in which regulatory intervention should ideally be focussed, not on banning products or dampening down the volatility of markets, but on disclosure and transparency requirements which will ensure that markets are as efficient as possible.

These propositions, and the strongly free market implications drawn from them, have played a somewhat dominant role in academic economics over the last several decades, though with dissenting voices always present. But they have been even more dominant among policymakers in some of the finance ministries, central banks and regulators of the developed world.13”

where we might like it to operate, but it does not. One example is monetary policy, where policymakers would like their models to convince everyone that inflation will stay on target, but unfortunately they have imperfect credibility.

Still, since the governments of Ronald Reagan in the United States and Margaret Thatcher in the United Kingdom, a specific kind of economic approach has become quite widespread in public policy. This approach puts an emphasis on markets as the organising principle for the economy and in particular advocates the merits of free markets. The role of the state should be confined to specific ‘market failures’ or the provision of certain ‘public goods’; textbooks give standard examples such as pollution, congestion, or the state provision of basic education. It is important to appreciate that the ideology of a minimal state and expanded ‘free markets’ only gained such enormous political traction because of the experience by the 1970s of profound ‘government failure’. Like many Britons of my age, I have powerful memories of doing homework by candlelight and walking past rubbish piling up on the streets. The subsequent privatisation of nationalised industries and deregulation of markets delivered better services and greater choice. We were finally allowed to take spending money freely on foreign holidays and could get a telephone line without months of waiting.

The economic theories embraced by the Thatcher and Reagan revolution were not the mainstream approach at the time; but the contemporary rational expectations revolution, at its high tide in the early 1980s, was successfully melded to the then-unfashionable economics of Friedrich von Hayek and economists such as Milton Friedman who admired him. Although academic and professional economists gradually moved away from the abstractions of the rational expectations models, this took many years and has been a particularly slow process in some important respects. This includes macroeconomics, the study of the aggregate economy, which even now remains wedded to simple ‘dynamic stochastic general equilibrium’ models even though the evidence of recent events demonstrates their inadequacy.12

It also, crucially, includes the standard economics applied to questions of public policy. Adair Turner, Chair of the Financial Services Authority, highlighted this in a post-crisis speech quoted in the adjacent box.

Academic economics has moved on substantially, but under Conservative and Labour governments for more than a quarter of a century, the scope of markets as a means of organising public as well as private economic activity has been extended. The privatisation of formerly nationalised industries is one example. Even though these industries are still regulated by the government, the intellectual framework for this regulation is, as Lord Turner describes, the correction of a well-defined ‘market failure’, a specified reason such as an externality or information asymmetry for a breach in the general principle of the desirability of markets. The boundaries of the economic activities that take place in the public rather than the private sector vary from country to country, suggesting there is room for debate about whether the market can and should organise the supply of water and electricity, or rail and air services, or even health care in part or as a whole — although it should be emphasised that the share of government spending in the economy has been on an upward trend everywhere over long periods of time, so it is hard to
sustain the argument that markets are displacing government extensively.

However, the market mindset has also been applied to the business of government itself, under the rubric of New Public Management. The logic of rational choice was first applied to politics and administration by James Buchanan and Gordon Tullock in their 1962 book, *The Calculus of Consent: Logical Foundations of Constitutional Democracy*. This first introduction of the idea that incentives determine administrative or policy decisions as well as economic choices in the marketplace paved the way a generation later for the much wider introduction of the calculus of incentives in public life. This approach, like the donning of market failure spectacles to circumscribe the government’s role in economic management, is still very much with us — probably too much so. There has been a backlash against some manifestations of it, including the use of quantitative performance targets that clearly divert the behaviour of public sector workers towards the achievement of their specific targets rather than the fulfilment of their underlying purposes. However, the philosophy of using incentives rather than ethos or values or professionalism to extract a better performance from the public sector is as live as ever in the current political debate. So too is the use of competition (or ‘contestability’) in the delivery of public services.

Unease about the growing scope of markets pre-dates the financial crisis, however, not least because the distorting effects of target-setting indicate that creating incentives for desired behaviours is a subtler and more difficult matter than the architects of public service reform imagined. Michael Sandel has revisited in a new book the subject of his 1998 Tanner Lectures at Brasenose.14 In *What Money Can’t Buy: The Moral Limits of Markets*, Sandel argues that economics is to blame for the extension of markets and market-like thinking into wholly inappropriate spheres of life. His argument is that markets have led to a degradation of moral and civic goods, because they introduce an inappropriate mode of valuation. Marketisation of areas such as prisons and even war (through the use of commercial security firms) has corrupted the democratic ideal of citizenship.

Post-crisis, the critics of economics have plenty of new ammunition to lob at the subject. However, mainstream economists tend to be dismissive of the critics, either the non-economists or the economists who identify themselves as ‘heterodox’, content with a rapidly-growing body of empirical research suggesting that in many contexts ‘markets’ do lead to more desirable outcomes than direct government management of the economy. However, economists know — as non-economists generally do not — that the character of economics itself has changed substantially during the past 25 years.15 In many areas of economics the free market version that has shaped so much public policy is long, long gone, replaced by a modern mainstream version that combines the classic emphasis on the power of incentives and the inevitability of choice with a more recent evidence driven understanding of human psychology, the effects of technology, the importance of institutions and culture, and the long hand of history. So, for example, economists have been eager adopters of so-called ‘behavioural’ models and findings from cognitive science that demonstrate without any doubt that the standard rationality assumptions of conventional economics are invalid in some circumstances. Similarly, institutional economics incorporates collective decisions as being more than the sum of separate individual decisions. It recognises that people have different interests and that politics — with either a small or a large ‘p’ — will have an important effect on economics.

In other words, much of the economics that academic economists now do bears surprisingly little relation to the everyday economics debated in politics and applied in public policy. Paradoxically, the leading economists practicing the eclectic modern mainstream (whether their field is behavioural or institutional economics, or the economics of ‘happiness’, or political economy) are often celebrated by commentators who at the same time are very critical of ‘economics’. By the latter, these critics seem to mean the narrow, abstract version of economics adopted by Mr Reagan and Mrs Thatcher. That has been taken too seriously for too long outside the profession.

Equally, though, economists have kept too quiet about its slow but steady decline within the profession. For example, historian and philosopher Jonathan Rée recently wrote a glowing review of a new book by Paul Seabright, a leading economist at the University of Toulouse. But Rée asserted that Seabright is regarded by other economists as an ‘oddball, even a miscreant’.16 This is so wide of the mark that it is baffling, and I think Rée simply cannot imagine that an economist interested in psychology and anthropology is a reasonably mainstream and highly respected member of the profession. Many of us have long known that economics as it is actually practised has become much subtler than the public version, but few have said so, prolonging the misperception that we are all free market ideologues. I think the explanation might be a kind of professional courtesy to just one branch of economics, albeit an important one. That is macroeconomics, a specialization of relatively few professional economists, but absolutely dominant in the public eye. Normal people think that macroeconomics, forecasting inflation and growth, setting interest rates or the level of government borrowing, is what all economists do. Macroeconomic forecasting is indeed an important function, and is covered by the media constantly, so people must be forgiven for thinking this is the most
important part of economics. Unfortunately, macroeconomics is one of the last specialisms within the subject to cling to the narrowness of perspective our critics habitually attribute to us. At least until the crisis, pointing this out from within the profession felt a bit like admitting to the mad wife in the attic, a guilty secret to be kept inside the family. It should be added that macroeconomists by and large disagree with this statement. Many would argue just that their area of the subject needs reform, not revolution.

NOTES:
1. Diane Coyle is Chairman of Enlightenment Economics and Visiting Professor, Institute for Political and Economic Governance, University of Manchester. Diane has also served on the Council of the Royal Economic Society.
2. The full text of the lectures can be read at www.bnc.ox.ac.uk/376/about-brasenose-31/tanner-lectures-244.html. Details of the Tanner Foundation can be found at www.tannerlectures.utah.edu/

Course on Panel Data Models

We invite you to attend a one-day ‘Course on Panel Data Models’ at the Faculty of Economics, University of Cambridge, on May 29th 2013. The event is intended towards researchers interested in topics related to panel data models, and in particular postgraduate students who would like to update and enhance their research skills on panel data analysis. The course will include a series of technical presentations and product demonstrations that will provide attendees with new knowledge and skills that they can start applying immediately. The course is free of charge.

Highlights
Spatial panel data
Prof. Badi H. Baltagi, Syracuse University
Large panel data models
Prof. George Kapetanios, Queen Mary, University of London
Panel data models
Prof. M. Hashem Pesaran, University of Cambridge
Developments in panel data modelling
Prof. Ron Smith, Birkbeck College, University of London

The GVAR Toolbox
Dr. L. Vanessa Smith, University of Cambridge

Please note that the course is highly competitive. Therefore, potential participants are encouraged to apply early. Go to:
http://www.econ.cam.ac.uk/CSDPDM/phd/phd.html

Fill in the application form and email it together with your Curriculum Vitae (CV) to: panel-conf@econ.cam.ac.uk by 28th September 2012.
The competitive position of Dutch schools of economics

Since English universities began charging substantial fees to undergraduates, there has been considerable interest in the possibility of English students studying elsewhere in the EU. The Netherlands is one popular destination. In this article Professor Ivo Arnold, Vice Dean and Professor of Economic Education, Erasmus School of Economics, Rotterdam, explains the situation from a Dutch perspective.

The recent decision of the UK government to substantially increase student fees for higher education will have an impact on international student mobility. Dutch schools of economics are well-placed to receive a larger inflow of UK students. At the same time, some Dutch politicians are concerned that higher international student mobility will increase the costs to the Dutch taxpayer. This article discusses the effects of the fee increase from a Dutch perspective.

Introduction
In February 2011, I happened to be in the UK for a conference. Watching the BBC news in my hotel room, I heard that Imperial College London had just announced that it was going to charge the maximum fee of £9000. The news item also included glimpses of Maastricht, a pretty small town in the south of the Netherlands whose university is a magnet for German students. The message was clear: the fee increase presents UK students with an international arbitrage opportunity. Back at Erasmus University Rotterdam, I called together my marketing team to discuss new marketing efforts specifically aimed at UK students.

This reaction illustrates the fact that in the Dutch system, educational institutions individually have an incentive to maximize their recruitment of foreign students. Students from within the EU pay a relatively low tuition fee (at present around €1600). The remaining costs are covered by the Dutch government. However, this rational response of universities has led to such an increase in inbound student mobility that some politicians openly question whether the Dutch government should continue to cover the cost of educating foreign students.

This contribution sketches the general Dutch context regarding student mobility and internationalization. Next, I discuss the positioning of Dutch programs in economics. I conclude with a summary of the policy debate.

General context
Dutch higher education consist of 14 research universities (240,000 students) and 39 universities of applied sciences (416,000 students). Together, these institutions offer 1,088 English-taught degree programs. Inbound international student mobility in Dutch higher education has risen from 10.6 per cent of the annual intake in the academic year 2006/2007 to 15.3 per cent in 2011/2012. In absolute numbers, 20,723 international students enrolled in 2011/2012 in a degree program at either the Dutch research universities of the universities of applied sciences. The majority (73 per cent) originate from the European Economic Area. By far the largest group comes from Germany (43 per cent), followed by China (7.8 per cent) and Belgium (4.9 per cent). The UK is ranked in 8th position, with 887 students enrolling in 2010/2011. A recent development is that the Dutch system welcomes an increasing number of students from Greece. In spite of free education at home, they are fleeing their country because of low educational quality and diminishing job prospects. My own institution last year received a record number of 200 applications from Greek students for master’s-level courses.

In contrast, outbound mobility is low, with ca. 6000 Dutch students leaving annually for a foreign degree program. Behind neighbouring Belgium (31 per cent), the UK is the most popular destination for Dutch students (20 per cent). In contrast, just 10 per cent choose a German destination.

Inbound student mobility is split evenly between the research universities (46 per cent) and the universities of applied sciences (54 per cent). In the latter group, international student primarily enrol in bachelor programs. Foreign enrollment at the research universities is evenly split between the bachelor (52 per cent) and the master (48 per cent) level. The most popular subject area for foreign students is Economics (which in the statistics includes Business and Econometrics). This also applies to students originating from the UK.

Positioning of Dutch economics programs
‘Good quality at a low price’ would be an adequate summary of the competitive position of Dutch programs in the European landscape. In addition to geographical proximity, the strong presence of German students at Dutch universities can be explained by a difference in educational quality. Even though the German system is state-funded and has low or zero tuition fees, many German students prefer the small-scale, student-centered educational system in the Netherlands to the more traditional system in Germany, which is characterized by crowded universities and large-scale teaching.
In contrast, under the old fee system UK students didn't have a strong reason to study in the Netherlands. UK universities have a more modern approach to teaching than their German counterparts and are also more advanced in educational innovation than their peers in continental Europe. For example, the economics network of the Higher Education Academy, which gathers and disseminates good practices in economics learning and teaching, has no equivalent in the Netherlands. For students from the UK, educational quality is not a commanding reason to move to the Netherlands.

In the perception of international students, the value of a degree is mostly linked to the research reputation of the university. Research reputation is thus an important factor in international student recruitment. Compared to the size of the Dutch economy, Dutch universities do very well in the international rankings. The Netherlands has four universities in the top 100 of the Times Higher Education (THE) ranking. Twelve Dutch research universities are listed in the THE top 200, a score which is only surpassed by the US (75) and the UK (32). Relative to GDP, only Hong Kong does better. The competing QS ranking, published by the Guardian, also lists rankings by subject. In Accounting & Finance, two Dutch schools are listed in the top 50 (Erasmus University Rotterdam at 37 and University of Amsterdam at 45). A similar outcome is shown in the QS ranking for Economics & Econometrics (Erasmus University Rotterdam at 36 and University of Amsterdam at 44). In the Tilburg University Economics research ranking (which, admittedly, is constructed in the Netherlands), Dutch schools are also well-represented, with five schools in the top 100 (compared to 9 for the UK). While Dutch economics schools are thus not in the same league as the top US and UK schools, they are highly-regarded internationally. Among Dutch economics schools, Erasmus University, Tilburg University and the University of Amsterdam are the main players, in size, in diversity of their program portfolio and in reputation. A legacy of the Dutch Nobel-prize winning econometrician Jan Tinbergen is the strong Dutch tradition and position in econometrics. The Netherlands is one of the few countries where students can follow a full-blown bachelor program in econometrics from the start. Erasmus University offers the largest econometrics program, which is also offered in English. This implies that Dutch economics programs can be an attractive proposition for UK students who do not qualify for the top UK economics schools and are searching for alternatives with a favourable price-quality ratio.

Evidence is still scarce

Does the evidence show that UK students are flocking to the Netherlands? Unfortunately, it is difficult to provide a definitive answer to this. The data collected by the Dutch statistical agency lag behind and also do not offer a detailed two-way breakdown by subject and nationality of international students. A complete overview is thus still missing. Yet there are signs that the UK fee increase has an effect on inbound student mobility from the UK. In November 2011, Maastricht University reported a surge in inflow from the UK. Compared to 2009 the number of UK students enrolling at Maastricht University has increased five-fold. At Erasmus School of Economics, we currently see an increase the number of applications from the UK from 10 in 2011 to 25 in 2012. Though this is a high percentage change, it comes from a small base. The UK contingent therefore currently remains small compared to the number of German, Chinese and Greek students. While our institution very much welcomes this increase and its positive effect on the diversification of our international student population, it is hard to imagine that flows of this size will have a serious negative impact on educational institutions in the UK.

Policy debate

The Dutch policy debate on the imbalance in international student flows has not been triggered by the UK fee increase, but by the high number of German students and the way in which Dutch universities have acted in the German market through their marketing efforts and even by offering German-taught programs specifically aimed at German students. The radical right-wing PVV party has been the most vocal opponent but also more moderate voices question the continued subsidizing of the education of foreign students by the Dutch taxpayer. However, a recent report by the CPB — the Dutch government agency for economic policy analysis — concludes that the presence of foreign students also enriches the Dutch educational system. In addition, when foreign students remain in the Netherlands after graduation, they contribute to the economy by working and paying taxes. The CPB estimates that this effect is stronger than the cost of educating foreign students. Still, the government plans to curb the excesses in tailoring Dutch programs to the German market. In the European context, plans for reforming the funding of higher education in order to limit arbitrage opportunities will remain on the policy agenda.

Conclusion

Dutch economics programs offer good value-for-money and are thus an attractive proposition for UK students considering a low-cost alternative to studying in the UK. The preliminary data show that inbound student mobility from the UK is on the rise. But it comes from a low base and is still smaller than outbound mobility of Dutch students to the UK. Dutch universities generally regard an increase in UK students as an opportunity to further increase the diversification of their international student population. The high number of German students in the Netherlands and the aggressive recruitment efforts of some institutions in Germany have recently attracted political attention. A strong future increase in inbound mobility from the UK would therefore certainly lead to more calls for reform of the way we fund international student mobility in Europe.

www.res.org.uk/view/resNewsletter.html
I am originally from Lancashire in the UK and completed my bachelor’s degree in Economics at the University of Bristol. Once I decided that I would like to study for a master’s degree, I focused on finding a course outside of the UK, as I wanted to do something a little different and was looking for more than just an academic education. Travelling has always appealed to me and I felt that studying abroad would provide a good opportunity to combine this interest with my studies. I also felt that this would help me to determine whether I would want to live abroad on a more permanent basis.

The Netherlands stood out as a good possibility as the country has a number of well-respected universities that offer a wide range of courses in English and it seemed possible to live perfectly well in the Netherlands without knowing the local language. In addition to this, master’s courses in the Netherlands are much cheaper than those in the UK, particularly for courses specialising in Economics and Finance. In the Netherlands, all students from EU countries pay under EUR 2,000 per year.

I eventually chose to study Financial Economics at Erasmus University Rotterdam. The university has a solid reputation in this field of study and the course allowed me to focus my studies on my core interests. Further to this, the University is very internationally orientated and seemed to provide good support to those coming to study at the University from outside of the country. Rotterdam itself is also an interesting and lively place that is well located for exploring other cities. Amsterdam and The Hague are just a short distance away, while Brussels, Antwerp and Paris also are easily reachable by train.

Unlike the UK, the majority of students in the Netherlands study for a masters degree following their Bachelors education. In terms of course content, contact hours and further studies beyond masters level, there is little difference between the UK and the Netherlands from what I’ve seen, although I have never actively researched the latter point.

The main difference that I have found between the two countries is that much less emphasis is given to traditional closed book examinations in the Netherlands and more focus is given to the practical application of material and soft skills. While this varies from course to course, only one third of my final grade for the programme I am following is determined through examinations. Instead, approximately half of my grade is determined by performance during seminars, whereby group work, participation in class discussions and presentations form the bulk of the assessment.

With regards to living in the Netherlands, there are few problems not being able to speak Dutch, as the majority of Dutch people speak very good English, although there are definitely times where knowing the language would come in useful.

Overall, I have felt that studying in the Netherlands has been a great experience for me and I would have no problem in recommending it to anyone considering studying abroad.
Members for the Migration Advisory Committee

The Migration Advisory Committee (MAC) is a non-statutory, non-time limited non-departmental public body established and funded by the Home Office. The MAC is comprised of a Chair and four other committee members who provide independent and evidence-based advice to the Government on migration issues. The questions the MAC addresses are determined by the Government. It has previously advised on the design of Tier 1 and Tier 2 of the Points Based System for managed migration; the transitional labour market access for citizens of new European Union accession states; the first and second limits on Tier 1 and Tier 2; and the impact of immigration on the labour market and public service. The MAC is regularly asked to update the Tier 2 Shortage Occupation Lists.

Committee Members

The MAC is seeking to appoint two members who will bring their weight of experience, professional expertise and credibility to this important role. They will be economists with distinguished records in business or academia.

The role

The two appointed committee members will have the responsibilities of:

- attending and contributing at MAC meetings;
- examining and challenging, if necessary, the assumptions on which advice is formulated;
- ensuring that the MAC has the opportunity to consider: the available evidence on a given issue; contrary views; and, where appropriate the concerns and values of corporate partners before a decision is taken;
- advising on how the MAC’s research budget should be spent;
- acting with a presumption of openness; and
- acting in accordance with the Home Office Framework Document for the MAC.

Remuneration and Time Commitment

This role attracts an allowance of £275 per day for two days a month (24 days a year). The initial appointment will be for a period of 3 years. The roles will be based in London; however, some travel within the UK may be required. If you want to find out more, including nationality and residency requirements, please request an information pack, by calling Migration Advisory Committee Secretariat on 020 7035 4339, 2nd Floor Fry Building, 2 Marsham, Street, London SW1P 4DF, during office hours or by visiting our website at MAC@homeoffice.gsi.gov.uk quoting reference [EC20720122]. The closing date for receiving applications is 25 July 2012.

Obituary

Brian Hindley (1935-2012)

I met Brian Hindley in 1985 at one of my very first international conferences on trade policy. After my presentation, Brian came to me, and, with his usual kind and warm simplicity, he told me that we should work together on European trade policy matters. Such a behavior reflects his spontaneity, lack of prejudice and ultimately deep modesty. At that time, Brian was already a deeply respected economist, one of the leading figures of the Trade Policy Research Centre (TPRC) which was at its zenith as a think tank.

First and foremost, Brian was a ‘man of conviction’. This is a frequent feature among PhDs from the University of Chicago — he was proud to be from this university. But, I never saw him aggressive or intolerant, even when his arguments were devastating for his opponents. He conveyed his convictions through a very active involvement to a string of think tanks: the TPRC, the Trade Policy Division at the World Bank (which was run as a think tank in the 1980s), the Bruges Group which supported a ‘Thatcherian’ view of Europe, the Centre for European Studies (CES), and lastly the European Centre for International Political Economy (ECIPE) where we were blessed to have him on board since its creation.

Brian was a very influential member of all these think tanks. In the 1970s and 80s, his TPRC years were largely devoted to fighting the then fashionable ‘new’ protectionism (voluntary export restraints). His papers focused on the costs of Britain’s trade policy, and he was one of the first to provide well-documented analyses of sectoral protection with calculations of the costs and benefits of protection in a partial equilibrium context. He was also among the first economists to deal with services (insurance) at a time when everybody was obsessed by steel and textiles.

When he became closely associated with the World Bank, he expanded his work on developing countries. He was among the first economists to both argue forcefully that the ‘special and differential treatment’ on which the developing countries were insisting in the GATT was a deadly trap for them, but also that the rich countries were imposing discriminatory protection very detrimental to the poorer countries’ development.

During his World Bank years, Brian discovered a topic that he never abandoned: the then still confidential instruments of protection-antidumping, anti-subsidy and safeguard. This ‘conditional protection’ was a topic of great fascination for both of us. Their intrinsic nature of well defined legal cases involving a limited amount of firms, the corresponding rich and detailed information on what was really going on allowed economists to have deeper insights on how protection really works—how a few firms are able to capture governments and to ‘privatize’ protection. All these features permitted Brian to be...
Obituary

Brian Hindley

one of the most persuasive economists on underlining how deeply these instruments were quietly-but devastatingly — taking over ‘industrial policies’ which were increasingly out of fashion.

It is when we were both working on conditional protection that Brian taught me the beauty of simple economic analysis and clear language. He was a master in these domains. Hearing Brian analyzing an antidumping case-jumping from law to economics and vice-versa, stating carefully and clearly his initial ‘propositions’ — in his classic and classy English was always a feast to my ears.

The next period was his ‘Thatcherian’ years, starting with the Bruges Group. The huge costs of the Common Agricultural Policy, the deep ambiguities behind the creation of the single market, the poor quality of the debates on the euro and on the so-called European Constitution convinced him that the United Kingdom would benefit from leaving an European Community rebaptised European Union. I only now realized that what he had in mind as the optimal British trade policy is indeed the trade policy that Chile or South Korea have pursued during the past decade with great success, by establishing a set of bilateral free trade agreements as a substitute for stuck WTO negotiations. He was a couple of decades ahead.

During his ECIPE years, he expanded his work on antidumping and services—with a special interest for ‘protection online’ related to internet in a WTO-based world where co-exist collusive strategies, political censorship, moral or religious considerations. He also turned to new issues, such as the naïve EU ‘soft’ power which is so short of serious analyses of the economic impact of EU regulations on the intended non-EU beneficiaries, such as in the case of illegal logging. He also became interested in the bumpy road to the WTO of two key former USSR countries—Russia and Kazakhstan—arguing for well-focused progress, rather than a WTO-based grand design.

When, twenty years ago, he was talking to me about this brave new world emerging in front of us, Brian showed a much deeper understanding of the full consequences of the rise of East Asia than many Europeans or Americans today. This is because he was looking at East Asia in a profound way, as the ‘adventurer’ he was, eager to meet people, and not only to talk about economics. He was very proud to have been an ally of Akio Morita, the charismatic Sony’s CEO. For him, it was one of the best recognitions he ever got of his role as a ‘bridge’ between people and of his independent mind. A final tribute to his personality. Brian was always ready to laugh but — and that is a true rarity — he also loved to be teased. We used to tease each other endlessly, including about his firm conviction as a Republican Englishman. I cannot resist to tease him a last time: Brian was a true nobleman.

Patrick A Messerlin
Sciences Po, Paris

www.res.org.uk/view/resNewsletter.html

Tax policy and operations

from standard optimal policy, and the immediate welfare gains from doing so can outweigh the loss in efficiency. This effect generates a bias in favour of deficit finance. The bias in favour of deficit finance is not without limit: today’s population or their descendants must still pay higher taxes and live with the distortions these taxes generate along with the immigrants. Instead, for a given rate of immigration and policy horizon, the government will choose policies that balance the deadweight losses associated with fluctuating tax rates suffered by the initial population and its descendants, against the benefits that accrue to this same population if postponing part of their tax payments can shift some part of the burden to future arrivals. This can be to the benefit of people already resident in the country and their descendants.

The flow of most international migration is from low-income to high-income countries so migrants typically arrive at their destination with negligible amounts of capital, at least in comparison to the stock of capital owned by the typical established resident. This provides an explanation for why the government might choose to shift the burden of taxation towards wages from which immigrants derive disproportionate share of their income and lower the tax on capital while maintaining a balanced budget.

Given this theoretical finding the talk proceeded to test whether the effect could apply for realistic parameter values. Michael used data for the United States between 1980-2010 to calibrate his model and calculate the optimal fiscal policy from the perspective of the native population. This was undertaken for a wide range of different rates of immigration. The welfare gain that accrued to the members of the native population as policymakers shift both the degree to which they rely on deficit finance to pay for government expenditure and the length of time during which they continue to accumulate this extra debt were quantified. The calculations showed that the predictions of the model did a good job of matching the forecasts produced by the US Congressional Budget Office under their Alternative Fiscal Scenario which predicts rising levels of the debt burden. The paper showed how expenditure policy can be influenced by the presence of immigration and gave a new perspective on rising debt levels.

The three papers from the Joint Research Programme presented at RES 2012 demonstrate the benefits of collaborative funding between ESRC and HMRC/HMT. The joint funding model has generated research of the highest academic quality but with relevance to strategic policy-making.

Note:
1. Professor of Economics, University of Exeter and Research Fellow, Institute for Fiscal Studies. A longer version of this report is available on our website.
RES News

RES Website

We hope that our members are enjoying the newly designed website. The latest news and events, online access to journals, webcasts of Public Lectures and Conference keynote speakers, online RES Newsletter, media briefings, conference diary and the full range of information on grants and funding available to our members can now be found easily at www.res.org.uk. We welcome your comments and feedback on the new design and any developments you would like to see via the Contact Us form or to the RES Office on royaleconsoc@st-andrews.ac.uk

The RES Policy Lecture series

is an opportunity for leading economists to speak both to academics and to policy-makers and to others interested in the development of economic policy. David Miles of the MPC Committee spoke at the inaugural session in 2011 (webcast available online) and the 2012 RES Policy Lecture will be given by Professor Nick Crafts (University of Warwick and member of the RES Council and Executive) in the evening of Wednesday 17th October at the Bloomsbury Theatre, UCL, London. Details and registration will be available through the RES website.

Membership Benefits

JSTOR 'Register & Read'

RES members working in academic institutions have long been able to access online articles from scholarly journals via JSTOR. JSTOR archives and provides access to archival and current issues of more than 1,400 scholarly journals across more than 50 academic disciplines. ‘Register & Read’ includes approximately 75 journals (including the RES journals) from more than 40 publishers, a subset of the content in JSTOR. This includes content from the first volume and issue published for these journals to a recent year (generally 3-5 years ago).

At the request of RES members who are no longer affiliated to academic institutions or libraries with membership of JSTOR, we have signed up the Royal Economic Society to the new JSTOR ‘Register and Read’ initiative for individual scholars. This will allow scholars working as individuals to:

• 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;
• some articles will also be available in pdf version for purchase and download to your shelf for access at any time.

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

RES 2013 Conference

The 2013 RES Conference will be held at Royal Holloway University of London, 3 to 5 April 2013. For further details go to the RES website www.res.org.uk

The Young Economist Essay Competition

Over 750 entries on the six set essay questions were received including a growing number from international schools. The list of Highly Commended essays can be found on the website together with those in the final shortlist. Judges RES President Richard Blundell, President-elect Charlie Bean and BBC journalist Stephanie Flanders will now review the list to choose the winners. The winning award and prizes of £2000 will be presented at the Public Lecture in London.

The RES Public Lecture

will be given by Nobel Prize winner Professor Chris Pissarides of the London School of Economics in London and another regional venue in late November. Please go to the RES website in October for full details and ticket applications.

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

Nominations for RES Council

Nominations for the next cohort of the RES Council (2013-2018) 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 2013 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.

www.res.org.uk/view/resNewsletter.html
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 your membership details including email address by registering at www.res.org.uk. Could we ask all members to please ensure that they 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.

8th RES PhD Presentation Meeting and Job Market
This will be held on Saturday 19 and Sunday 20 January 2013 at Queen Mary, University of London. The aim of the event is to provide a service both for UK and European university economics departments who wish to recruit lecturers, and for PhD students seeking academic jobs in the UK or elsewhere in Europe. This annual meeting has grown to be a successful event well supported by both students and potential employers. The event consists of two days of students’ presentations and poster sessions. Participating institutions attend these presentations and are allocated space at the conference site in order to arrange individual appointments with participating students during the course of the conference. For further information please contact Elizabeth Price at e.a.price@qmul.ac.uk or Amanda Wilman at royaleconsoc@st-andrews.ac.uk

Collected Writings of John Maynard Keynes
As one of Cambridge University’s most influential alumni, John Maynard Keynes had a profound impact on macroeconomic theory and policy across the world. Cambridge University Press are proud to announce the publication of the Collected Writings of John Maynard Keynes comprising 30 volumes including The General Theory, his experiences at the Versailles Peace Conference, and correspondence with other economists demonstrating the development of his ideas.

These will be available from October 2012 in paperback for individual purchase or digital for institutional purchasers. RES members will receive an exclusive 30 per cent discount.

Contact royaleconsoc@st-andrews.ac.uk for details.
Paperback c. £19.95. RES member price c.£13.97.
Entire pb set c.£550.0. RES member price c.£385.00
3 month Introductory set price special
Entire pb set c.£500.00. RES member price c.£ 350.00

Conference Diary

July

July 16-18 Budapest, Hungary
SING8 — 8th Spain, Italy, Netherlands Meeting on Game Theory organised jointly by the Institute of Economics, Hungarian Academy of Sciences and Corvinus University Budapest. While many of the participants come from the founding countries or other European countries, the conference is open to all and covers all areas and aspects of game theory.

Further information: http://sing8.iehas.hu/

July 16 - 23 Trinity Hall, Cambridge, UK
Cambridge 2012 Econometrics Summer School.
Three x 2.5-day sessions as part of the Cambridge Econometrics Summer School. These sessions will cover a range of econometric techniques, as well as being delivered by leading academics from the University of Cambridge - Prof. Andrew Harvey, Prof. Sean Holly and Dr. Melvyn Weeks.

Further information: http://www.timberlake.co.uk/Training/?id=147&cid=47&utm

August

August 16- 18 Ontario, Canada
RCEF 2012 Conference: Cities Open Economies and Public Policy. The Rimini Conference in Economics and Finance (RCEF) is a biennial conference series that alternates between Italy and Canada, but with a different focus each time. This year’s theme will draw researchers from urban economics, with a micro focus on long run development, trade, and increasingly the environment and from international macroeconomics with a focus on business cycles, financial markets, and monetary policy.

Further information: www.rcef.ca
Other enquiries to: rcef@economics.utoronto.ca

27-31 August Malaga, Spain
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. JEL classification(s): A, B, C, D, E, F, G, H, I, J, K, L, M, N, O, P, Q, R, Z

Further information: 2012 EEA-ESEM joint meeting (http://www.eea-esem2012malaga.org/
September

September 3-5  Tokyo, Japan

International Conference on Structural Economic Dynamics. The main theme of this conference is to deepen and expend the analysis of Structural Economics Dynamics in the theoretical perspectives as well as in the perspectives of history of economics thought. We also discuss the application of Structural Economics Analysis and some empirical studies. Keynote Speaker: Prof. Luigi Lodovico Pasinetti (Università Cattolica del Sacro Cuore).

Further Information: http://www.kisc.meiji.ac.jp/~confyagi/September2012.html

September 5-8  Vienna, Austria

CIRET conference. The CIRET conference will take place during 5-8 September 2012 in Vienna, Austria, is hosted by WIFO and concentrates on topics related to economic surveys.

Further information: https://www.ciret.org/conferences/

12-14 September  Birmingham

4th International Social Innovation Research Conference (ISIRC). Each year ISIRC brings together the international academic community focusing on social entrepreneurship, enterprise and innovation.

Further information: Simon Teasdale, Third Sector Research Centre ISIRC@tsrc.ac.uk


UK First LSE / BOE conference on Macroeconomics. The Bank of England and LSE are holding a joint conference in the autumn, the first of an annual series. The aim is to ask what economics can tell us about unemployment, productivity and potential output, with a particular focus on the effect of the financial crisis and recession. Confirmed keynote speakers include Philippe Aghion, Bart Hobijn and Fabien Postel-Vinay.

Further information: http://www.bankofengland.co.uk/publications/Pages/events/conf1012/default.aspx

October 26-27  Nanjing, China

Deadline for paper submissions: July 31, 2012. JEL classification(s): F, O, Q

November

8-9 November  Amsterdam, Netherlands

DNB / CGIC Workshop on Corporate Governance of Financial Institutions wishes to contribute to the emerging trends in academic research and to take stock of the most important developments in the theory, policy and practice of the corporate governance of financial institutions. The keynote speakers at the conference are Rene Stulz (Ohio State University) and Luc Laeven (IMF, Tilburg University). Deadline for paper submissions: July 31, 2012. JEL classification(s): G

Further information: http://www.dnb.nl/en/onderzoek/2/test-conferences/other-conferences/conferences/dnb269565.jsp

December

December 17-18  Shanghai, China

World Finance and Banking symposium: ‘Asian Finance and Banking’ at the Cheung Kong School of Business. The aim of this symposium is to establish a high quality discussion forum for the academics, professional societies and practitioners. The conference will additionally provide the opportunity to present research papers in the all areas of finance, these shall be considered for presentation at the World Finance Symposium.

Further information: http://www.world-finance-conference.com

2013

May

May 30-31  Cambridge UK

Conference on Cross-sectional Dependence in Panel Data Models. Submissions of papers will be possible until 28th September 2012.

Further information: http://www.econ.cam.ac.uk/CSDPDM/panel-econometrics-conf/submission.html

www.res.org.uk/view/resNewsletter.html
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*, a new electronic journal published by the Royal Economic Society and Blackwell 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

2012 are £46 ($79, €71)*

There is a reduced rate of £23 ($40, €36) for members who reside in developing countries (with *per capita* incomes below US$500) and for retired members.

A special ‘on-line only’ offer of three years membership (2011-2013 incl.) for the price of $28/€19/£16 is available to full-time students.

* All customers in the UK should add 7.5 per cent 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.

---

www.res.org.uk/view/resNewsletter.html