Royal Economic Society

Issue no. 163
October 2013

Newsletter

Royal Economic Society

Correspondence

Letter from America p.3

Comments and notes

Letter to the editor p. 18

Features

Keynes as investment manager p.5
Reflections on CHUDE p.9
Dangerous home ownership p.10
Government, investment, technology and growth p.12
Developments in economics education p.14
The labour market after the global financial crisis p.15
Trends in student numbers p.16
Restoring the bank lending channel p.19
Teaching evidence-based economics p.22

RES news

p.25

Conference diary

p.26

Crises and news

A major crisis is certainly good for copy. Since 2008, this *Newsletter* has published over 20 contributions linked in some way the events of that year and their aftermath. Even in this issue we have articles on home ownership, government investment, the labour market, bank lending and teaching economics, all of which acknowledge some connection with recent upheavals.

Amongst the 20, we had eight contributions which focused directly on the wisdom, or otherwise, of what became known as the 'austerity' regime of the present UK (and other) governments. We left that debate, some six issues ago, with the conclusion that 'time will tell'. Now that time has passed and there appears to be some evidence of growth in the economy we might think the debate could be resolved. Certainly those organs of the press sympathetic to the coalition have been quick to claim that signs of recovery mean that 'Osborne was right!'. But critics never doubted that growth would resume at some point. And it is hard to believe that supporters of austerity four years ago were thinking that it would take so long to happen. Once again, appeals to 'the long-run' help to muddy the waters. Whatever our view of the debate, let us hope that the growth is firmly established.

This is another very full issue. It starts with Angus Deaton's regular Letter from America, but is dominated by the largest number of features (solicited and unsolicited) that we have ever had. A consequence of this is some degree of overcrowding. The RES news section, in particular, has suffered and members will need to go to the website for details on regular items like funding and publications. This is not a new policy. It is an emergency measure and we apologize to anyone who is seriously inconvenienced.

ROYAL ECONOMIC SOCIETY

NEWSLETTER

Published quarterly in

January, April, July and October

Editor

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

Email: peter.howells@uwe.ac.uk
mail@sarum-editorial.co.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

Designed by
Sarum Editorial Services
www.sarum-editorial.co.uk

Next issue

Newsletter No. 164 - January 2014

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

15 December 2014

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

16 December 2014

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 our website at:

www.res.org.uk

Letter from America — The NIH, the Supremes, and the Economists

In his latest letter, Angus Deaton shows how economists, perhaps inadvertently, have helped to limit the levels of inequality in some aspects of US life.

It is hard to think of the American economics profession as a defender of equality. Economists, like most of the public, are deeply divided on whether or not current levels of inequality are a problem, and along predictable lines.

Yet here are two areas where I believe that economists, not through any political commitment, but through their regular activities, have been helping keep inequality under control, and where, as is often the case, the realisation comes only when they stop doing so, or when the forces on the other side win a victory.

Economics helps restrain health inequality…

The first case comes from the National Institutes of Health, in Washington. As readers of this Letter will know, the NIH has over the years become a major funder of economics-and other social science-both through research grants, and through the provision of large scale data sets, including the Health and Retirement Survey, the SHARE in Europe, and other clones around the world. The number of health-related titles in the NBER working paper series is one indication of the importance of funding for health economics. There are two NBER programs on health, as well as programs on children and on aging, both of which have large health components. Economists now regularly publish in the top medical journals, sometimes jointly with doctors, and sometimes on their own. A recent well-publicised case, published in the *New England Journal of Medicine* is an analysis of the effects of providing public health insurance to a random sample of low-income Oregonians on an oversubscribed waiting list.

> "Class-action suits by women, or minorities, are regularly brought against firms, and economists make a modest consulting income arguing the case for the plaintiffs (or somewhat less modest if they work for the defendants.)"

The Republicans in the House of Representatives are determined that this funding should stop. Eric Cantor, the House Majority Leader, argued that, 'funds currently spent by the government on social science — including on politics of all things — would be better spent on trying to find the cures for diseases.' (It is hard not to admire a politician who can use the public's detestation of politicians to enlist public support.) In the short run, the target seems to be any research that might support Obamacare. In the long term, the deeper force is likely the richly funded lobbying machine of pharmaceutical firms and medical equipment manufacturers who see cost effectiveness analysis as potentially leading to cost control, the ultimate enemy. Economists, who might discover that public health insurance is good for people, or who might argue that some treatments enrich suppliers without helping patients, are decidedly unwelcome at the party, particularly when financed by public money.

What will happen to NIH funding for social and behavioral research, including economics, is currently unresolved. Economists and other social scientists have organized in opposition, but it was difficult to get politicians to support the effort, though in the end eighty-three (Democratic) congressmen, led by Representative Lucille Roybal-Allard from California, signed a letter to Francis Collins, the Director of the Institutes, making the case for health economics and urging continuing funding. Of course, NIH already faces budgetary difficulties because of the automatic cuts from the 'sequester' and the social science budget may be relatively weakly defended inside the Institutes.

…while econometrics battles gender inequality

My second example will be familiar to anyone who has taught-or even taken-a basic econometrics class. One of the workhorses of teaching regression analysis is the 'discrimination' regression. Data on wages show that women in the Plastic and Elastic Shoe Company earn less than men. P & E admit the fact, but argue that they do not discriminate, and the difference in means comes from the fact that the men and women that they employ are different, that the men have more experience and are better educated. So the regression is run again, now including, not just a constant and a gender dummy — which showed the difference — but also including years of education and years of experience in the firm. If the gender dummy is now insignificant, P & E is innocent: if it remains negative and significant, P & E is guilty.

Class-action suits by women, or minorities, are regularly brought against firms, and economists make a modest consulting income arguing the case for the plaintiffs (or somewhat less modest if they work for the defendants.) The argument often focuses on what variables can legitimately be included in the regression. For example, if the gender effect can only be eliminated by adding a dummy for attendance at an all-female college, or a measure of hair length, or heavily disguised versions thereof, then P & E should still be guilty. More contentious is whether to control for job assignment, clearly illegitimate if women are systematically denied access to better-paying jobs for which they are qualified.

These procedures are currently under threat from a Supreme Court decision on a discrimination class action suit by 1.5 million women against Wal-Mart, the largest employer in the US, alleging systematic discrimination in wages, training, and promotion. The case, Wal-Mart v Dukes *et al*, was settled in June 2011 when the Supreme Court unanimously decided that the class-action suit could not go ahead. The grounds are technical, but the problem appears to have been that the suit was too large, and that the women who were party to the suit did not have a common complaint that, if proven, 'will resolve an issue that is central to the validity of each one of the claims in one stroke.' The court demanded significant proof that Wal-Mart operated under a general policy of discrimination, and dismissed 'a sociologist's analysis asserting that Wal-Mart's corporate culture made it vulnerable to gender bias' as 'worlds away from significant proof,' particularly given that Wal-Mart's own announced policy forbids sex discrimination. If some individual managers discriminated, but others did not, then there was no valid class-action suit against Wal-Mart as a whole.

Reports from the courts suggest that Wal-Mart v Dukes is undermining the operation of the regression conviction in the courts. Even if the gender dummy remains negative, that is no longer enough to convict P & E; instead, there must be direct evidence of a discriminatory policy by the company, for example a company document, e-mails, or instructions to managers. This much more severe standard, makes it much harder for those who face discrimination to obtain redress.

That the current Supreme Court — with its conservative majority — should be an engine of inequality is no surprise. Nor is it a surprise that the bloated healthcare sector should seek to bloat itself further through its influence on politicians. Yet who would have thought that the economists would be on the other side?

Houblon-Norman/George Research Fellowships

Applications are invited for Houblon-Norman/George Research Fellowships tenable at the Bank of England during the academic year 2014/2015. Appointments will be for full-time research on an economic or financial topic of the candidate's choice, preferably one that could be studied with particular advantage at the Bank. The length of any appointment will be by agreement with successful applicants, but will not normally be less than one month, nor longer than one year. Senior Fellowships will be awarded to distinguished research workers who have established a reputation in their field.

Fellowships will also be available for younger post-doctoral or equivalent applicants, and for these, preference will be shown to British and other EU Nationals. The award will normally be related to academic salary scales.

Application forms (to be returned no later than **24 November 2013**) and details are available from: http://www.bankofengland.co.uk/research/houblon-norman/index.htm or by emailing the Houblon-Norman/George Fund account: MA-HNGFund@bankofengland.co.uk. Postal applications should be addressed to the Secretary to the Houblon-Norman/George Fund, Bank of England, Threadneedle Street, London EC2R 8AH.

The Rybzcynski Prize for Business Economics

The Society of Business Economists has, since 2000, awarded an annual prize for the year's best piece of writing on an issue of importance to business economists. The Rybczynski Prize is awarded in memory of the late Tad Rybczynski, an eminent economist and long-serving former Chairman of the Society.

This year is the 50th anniversary of his appointment as Chairman and to mark the occasion the Council of the Society — with the generous support of our sponsors, KPMG — will offer an enhanced Prize of £5000.

Essays can be written especially for the competition, or may be work published in the course of 2013. The judges will be looking for around 3000 — but not more than 4000 — well-written and thought-provoking words. Previous winners have been Roger Bootle, Simon Briscoe, Joanne Collins, Fergus Hicks, Thomas Mayer, Pam Woodall, Kevin Daly, Ian Bright, George Buckley and, last year, José Ursúa of Goldman Sachs. To have the chance of adding your own name to this list, please contact the SBE secretariat at admin@sbe.co.uk, or visit the SBE website, for an entry form. The closing date for entries is

9 December 2013.

How Keynes innovated a new style in investment management

J M Keynes is well-known as a patron of the arts and as the owner of one of the finest private collections of modern paintings when he died. In this article, John Wasik describes Keynes's role as investor and fund manager and shows how his practical experience of markets influenced his ideas about how capitalism worked.*

When I was asked by my publisher to explore the investment portfolios of John Maynard Keynes, it didn't appear to be a daunting task. After all, Keynes was not only one of the greatest economists in history, but the subject of numerous biographies, including the multi-volume masterwork by Lord Skidelsky.

Yet none of the biographies looked deeply into what Keynes owned and how he traded. Most acknowledged the well-worn tales of Keynes reading the daily stock tables in bed every morning and naming his favourite stocks his 'pets'. But few economists today, I suspect, are aware of the extent of his trading prowess.

For the many detractors of Keynes who, even now, maintain that he was the progenitor of socialist-style government control of entire economies, they are sure to be profoundly disappointed by what I found. Keynes was clearly a rabid speculator and active trader. He loved markets and was able to adapt to some of the worst financial and historical calamities ever. Although Keynes was one of capitalism's sharpest critics — albeit one who recognized its efficiency — his trading experience is often understated and provided a unique contribution to the future practice of money management.

More importantly, Keynes learned from his mistakes and near financial ruin. He was able to move on, reach new conclusions about how to regard market movements and earn a place in the pantheon of great investors that include Benjamin Graham, Warren Buffett and George Soros. It's no small stretch to say that Keynes was also the godfather of behavioral economics and value investing at a time when such things had little or no currency.

Among other things, Keynes genuinely enjoyed being a speculator and investor. In addition to eventually crafting ideas and institutions that would rescue Western economies (and Japan) after two devastating cataclysms, he managed money for his own portfolio, his Bloomsbury friends and several institutions. Keynes was most likely one of the first hedge fund managers and established some time-honoured principles that the best investors follow today.

It was only after going through thousands of brokerage account statements, ledgers, shareholder letters and portfolio summaries that Keynes's investment personality emerged. Thanks to gracious access granted to me by the King's College archives at Cambridge University, I was able to piece together a mostly unknown side of Keynes that most Keynesian economists have never seen. The narrative starts with a brilliant Cambridge lecturer who is starting to make his way in academia after an unsatisfactory post in the India Office prior to World War I.

Early investments

Keynes probably felt unchallenged in his position in the India office, although he relished being in London and the immersion in the Bloomsbury Group. He also wanted to return to Cambridge, where his intellect could be stimulated as a scholar and lecturer. By mid-1908, he was back at King's College. The following year, he started lecturing on money, credit, prices and the stock market (in 1910).

It's at the end of the 20th century's first decade that we see Keynes's growing interest in markets, investing and speculation. In his lecture notes, we see a curious Keynes who has, up until that point, little direct engagement in investing, but a yearning to explore. His lecture on the stock market, in the Lenten term of 1910, calls it 'essentially a practical subject, which cannot properly be taught by book or lecture.'

According to economist Professor Victoria Chick, whom I interviewed in London in March, Keynes 'loved gambling and was always one to get involved in a card game.'[1] But it was a penchant for market speculation and his friendship with stockbroker Oswald Falk that propelled Keynes to explore the markets just before World War I. When I asked his biographer, Lord Skidelsky, when he first saw evidence of Keynes's serious interest in investing, he surmised it was before 1910, when 'like (George) Soros, I think he used the financial markets to test his theory of probability.'[2] Keynes had begun work on a book on probability — later published in 1921 as *A Treatise on Probability* — prior to the war.

Before World War I, Keynes was mostly unchastened in the stock market. Since he didn't have inherited wealth —- and lecturing at Cambridge didn't pay much at the time — he was dependent upon allowances from his father (a Cambridge don and administrator), his mentor economist Alfred Marshall, and tutoring fees. Although he managed to accumulate money from birthdays and

academic prizes in a 'special fund' started in 1905, he didn't really start investing in earnest until 1914, according to the editor of his papers, Donald Moggridge. 'By 1911, he was not only buying additional shares, but also making switches and helping manage certain family trust funds,' Moggridge discovered.[3]

After World War I broke out, Keynes took a post in the Treasury, where he helped finance the conflict for Great Britain. When the war concluded, Keynes began to speculate in the currency markets with unbridled enthusiasm, setting up investment funds for his friends, family and London colleagues.

Using his knowledge of international finance, Keynes took to the currency markets with abandon. Floating currencies, which had been fixed before 1914, were notoriously volatile at the time, but Keynes thought he had the advantage of 'superior knowledge'. Believing that post-war inflation would hurt the values of the French *franc,* German *reichsmark* and Italian *lira*, Keynes shorted those currencies. This transaction made money if the currencies dropped in value relative to other, stronger currencies such as the British Pound or U.S. Dollar. He went long on the Indian rupee, Norwegian and Danish kroner and dollar.

'He wanted to make money in a hurry in the 1920s,' Skidelsky told me, 'and thought gambling on currencies (when currencies were floating in the early 1920s) was the way to do it.' [4]

Portfolio Snapshot
Early Stock Holdings:
Buying on the Way Down/Dollar cost averaging

In this small sampling of Keynes's early personal portfolio, we see how he was buying and selling one of his favourite stocks at the time: U.S. Steel. (He also owned longtime favourite Mather & Platt, an engineering firm, and Marine Insurance). He consistently purchased shares at lower prices, thus reducing his average cost. The 20 shares he sold (in this sample), were within 10 percent of the highest purchase price. This is a tried-and-true method called dollar-cost averaging that has worked for individual investors for decades because it avoids buying at the absolute highest price and selling at the lowest. This is a good method for long-term, buy-and-hold investors who want to own companies that offer dividend-reinvestment plans, where new shares can be purchased — preferably on a regular basis — at no commission. Dividends can be reinvested in new shares commission-free as well. If Keynes liked a stock, he kept buying it and was encouraged when the price came down — so he bought more and got better bargains.

Year	Share	No.	Price	Year	Share	No.	Price
1911	USS	10	71.75	1913	USS	20	65.75
1912		10	60.75	1913		30	65.75
1912		10	66.75	1913		30	61.5
1912		20	66,75	1913		30	62
(Sell)		10	68.375	(Sell)		10	67
1912		10	65.00	1913		20	59.5
1913		10	66.33	1913		20	60.188

High = 71.75 Low = 59.50
Number of Shares Bought = 220 Avg. Price = 64.33
Number of Shares Sold = 20 Avg. Price = 68
Average of All Transactions = 64.80

Source: King's College archives, Keynes's personal ledgers/Buckmaster & Moore brokerage statements.

Along with Falk, his brother Geoffrey and Bloomsbury friends, Keynes set up an investing syndicate in 1920, which many financial historians claim was one of the first hedge funds. Rather than manage money for preservation of capital or yield, Keynes was speculating pure and simple. At first, his strategy paid off, netting $30,000 for his investors in the first few months. By April 1920, notes Liaquat Ahamed in *Lords of Finance*, Keynes made an additional $80,000, which was astounding considering that most of Europe was essentially broke from the war. Then something unexpected happened: 'Suddenly, in the space of four weeks, a spasm of optimism about Germany drove the declining European currencies back up, wiping out their entire capital.' [5]

Embarrassed, though willing to get back on the speculation horse to make up the losses he suffered for his friends and family, Keynes re-invested in currencies following his 1920 shellacking. It also helped he was staked by his father and wealthy investors, who had unwavering confidence in Keynes.

The Roaring Twenties

As a trader who believed that he could profit from the impact of supply and demand curves, Keynes became enraptured with the idea of commodities trading in the 1920s. Europe clearly needed every kind of commodity to rebuild after the Great War. Prices generally followed the demand. There were opportunities for astute speculators and Keynes started researching and writing about commodities in the early 1920s for the London and Cambridge Economic Service and *Manchester Guardian*.

When it came to commodities, Keynes was an absolute data wonk. His documenting of commodity price supplies and fluctuations fill nearly 400 pages of Volume XII of his collected works. Why this intense interest? He figured if he could discern pricing patterns relative to supply and demand, he could make a fortune. And there seems to be an endless fascination with a variety of compiled figures. Here's one of his earliest investment funds, which also included some of his stock purchases that had

businesses related to commodities:

Portfolio Snapshot: A.D. Investment Trust Ltd.

As another virtual hedge fund, A.D. was founded by Keynes and his associates at the British Treasury in July, 1921. Keynes was a director until November, 1927, when he sold all of his shares. From 1923 through 1927, dividends were 10 percent annually. After Keynes left, the firm didn't survive the 1929-32 sell-offs.[6] This was largely a commodity-price oriented portfolio that focused on the rise of commodity prices in the wake of World War I. Even the stocks reflected growing demand for staples like rope, metals, oil and food. Currency speculation was also part of the mix. As the decade wore on, though, the portfolio direction headed more into stocks and less than in commodities and foreign exchange. As you can below, this is a classic example of what Keynes called 'opposed risks', where gains in one asset class could offset losses in another. While he was losing money in commodities, for example, he was making money in stocks. If it weren't for the fact that this was a highly speculative and risky portfolio, this would be a good example of diversification that shows how holding relatively uncorrelated assets can amount to overall gains. Ultimately, though, at the end of this sampled holding period, stocks would be the winning asset class.

Commodities traded

American cotton (New Orleans and New York cotton exc.)
Copper, Tin, Zinc (spelter) & Lead
Jute (India)
Lard
Linseed oil
Petroleum
Rubber
Sugar, Coffee, Tea
Nitrate (fertilizer component)
Wheat (U.S. and Canada), corn (maize)
Wool (Australia, New Zealand and South Africa)

Stocks Owned

British Ropes
Courtaulds
El Oro Mining
Francois
J. Finley
Jute Industries
Shell Oil
Wallpaper Manufacturing
Watney Combe

Breakdown of profits by asset class (£)

Years	Currencies	Commodities	Stocks
1921-22	5,000	5,400	2,700
1922-23	14,400	-6,400	3,600
1923-24	-300	28,300	0
1924-25	2,000	-15,000	14,500
1925-26	1,500	-700	2,600
Totals	22,600	11,600	23,400

Source: *Collected Works of Keynes,* Vol. XII, p. 32, King's College Archives.

How did Keynes do overall during the 1920s? While it's difficult to tell because he traded so many contracts in the 1920s, Skidelsky found that in 1927 his net assets totalled some $3.4 million (in today's dollars). But everything in world markets began to change in 1928, when prices began to drop and he was still long in rubber, wheat, cotton and tin. After the stock-market crash of 1929, he would eventually lose some 80 percent of his net worth, forcing him to put some of his paintings on the market (he ended up not selling them).

By the end of the decade, Keynes's foray into commodities ended much the same way the 1920s began (with currency losses), only worse. He was on the wrong side of most of his trades when demand collapsed. By 1930, after Wall Street crashed and the world plunged into the Great Depression, wholesale prices had plummeted 20 percent. Many commodities -— wheat, cotton, wool, silk, sugar, rubber and metals — took a 50 per cent hit.

The Great Depression and World War II

Having lost the bulk of two fortunes, Keynes re-oriented his thinking about trying to predict market movements. If one couldn't rely upon a mountain of data analysis and speculative insights on supply and demand, then what was left? As he concluded in his 1936 masterpiece *The General Theory of Employment, Interest and Money*, 'animal spirits' were the force behind market activity. They were hard to reckon with and impossible to predict, so he needed to adjust to this unpredictable current of irrationality. As he began to step outside the bounds of classical economics, he was doubtless influenced by his investment failures. Instead of trying to anticipate the market, Keynes now focused on the enterprise, or intrinsic, value of what stocks were worth. He drastically reduced his commodity positions. Then he latched onto high-dividend stocks in the 1930s when most traders were out of the market. It was this contrarian view that launched Keynes as not only one of the first value investors, but a long-term investor who turned his back on short-term valuations and market trends. Even more remarkable was that Keynes stuck to his new investment theory during one of the most decades for stocks in history.

More importantly, the results from this tumultuous period show Keynes's resilience and willingness to adapt to changing markets. Keep in mind that during the Great Depression, there were a series of recessions followed by stock-market comebacks. Although Keynes wasn't able to avoid some of the largest sell-offs in 1930-31, 1938 and 1940, the Kings College Chest Fund had a winning streak from 1932 to 1937, a period in which

U.S. stock market losses ranged from 43 to 25 percent annually. Over those six years, US big companies lost money in three annual periods. Considering the time in which he was investing, Keynes showed either amazing skill or sizzling luck.

Looking at the three-worst recorded years for large U.S. stocks (measured by total return since 1926) — 1931, 1937 and 2008 — Keynes did reasonably well (he was managing money during only two of them). He only lost about 25 per cent in 1931 when American shares lost 43.3 per cent and gained 8.5 per cent in 1937, the year of a 35-per cent loss in the US He beat the UK market in 12 out of 18 years.[7]

Much of Keynes's innovative style was fuelled by his growing preference for stocks, although he contributed a plethora of insights and advances to institutional money management as well. David Chambers of the Cambridge Judge Business School and Elroy Dimson of the London Business School recently published a landmark study that showed that 'Keynes's experience in managing the [King's College] endowment remain of great relevance today.'[8]

What's even more remarkable is that Keynes was not only managing money for King's College during his heyday, but institutional funds for National Mutual Life Assurance Society (he was chairman from 1921 to 1938), the Provincial Insurance Company (director from 1923 to his death) and personal funds for himself, friends and colleagues.

As the table (right) shows, Keynes pivoted from his losing macro strategy in the 1920s, in which he underperformed indexes from 1926 through 1928, to a more bottom-up style thereafter. His outstanding performance reflects his modified style: *He only fell behind market indexes once in the 1930s (1938 was his worst year, but it was also dismal in the US) and once in the 1940s. His Sharpe ratio and average performance are excellent as well.*

Keynes at King's: Performance from 1925-46[9]

In this table, the total returns of the Discretionary Portfolio, Restricted Portfolio, and the Total Fund ex real estate of King's College are estimated from the annual Reports to Inspectors of Accounts, King's College Archives for financial years ended August. The UK Equity Index is based on the equally-weighted DMS total return index.[10] The UK Government Bond Index is the total return on UK Consols, the benchmark UK government security. The risk-free rate is the Treasury Bill rate. Returns are expressed as percentages. Maximum and minimum are shown in bold typeface. AM = arithmetic mean; SD = standard deviation; Sharpe = Sharpe ratio. Financial year-end is August.

Year	*Discretionary Portfolio (1)*	*Restricted Portfolio (2)*	*Total fund ex real estate (3)*	*UK Equity Index (5)*	*UK Govt Bond Index (6)*	*Relative Performance (1)-(4)*
1922	35.33	16.80	18.17	31.40	26.40	3.94
1923	9.55	9.41	9.43	30.66	4.59	-21.11
1924	15.68	5.59	6.47	0.69	2.26	14.99
1925	41.32	4.70	9.62	11.46	3.10	**29.87**
1926	6.29	5.42	5.61	10.81	2.65	-4.53
1927	1.42	2.70	2.48	26.30	3.08	**-24.88**
1928	2.96	7.95	6.99	18.78	8.12	-15.82
1929	6.36	3.64	4.14	5.99	-0.31	0.37
1930	-14.21	0.36	-2.19	-18.74	9.13	4.53
1931	-11.53	-6.34	-7.16	**-30.89**	8.03	19.37
1932	32.65	5.82	9.40	26.15	**29.40**	6.50
1933	**51.43**	**30.93**	**34.40**	**32.13**	5.87	19.30
1934	26.60	13.39	17.50	11.38	12.92	15.21
1935	34.02	7.77	17.27	7.21	6.71	26.81
1936	39.57	11.77	23.40	22.83	4.39	16.74
1937	11.30	-1.00	4.26	1.67	**-10.15**	9.63
1938	**-22.58**	**-8.55**	**-15.01**	-8.71	4.93	-13.87
1939	8.92	-3.93	1.36	-5.57	-10.01	14.50
1940	-5.85	5.83	0.41	-18.84	16.61	13.00
1941	30.45	23.74	26.60	28.52	15.01	1.93
1942	8.39	9.04	8.77	10.85	4.43	-2.46
1943	39.74	7.82	22.04	27.86	-0.49	11.88
1944	15.60	5.24	10.70	12.06	2.87	3.54
1945	13.29	4.42	9.67	5.59	12.33	7.70
1946	22.48	7.84	17.36	19.66	14.58	2.83
AM	15.97	6.81	9.67	10.37	7.06	5.60
SD	19.08	8.48	10.85	17.11	9.06	13.87
Sharpe	0.73	0.57	0.71	0.49	0.56	n/a

Keynes the investment innovator

Keynes's performance under fire during the 1930s and World War II (his street in London was literally bombed), inspired several generations of investors that followed. His dogged pursuit of value stocks, dividends, cash flow and future earnings established him as a durable 'buy and hold' investor who was confident he would be rewarded in the long run.

After his death, the vindication of Keynes's portfolios proved that he deserved to be emulated. Although his estate was worth at least $22 million (in 2013 dollars) when he died, his contribution to the arts, modern economics and a more stable global economic climate is incalculable. As an investor, he championed the merit of examining the 'earning power' of stocks, looking deep into the ability of a business's ability to survive in a variety of economic conditions and the abandonment of market timing and speculation.

Even more significant is his recognition of 'animal spirits' and the role that mass psychology plays in investing and markets. In doing so, he tackled one of the most elusive — and powerful — elements of markets, behavior that modern economists have still yet to fully understand, much less predict.

Notes:

* John Wasik is the author of the forthcoming book *Keynes' Way to Wealth: Timeless Investment Lessons from the Great Economist* (McGraw-Hill, 2013). He also writes a weekly investment column for Reuters and contributes regularly to other business publications. Email: johnwasik@gmail.com

1. Interview with Victoria Chick, Bloomsbury, London, March 3, 2013.

2. Email response from Lord Skidelsky, 1/9/2013

3. *Maynard Keynes: An Economist's Biography*, by Donald Moggridge (Routledge, 1992), p. 194.

4. Emailed response from Robert Skidelsky, 1/9/2013.

5. *The Lords of Finance: The Bankers Who Broke the World*, by Liaquat Ahamed (Penguin, 2009), p. 165.

6. *Collected Works of Keynes*, Vol. XII, p. 32.

7. Chambers, D., and E. Dimson. 'John Maynard Keynes, the Investment Innovator', *Journal of Economic Perspectives,* 27 (3), Summer 2013, pages 1-18.

8 Ibid.

9. D Chambers and E Dimson (forthcoming) 'Keynes the Stock Market Investor', *Journal of Financial and Quantitative Analysis*. table 2. Available at http://ssrn.com/abstract=2023011.

10. 'DMS' refers to the authors of the UK equity index Dimson Marsh and Staunton. See p.6 of Chambers and Dimson in note 9, above.

Reflections on CHUDE

Neil Rickman, University of Surrey, has just retired after six years as chairman of the RES's Conference of the Heads of University Departments of Economics. Here he recalls some of its activities and achievements.

CHUDE is the Conference of Heads of University Departments of Economics. It's a formal committee of the RES and its membership consists of the heads of the departments, schools, units, etc, that deliver Economics in each British university: there are about 90 of these. I was fortunate to chair CHUDE for six years up to 2012, benefiting enormously from being able to work with Tim Worrall as Secretary: Tim's knowledge, organization and good sense were frequent substitutes for my lack of all three. Tim and I were, in turn, both fortunate to take over from Denise Osborn (Chair) and Alan Carruth (Secretary) who were a tough act to follow but handed on a fully functioning model for which we were extremely grateful. We were had the pleasure of working with many committed heads (not least on the CHUDE Steering Committee) and Presidents of RES who all involved themselves with CHUDE.

As heads of departments will be only too aware, their units find themselves at the intersection of many of the main aspects of Higher Education research and teaching policy. By collecting heads together, CHUDE can act as a focus for discussion and reaction to these, and as an important conduit for the RES to develop its awareness and views in these areas, not least by straddling the various forms of Economics unit based in and outside Business Schools. Its activities therefore range across most aspects of the discipline: UG applications, and A-level content, UG/PG teaching through its links with the Economics Network and QAA consultations, careers and professional practice through links with the Government Economic Service and the Bank of England, training of new lecturers and PhDs for teaching through the Economics Network again, Post-graduate Research through ESRC consultations, and UK research through the REF and developments of ESRC funding policies, and important demographic issues such as those covered by the RES Women's Committee.

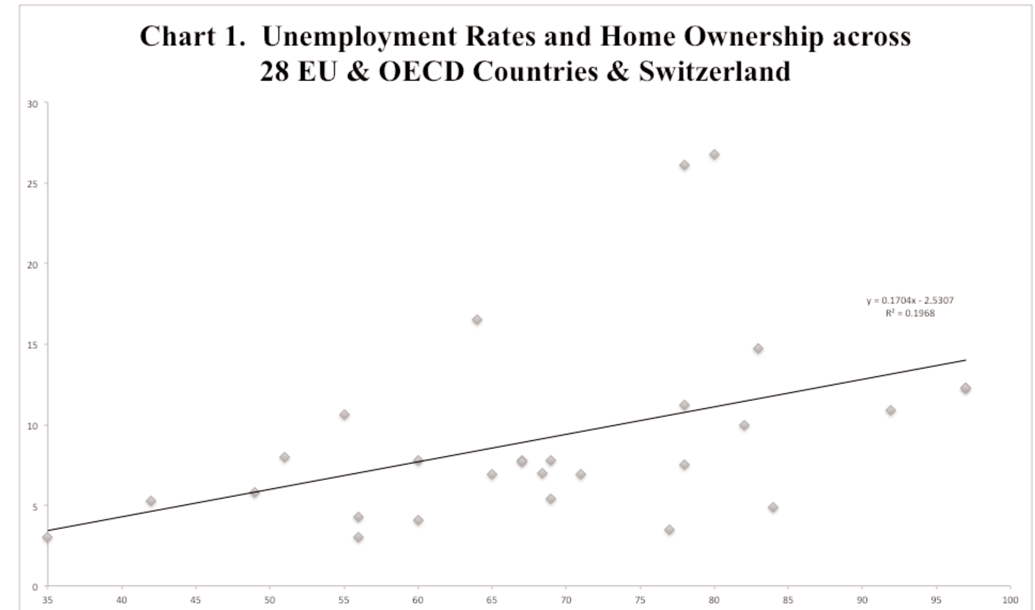
I was Chair at the time of several developments which had an impact on departments' activities and, as such, helped to define CHUDE's agenda during my term. There are numerous examples. The introduction of the NSS and fee-paying undergraduates have both sharpened the focus on the undergraduate offer in most departments. At the level of research students and income, the introduction of DTCs and discussions of demand management have both affected the ways that a number of traditional activities have been undertaken by departments.challenges for the discipline.

...continued on p.14

Dangerous Home Ownership

While the government increases its efforts to boost the housing market (and the Governor of the Bank of England says he is on the alert for a housing bubble) Andrew Oswald reports on research that shows that high levels of home-ownership cost jobs.

Unemployment is a major source of unhappiness, mental ill-health, and lost income. Yet after a century of economic research on the topic, the determinants of the rate of unemployment are still imperfectly understood, and jobless levels in the industrialized nations are today 10 per cent, with some nations over 20 per cent. The historical focus of the research literature has been on which labour-market characteristics — trade unionism, unemployment benefits, job protection, etc — are particularly influential. With my colleague David G Blanchflower, I propose a different way to think. Our results are relevant to, and a potentially worrying for, a wide range of policy-makers and researchers. The technical version of our work is described in Blanchflower and Oswald (2013).

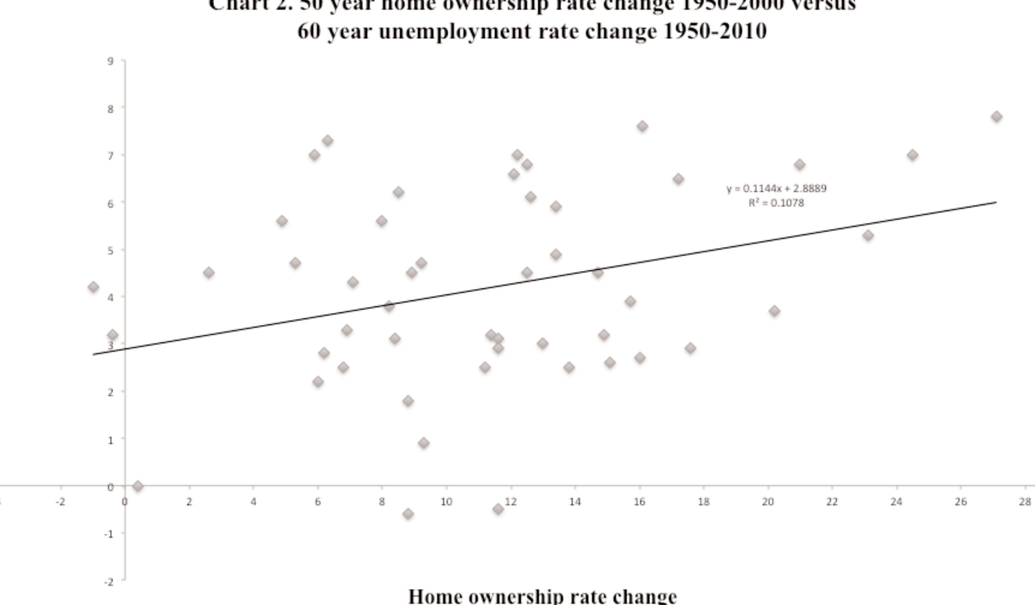


We argue that the housing market plays a fundamental role as a determinant of the rate of unemployment. Because it makes a good 'laboratory', we study modern and historic data for the states of the United States. Our statistical analysis finds the following:

- First, rises in a US state's home-ownership rate are associated with later rises in joblessness in that state. The effects are strikingly large. A doubling of home-ownership in a state would be associated in the steady state with more than a doubling of the unemployment rate.
- Second, after controlling for state fixed-effects, we show that areas with higher ownership have lower mobility.
- Third, high home-ownership areas have longer commute-to-work times, which can be expected in those areas to raise costs for employers and employees.
- Fourth, high home-ownership areas have lower rates of business formation. It is conceivable — we are not able to offer proof — that this may be due to zoning or NIMBY effects.

We examine the US states as a panel through time and then estimate unemployment equations. Using micro data on millions of randomly sampled Americans, we also estimate equations for the number of weeks worked, the probability of a person being unemployed, the extent of labor mobility, the length of commuting times, and the number of businesses. In this way, our analysis documents statistical links between high levels of home-ownership in a geographical area and high later levels of joblessness in that area. We find that this result is robust across sub-periods going back to the 1980s. The lags from ownership levels to unemployment levels are long. They can take up to five years to be evident. This suggests that high home-ownership gradually interferes in some profound way with the efficient functioning of the labour market.

The data used in our paper are almost wholly from the United States. However, we think our conclusions have wider implications — for Europe and elsewhere. Taken in conjunction with new work by Laamanen (2013), which was done independently of our own , and reaches similar conclusions for the country of Finland, the findings may go some way to explain why nations like Spain



(80 per cent owners, 20+ per cent unemployment) and Switzerland (30 per cent owners, 3 per cent unemployment) can have such different mixtures of home-ownership and joblessness. Chart 1 shows that there is a strong positive correlation across the wealthy countries between their home-ownership rates and the latest unemployment rates. Such a chart is open to the sensible criticism that the scatter might be a fluke or an illusion caused by particular countries characteristics.

However, that objection cannot be raised about Chart 2, which is for the United States. It plots very long changes (approximately half-century changes) in home-ownership rates and unemployment rates across the US states — minus Alaska and Hawaii — and generates a similar result. It plots the fifty-year change in home-ownership rates (1950-2000) against a sixty-year change in unemployment rates (1950-2010).

Crucially, the full analysis does not depend on data from the special period of the 2007 US house-price crash; nor does it rely on the idea that home owners are themselves disproportionately unemployed (there is a considerable literature that suggests such a claim is false, or, at best, weak); nor does it imply that spatial compensating differentials theory is incorrect; nor is it Keynesian in spirit; nor does it rest upon the idea of ‘house-lock’ in a housing downturn.

Given the emphasis that most post-war western governments have put on the promotion of home-ownership (one exception is Switzerland, which taxes home-owners’ imputed rents), and the tremendous exchequer cost in tax breaks to having done so, we view our statistical results as deeply worrying for policy-makers. A possible reason why these patterns have attracted so little notice from both researchers and the public is that the time lags are long. High levels of home-ownership do not destroy jobs this year; they tend to do so, on our estimates, some years later. Unless these long linkages are properly understood by researchers and politicians, the deleterious consequences of high levels of home-ownership cannot be appreciated.

What mechanisms lie behind these findings? It is not yet possible to be certain. Our contribution should be seen as a statistical one — as documenting patterns of potential interest to economists and social scientists, and perhaps especially to labor economists, macroeconomists, economic geographers, and urban economists. Nevertheless, we have made an attempt to look below the underlying link between current home-ownership and later joblessness. In doing so, we have found evidence that high home-ownership in a U.S. state is associated with

(i) lower labor mobility,
(ii) longer commutes, and
(iii) fewer new firms and establishments.

It should be emphasized that this is after we have controlled for a wide range of possible confounding influences. Our results are consistent with the recent conclusions of a European study done independently by Laamanen (2013).

Our research does *not* claim that home owners are unemployed more than renters (very probably they are not). Nor is it an attempt to build on the idea that home owners are less mobile than renters (though they probably are). Instead, because the statistical estimation can control for whether individuals are themselves renters or owners, the patterns documented in the paper are consistent with the idea that the housing market generates negative externalities upon the labour market. Home ownership is dangerous.

References:

Blanchflower, D.G., and Oswald, A.J. 2013. ‘Does high home-ownership impair the labor market?’ NBER working paper.

Laamanen, J-P. 2013. ‘Home ownership and the labour market: Evidence from rental housing market deregulation’. Tampere Economic Working Paper, No. 89, University of Tampere, Finland. Downloadable at http://tampub.uta.fi/handle/10024/68116

Government investment, technology and growth

In this article, Mariana Mazzucato[1] argues that the 'austerity' debate is missing the point. It is not the level of debt that matters, but what that debt is financing. Contrary to poular belief, it is often 'big' government 'mission oriented' investments that generate long-term economic growth.

Is government debt slowing economic growth, if not impeding it? The world-wide economic crisis that began in 2007 has kept that question alive, despite the fact that it was *private* debt that caused the crisis in the first place. But attempts to curb the crisis have indeed also led to an explosion of 'public' sector expenditures like bank bailouts and unemployment insurance that have ballooned debt levels. At the same time, lower tax receipts due to falling incomes have forced even more borrowing.

Yet amnesia and dogma have conflated the public debt that helped cure the crisis with the private debt that caused it. And although the Reinhart-Rogoff saga seems to have ended with evidence winning out over ideological fiction, countries across the globe are still being asked to slash spending in hopes of kick starting economic growth.

> "What matters is not the absolute size of debt, but what that debt consists of. Throughout history, strategic government expenditures have played a key role in spurring economic growth."

My own work shows the utter foolishness of such a strategy. What matters is not the absolute size of debt, but what that debt consists of. Throughout history, strategic government expenditures have played a key role in spurring economic growth. Indeed, by forcing the world's weakest economies to cut public spending — in key areas like education, research and health-their potential for long-run growth is weakening. Spain, for instance, has cut its research spending by 40 per cent since 2009. Will this help it become as 'competitive' as Germany?

The key question is simple: what causes GDP growth? And the answer from economists is that at the very least, spending on education, human capital, and research are tightly related to it. Indeed, Robert Solow, who won the Nobel Prize in Economics in 1987, found that close to 90 per cent of growth is *not* explained by the usual suspects, capital and labor. They account for only 10 per cent. So Solow called the unaccounted-for 90 per cent the *residual*. And what drove the residual? It had to be *technology*. And how is technology fostered? More often than not, down through history, by *government* investment, from the roads of ancient Rome to the Internet of modern America.

However, things are not quite so easy. Which areas should the government fund? Traditional economic theory argues that government funding should be limited to areas where the free market is not working properly due to so-called 'market failures', some of which might be due to the existence of 'public goods' like basic research, which are hard to make proprietary and profit from since they're quickly available to everyone. As a result, the private sector under-invests.

So if government *nudges* the private sector to invest, business will promptly respond by innovating. Thus policy makers have obsessed over different types of tax incentives (from R&D tax credits to recent tax cuts related to patents) in order to increase the amount which the business sector spends on R&D.

I have been arguing a very different view, as embodied in my recent book.[2] I argue that businesses are typically *timid* — waiting to invest until they can clearly see new technological and market opportunities. And evidence shows that such opportunities come when large sums of public money are spent directly on high risk (and high cost) technological *missions*. This raises debt of course, but also GDP, keeping the ratio of debt-to-GDP in check.

These missions are expensive precisely because the government does much more than just solve market failures. It intervenes in both basic and applied research and even provides early stage seed finance to private companies. Indeed, Small Business Innovation Research (SBIR) grants have funded a higher percentage of early stage seed finance than private capital. This is because private finance is too risk-averse — afraid — to engage with industries characterized by high technological and market risk. The fear explains why we have seen venture capital entering, in industry after industry, only decades after the initial high risk has been absorbed by government.

Mission-oriented public investment put men on the moon, and later, lead to the invention and commercialization of the Internet, which in turn has stimulated growth in many sectors of the economy. Indeed, as I describe in the longest chapter of my book, the U.S. government has been a leading player in funding not only

the Internet but all the other technologies that make the iPhone so 'smart': — GPS, touchscreen display, and the new SIRI voice-activated personal assistant — that make the iPhone, for example, a miracle of American technology. Indeed, it is not surprising that Apple is one of the least R&D intensive companies in the PC industry: it puts together existing technologies, it does not fund new ones.

Crucially, mission-oriented policies are needed today to tackle climate change and other large societal, technological challenges. But the fear that such investments will cause debt to rise too high and stymie growth — ignoring the potential *positive* effects on growth that these investments can make in the long run — is paralyzing governments throughout the world

Furthermore, there is the general belief that the direction of investments should be determined by the market, not government. That the latter lacks the expertise — just a bunch of political bureaucrats. But this is a self-fulfilling prophecy. It is precisely in those countries that have been mission-led, and which have set up a decentralized network of well-funded state agencies, that the public sector has been able to attract the kind of expertise needed to steer 'directionality'. And given that the spending 'multiplier' has been shown to be higher (in the long-run) when spending is 'directed' rather than just 'digging ditches', getting that directionality right (the IT revolution in the past, 'green' in the future) means the denominator of debt/GDP grows more. The US Department of Energy (DoE) was recently run by a Nobel Prize winning physicist. The atmosphere in ARPA-E, the agency in the DoE which is trying to do for renewable energy, what DARPA did for the Internet, is just as dynamic and creative as Google. And historically it is investments driven by such agencies (including the National Science Foundation, National Nanotech Initiative, National Institutes of Health) that galvanize private sector investment. Indeed, when Pfizer recently closed down a large R&D lab in Sandwich, Kent, and transferred it to Boston, Massachusetts, it was not due to the lower taxes or laxer regulation for which industry is constantly lobbying. It was due to the large amounts of money that the National Institutes of Health (NIH) has been spending on research and the mission of improved health care in the United States: $792 billion from 1936-2011 (in 2011 dollars), with $30.9 billion in 2012 alone. And today the technological leadership being witnessed in countries like Singapore, Korea, China, Israel, Brazil, Finland, Denmark and Germany is also a result of the strategic well funded network of state agencies in those countries, that able to attract expertise, and drive change-working of course alongside the private sector but often leading it.

These lessons are important for policy makers interested in fostering 'entrepreneurship'. While Steve Jobs was a genius in his ability to exploit existing government-funded technologies in new ways, he would have had little to work with absent massive public spending. And given the public spending *cuts* that are happening in most countries the world over, the question then becomes: will there be a future *wave* to surf in places like Silicon Valley, or is the technology tide destined to turn?

Furthermore, casting the public sector as the villain and business as savior has relieved the private sector from any obligation to increase its own commitment to the innovation process. There simply are not enough large businesses today playing the role that Xerox PARC (the Palo Alto Research Center) and ATT (Bell Labs) played in the past. Today's big companies like Cisco and Pfizer spend almost as much on share-repurchase schemes (which enrich those who own stock) as they spend on research. Interestingly, the big 'repurchasers' (the biggest being in oil and pharma) often justify such buy-backs with the claim that there are no other 'opportunities' for their investments. But really? No opportunities in health for pharma these days? Nothing for oil companies to invest in? Like safe and clean renewable energy?

When building innovation 'eco-systems', then, it is important to make sure the role of business is symbiotic, not parasitic. That means, if we want to rebalance the economy, we need to rebalance the story we tell about who the innovators really are. Not admitting the State's role in the success of companies like Apple is what allows these companies to justify paying back so little tax to the public purse. And if taxes remain so low and easy to be avoided, perhaps we need to consider more direct rewards for government: when Google made billions, should it not have been asked to contribute to a government 'innovation fund'. Should not something Interestingly, it was the venture capital lobby in the mid 1970s that pushed for the capital gains tax to fall by 100 per cent (from 40 per cent in 1976 to 20 per cent in the mid '80s). It has been falling ever since, based on the narrative that only thus will the entrepreneurial 'risk-takers' do their thing and enrich us all. And is it healthy or rotten Apples that will be falling from the trees?

But that narrative is false. The *entrepreneurial state* has funded the radical innovation behind much if not most of modern economic growth. Denying government today the resources to do *its* thing endangers us all.

Notes:

1. Mariana Mazzucato (www.marianamazzucato.com), Professor in Economics of Innovation, Science and Technology Policy Research (SPRU), University of Sussex. She tweets on @MazzucatoM

2.*The Entrepreneurial State: debunking private vs. public sector myths* (Anthem, 2013)

CHUDE

...continued from p.9

At the level of research itself, the introduction of impact to the REF and the developing open access agenda have both raised challenges for the discipline.

In some cases, CHUDE was able to use its network of departmental contacts to perform an information gathering and response role. Thus, it played a central role in helping to inform RES policy during ESRC consultations over DTCs and demand management. The same was true of the ESRC's International Benchmarking of Economics (which overlapped the handover between Denise and I). When HEFCE needed RAE/REF sub-panel members, CHUDE's infrastructure was helpful.

Perhaps the best, and most rewarding, example of CHUDE's activity during my time was the development of the Economics Network. This began as one of a number of subject centres funded by the Higher Education Academy and developed a strong network of academics with a shared interest in supporting the teaching of economics, producing online materials, training workshops, etc, under John Sloman's energetic leadership. When the HEA's funding was removed, all but two of the subject centres died — Economics being one of the exceptions. Instead, perhaps assisted by the profile earned by the Network at CHUDE meetings, the shared interests in reaping the economies provided by the Network's experience and resources surfaced as a demand to maintain several of its core functions. Along with RES support, the result was generous assistance from departments in terms of funding and more general support, and the University of Bristol's offer to host the Network. Economics therefore retains a designated resource, responsive to the departments (not least through CHUDE), at a time of growing demands on teaching quality and support — from HEFCE, students and universities. This initiative could develop in a number of directions but the role of departments gives RES a clear interest here — one that actually harks back to the foundations of CHUDE by the Association of University Teachers and Lecturers.

Looking ahead, there are plenty of interesting challenges for CHUDE, as I know Eric Pentecost (Chair) and Daniel Zizzo (Secretary) are aware! They'll have plenty of their own ideas and views about these so I'll just list a couple of the more obvious ones. The REF results themselves will be important, especially if they continue the trend of falling submissions to the Economics and Econometrics sub-panel and confirm CHUDE as a crucial link between the various bases for Economics departments these days. How will the REF impact agenda, or open access policy develop? Both are areas where CHUDE will be consulted and needs to reflect the views of members. The evolution of the Economics Network itself will also be important.

My main sense at the end of six years is that CHUDE is a good example of the whole being greater than the sum of the parts — or, at least, having the potential to be so when it can gather up the various constituencies within the discipline (large and small, Economics and Business-based, etc). It is more effective, and more fun, when departments engage: we learn more about each other, share problems and solutions, play a greater role in RES decisions and strategy and are a stronger voice for the discipline in universities and the HE policy world beyond.

You might have guessed from the above that I enjoyed my time as Chair of CHUDE: I was able to engage with issues that seemed important and with a lot of good (and busy) heads of department. So my final reflection is one of thanks to all for letting me have a go!

Developments in Economics Education Conference 2013

The Economics Network held its seventh Developments in Economics Education conference at the University of Exeter on the 5th and 6th September 2013. This biennial conference, attended by over 100 delegates from the UK and overseas, explores advancements and innovation in teaching practice and presents new and insightful research into economics education. Ashley Lait reports.

The Network received an unprecedented number of high-quality submissions for the conference and a number of delegates also commented on the excellence of the presentations at this year's DEE. In addition to the paper presentations, there were a series of workshops at the conference, which provided practical demonstrations of teaching methods and as in previous years, proved popular with the attendees.

A central aspect of the 2013 DEE conference was the focus on recent changes in higher education, including increased tuition fees and their impact on students' expectations and behaviour. This theme arose in a number of presentations but was also discussed through the meeting and parallel session on the Economics Network's collaborative research project involving 22 economics departments from across the UK. The conference offered the first opportunity for project leads and other interested parties to compare their findings and see the initial results from the Network's analysis of the aggregate data. For further information on the project and its results so far, please visit our website at: www.economicsnetwork.ac.uk/projects/research2013.

...continued on p.24

Report on Section F (Economics) Event at BSA Festival of Science

The labour market after the global financial crisis

The President of Section F for 2013, Prof Steve Machin (UCL), organised a session for the Festival of Science on September 11 at the University of Newcastle at which Prof Paul Gregg (Bath) gave a presentation outlining the unusual behaviour of the labour market since the global financial crisis and the resulting 'great' recession. This is David Dickinson's account of the event.

Some unusual features

Gregg's analysis started by explaining the profile of jobs, hours and real wages over 2008-13. He highlighted the unusual picture (compared to previous recessions) of relatively small loss in jobs, a fall in hours worked which was similar to previous recessions. He suggested that although there has been an increase in part-time workers (and those on zero hours contracts), the substantial increase in under-employment (workers wanting but unable to get full-time work) was mainly driven by people wanting to work longer hours. The main way that the pain of the recession had been borne this time, and unlike previous recessions, was on falling wages. Gregg observed that the data patterns were consistent with the empirical regularity that a 10 per cent fall in real wages would be associated with saving 5 per cent (or 2mn) jobs. So the economic pain from the current recession was widely borne by falls in living standard across the board rather than being restricted to the group of workers who became unemployed. He also noted that a deep recession combined with a limited loss of jobs meant that productivity growth had stalled and was around 15 per cent lower than would be expected.

Looking for explanations

He then went on to explore in more detail why these patterns were being observed. Firstly in terms of productivity he noted that firms were responding to relatively high cost of capital and relatively low cost of labour. As a consequence real investment had been very weak during the current recession and firms were using more labour instead. The picture for falling wages appears to be driven by two factors. First, Gregg pointed out that there had been a slowdown in wage growth since 2002. This was associated with a breakdown in the long-standing relationship between (median) wages and productivity. Part of this trend was due to increasing pension costs which added to the overall cost of employing a worker and part was the result of rising wage inequality with higher paid workers gaining a rising share of national output. These created a growing wedge between total per worker compensation which still rose in line with productivity and median wages. On top of this was a feature that wages have become more sensitive to unemployment movements with a doubling of unemployment reducing wages by around 12 per cent through this recession compared to around 6 per cent previously. The slower underlying wage growth combined with greater downward pressure from unemployment was driving wage changes into negative territory. He offered tentative explanations based on the decline in Trade Union power and the impact of increased unemployment.

Contrasting fortunes of young and old

Gregg then went on to examine the age profile. He showed that the current recession had seen a large increase in the number of older workers staying in employment and a large rise in unemployment among young people. The problem for the young unemployed is a sharp fall in new vacancies which young people rely on for entry into the labour market, whilst older workers were staying on in work and driving an upturn in overall employment. Gregg argued that it was good news for the economy that older workers were choosing to stay on in employment since it increased the stock of productive workers to cope with the pensions and health costs of an ageing population. He was however concerned about the implications for young people. One response was for them to stay on in Education and Training. This was a positive development given that they would have enhanced skills. However there was still a substantial minority of young people who were unable to gain either training or education and hence had difficulty transitioning into full-time employment. Providing support to young people wishing to enter the labour market was a key policy issue. Gregg also speculated that those in employment will need to adjust to the fact that wages will not continue to grow and there will come a time when children are not wealthier than their parents. The session finished with around 30 minutes of questions from the audience and a lively discussion around Gregg's analysis.

Note:
Support for this event from the British Science Association and the Royal Economic Society is gratefully acknowledged.

Trends in student numbers in economics in the UK

In the last issue of this Newsletter*, we reported the record number of entries for the Royal Economic Society's Economics Essay Competition for 2013. Possible reasons for this surge in popularity almost certainly include the efforts of the RES, the tutor2U economics community and the Economics Network to promote economics as a challenging and interesting discipline. It is also notable that the numbers of students taking A-level economics has also increased in recent years. In this brief article, Peter Smith[1] summarises the trends and speculates on possible reasons for this increase in popularity.*

UCAS data

Data on applications at subject level are available through UCAS back to 2006, as shown in Figure 1. Applications increased from 37,766 in 2006 to 50,443 in 2012, but have remained almost flat since 2009. This is broadly in line with total applications on all courses, although applications to Economics increased slightly from 1.7 per cent of the total to 1.9 per cent in 2012.

Figure 1: UCAS applications for L1 Economics

HESA data

Data on the number of students studying on economics degrees are published by the Higher Education Statistics Agency (HESA), as shown in Figure 2. Notice that there were changes to the JACS codes that allocate students to subject areas in 2002/03 and in 2007/08. The figure suggests that the first of these changes affected economics, resulting in a break in the data series.

The picture thus emerges of relatively flat applications but a steadily rising total population of full-time students at both undergraduate and postgraduate level.

Some thoughts

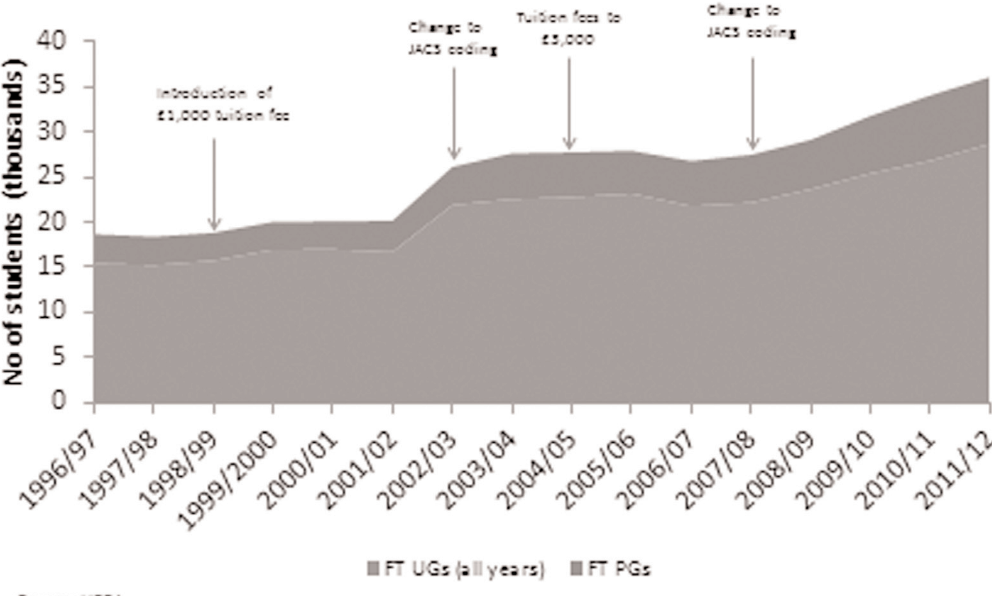
We might identify some possible explanations for the rise, both on the demand-side and the supply-side, although these are based on anecdote and speculation rather than fact.

On the demand-side, there may be reasons why economics would be attractive to students as a subject of study. For example, *The Complete University Guide 2014* lists Economics as being a subject in which graduates earn high salaries. Economics comes 5th in this particular league table, after dentistry, medicine, geology and chemical engineering. Walker and Zhu (2013) also note relatively high wage differentials for economics graduates as compared with most other disciplines. Without more research it is not possible to evaluate the extent to which such information sways the decisions of students when considering their choice of subjects. Anecdotal evidence does suggest that students may perceive that economics as a discipline provides them with opportunities to improve their job prospects, as shown on the Economics Network website, which contains videos of students describing why they chose to study economics. However, this explanation must be treated with some caution, given that the applications data in Figure 1 show that applications were relatively flat during the period when student numbers were increasing.

On the supply-side, there may be some evidence that more students are becoming better qualified for entry into economics undergraduate programmes. Figure 3 shows trends in entries of students for A-levels in a selection of subject areas.

There has been a general trend over this period of expansion in the numbers taking Economics and a decline in numbers taking Business Studies, which in many schools and colleges is seen as a substitute for Economics, rather than a complement. Indeed, it is apparent in Figure 3 that both Economics and Mathematics have been expanding in recent years rela-

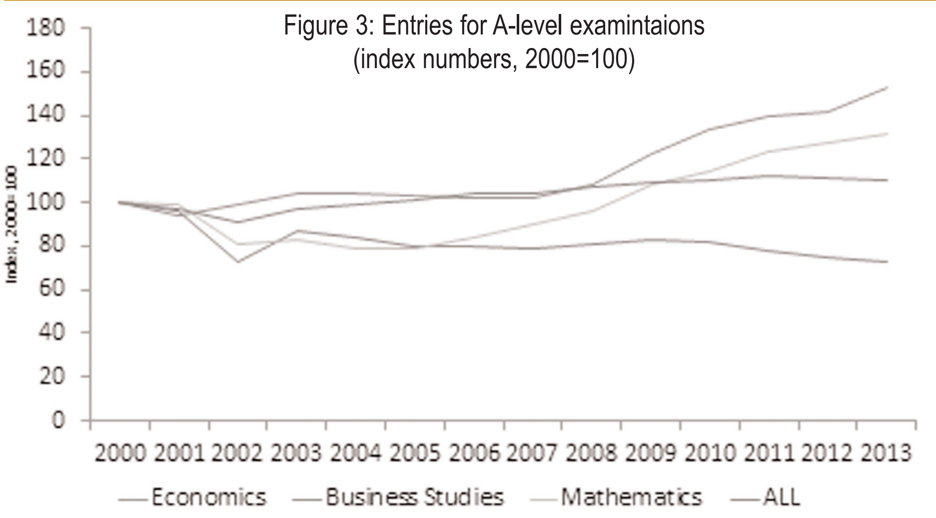
Figure 2: Number of university students studying economics in the UK



Source: HESA

tive to overall A-level entries. This may have meant an expansion in the numbers of students seen as well-suited to pursue an economics undergraduate degree.

Universities concerned about league table positions may have been content to see numbers increasing in Economics relative to some other social studies disciplines because of the higher entry tariffs that such students bring. Another rather speculative possibility is that Universities in which postgraduate programmes in business and management-related areas have been booming may have wished to cut down on undergraduate programmes in these areas, releasing quota for economics programmes.



Source: Joint Council for General Qualifications

Summary

These remarks are intended to provoke discussion, rather than to offer serious explanations, but may lead to a more careful analysis of the data in the future.

Note:

1. Peter Smith is currently University Director of Education at the University of Southampton, seconded from Economics to head a project on curriculum innovation as part of the University's strategy to increase flexibility of student choice. He is also editor of *Economic Review*, a magazine designed for A-level Economics students, now in its 31st year of publication., and an Associate of the Economics Network.

References and sources:

Statistics from HESA from http://www.hesa.ac.uk/

A-level data from http://www.jcq.org.uk/

UCAS data from http://www.ucas.com/data-analysis

Economics Network website with student views at http://whystudyeconomics.ac.uk/

Ian Walker and Yu Zhu (2013) 'The impact of university degrees on the lifecycle of earnings: some further analysis, BIS Research Paper No 112' at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/229498/bis-13-899-the-impact-of-university-degrees-on-the-lifecycle-of-earnings-further-analysis.pdf

See also http://www.thecompleteuniversityguide.co.uk

News from the Economics Network

Developments in Economics Education Conference

The 2013 DEE conference was held at the University of Exeter on the 5th and 6th September 2013. (see p.14 above). More information on the conference, including presentations and recordings of the plenary sessions will be available on our website shortly: ww.economicsnetwork.ac.uk/dee2013.

Economics Network Teaching Awards

At the Developments in Economics Education conference dinner, the Economics Network presented their 2013 Learning and Teaching Awards in recognition of exemplary teaching practice that encourages understanding of and inspires interest in economics. We received an unprecedented number of high quality nominations so choosing the winners was a difficult task. In the end the judging panel decided on the following:

Outstanding Teacher Award:
Winners: Paul Middleditch (University of Manchester) and Jeremy Smith (University of Warwick)
Commendations: Peter Dawson (University of East Anglia) and Ralf Becker (University of Manchester)

B*est New Lecturer Award:*
Winner: Chris Colvin (Queen's University Belfast)
Commendations: Parama Chaudhury and Christian Spielmann (University College London) and Laura Delaney (City University)

Outstanding Student Support Award:
Winner: Fabien Winkler (London School of Economics and Political Science)

Economics Network workshops

With the support of the Royal Economic Society and the Scottish Economic Society, the Economics Network has once again run its autumn programme of workshops for graduate teaching assistants and new lecturers. We have run 12 workshops for graduate teaching assistants and the new lecturers workshop will be on the 18th and 19th October, further details are at: http://www.economicsnetwork.ac.uk/events/newlecs.

Economics Network Interdepartmental Research Project

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

Over twenty UK economics departments are engaged in the project. The Economics Network has surveyed first and second year students at these universities and over the summer did the initial analysis on the data. Individual results were returned to departments and at the Developments in Economics Education conference four departments presented their initial findings and the Economics Network presented the aggregate data. The conference also gave the opportunity for project leads to discuss the next phase of the project, including focus groups and the 2014 survey.

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

Letter to the editor

Sir,

I was interested in the piece by Andy Feng and George Gratz on the value of a first class degree. I am sympathetic to a regression discontinuity methodology. However, I was somewhat surprised by their claim that, 'whether a student receives 70 or 69 on the critical [LSE] exam is down to random luck'. I recall from my experience a decade ago as an LSE external examiner that an internal mark of 69 (equally 59 on the 2.1/2.2 borderline) was an invitation to the externals to carefully review the script in question. In the case that this mark was crucial to the overall classification, that review might well involve reading the script in the overall context of the candidate's other papers.

Of course, the student's performance can be regarded as a random variable given his/her ability and knowledge of the subject. The examination process attempts, so far as is possible, to get behind this randomness and to assess the underlying 'fundamental'. I do not recall any coin tossing in the often lengthy discussions that took place in the critical cases on which Feng and Gratz rely.

Yours sincerely

Christopher Gilbert

University of Trento
Department of Economics and Management
Via Inama 5
38122 Trento

Restoring the Bank Lending Channel of Monetary Transmission

This paper reports on a 'round table' panel discussion that that took place at the 30th International Symposium on Money, Banking and Finance, at the University of Nantes, 27-8 June 2013. The conference was organised by the European Research Group GdRE (Groupement de Récherche European) on Money, Banking and Finance which is part of the CNRS (Centre Nationale de la Récherche Scientific) in France. The round table discussion was organised by the UKs ESRC (European and Social Research Council) and Bank of England sponsored MMFRG (Money, Macro, Finance Research Group).[1] This article is based on a longer report by Andy Mullineux.[2]

The conditions underlying the credit crunch of the last five years are now well-known. So too are the measures taken by central banks to mitigate the effects. These include holding short-term interest rates at unprecedentedly low levels; introducing unconventional measures such as 'quantitative-' and 'credit-easing' in order to increase liquidity and hold down longer-term interest rates.

However, these central bank initiatives have sometimes the appearance of 'pushing on a string'. To bring about a significant stimulus to the economy, banks must start lending the idle cash and firms hoarding cash must start investing it. Improved 'animal spirits' will eventually, it is hoped, bring this about, and then the central banks will face the problem of extracting excess liquidity before asset bubbles and price inflation accelerate. The observation that, despite the best efforts of the national central banks (including the European Central Bank, ECB) to hold down interest rates and pump liquidity into their economies, bank lending remains restrained, prompted the choice of the title for Panel discussion. Essentially, the question was: *under what conditions will the banking system resume 'normal' lending, particularly to SMEs?*

The panel discussion

Leonardo Gambacorta pointed out that the bank lending channel had changed a great deal over the last 20 or 30 years (see also: Gambacorta and Marques, 2011) and also emphasised how the crisis had reminded us of the importance of liquidity, a theme picked up by Douglas Diamond in his keynote lecture at the conference.

Leonardo highlighted the major differences between cycles with and without financial crises and illustrated how monetary policy is less effective in a financial crisis. This explains the deployment of unconventional monetary policies, such as quantitative easing, in response to the globeal financial crisis (GFC).

Whilst deleveraging in a 'normal' downturn is of little importance, a financial crisis is preceded by over-leveraging, and thus substantial deleveraging is required after the crisis (Bech, Gambacorta and Kharroubi, 2012). In this situation over indebted economic agents may not consume more in response to lower interest payments, but rather seek to repay debt. Moreover a struggling banking system may be not to pass on lower rates to the rest of the economy because of the need to restore appropriate risk margins and recapitalise from earnings retained from interest margins. Leonardo argued that deleveraging achieved during a downturn following a financial crisis is ultimately beneficial for the subsequent recovery. Whilst in normal business cycles, in which debt levels are not excessive, any increase in leverage would help to finance profitable investment projects and consumption; during a financial crisis, in contrast, such benefits are more than offset by the costs of failing to repair balance sheets. In this case, he postulates, sectoral credit policies that aim to reallocate resources towards sectors that are most productive, and have not been drugged by the crisis, could be very helpful.

Leonardo observed that, both as a legacy of the pre-crisis financial boom, and as a result of accommodative monetary policies in response to the crisis, the level of private non-financial sector debt is historically high globally . Despite some progress in reducing private sector debt, particularly in advanced economies that experienced a significant accumulation of debt during the boom, balance sheet repair remains incomplete and is acting as a drag on economic growth. Meanwhile, increased leverage in other advanced economies and in emerging market economies (EMEs), suggests the potential build-up of vulnerabilities in some regions. Debt levels in 'Emerging Asia' are, for example, trending toward the peak reached before the Asian financial crisis of the late 1990s. Moreover, while debt levels are serviceable at current very low interest rates, what will happen when interest rates rise to positive real rates? To service the debt at such levels, Leonardo concluded, faster GDP growth are required to reduce debt to GDP ratios.

Next, Paul Mizen illustrated the rationing of this supply of bank lending and the rise in the cost of bank lending in the UK. Because banks had increased their 'risk

spreads' following the crisis, lending rates to SMEs remained significantly above zero. Supply and demand factors were at work and it was difficult to disentangle them. SMEs are the most 'bank dependent' firms in the UK and pose the highest credit risk for lenders as they have little equity to absorb losses and the value of their collateral (oFten the family home) has become less reliable.

As regards restoring bank lending, Paul asked, 'to what?'; noting that banks over lent before the crisis. Relaxation of credit standards had led them to under-price credit risks. Nevertheless, there was an acute need to reduce the currently excessive credit rationing in the UK.

The UK government responded to the Credit Crunch by reviewing its Small Finance Loan Guarantee Scheme (Cowling, date) and replacing it with the Enterprise Guarantee Scheme. HM Treasury and the Bank of England also tried to stimulate bank lending to SMEs, first through 'Project Merlin' and subsequently via its current 'Funding for Lending Scheme' (FFLS); which provides cheap funding for banks engaging in mortgage and SME lending. The banks have shown much more interest in using the funding to advance mortgages, than SME loans.

Clas Wihlborg, the third speaker, emphasised that the Credit Crunch was particularly prevalent in the periphery countries of the Eurozone as a result of the 'Doom Loop' linking the sovereign debt crises to the banking crises; which had been the topic of the Panel session at the 2012 conference in Nantes.

The pre-crisis single Eurozone credit market had fragmented, so that German SMEs could borrow much more cheaply than Spanish SMEs. To get banks to lend more with lower risk premiums, it was first necessary to restore the health of banks. The long term solution might be a Banking Union, although Clas Wihlborg's view, shared in particular by one of last year's panellists, Jean-Paul Polin (University of Orleans), was that the Banking Union project was too grandiose and required progress towar@s fiscal and political unions that would take decades, rather than a few years, to achieve.

In the short term, the problem of the 'Zombie banks', that are technically insolvent, but propped up by governments, needed to be resolved; even if common bank regulation and supervision under the ECB can be operationalized. Loss recognition was essential and bad debt problems had to be resolved; echoing Charles Calomiris (Columbia University) comments at last year's Panel (Mullineux, 2013a and b). Bank losses should be written down whilst establishing 'depositor preference'; assuring depositors have seniority as creditors. This must be agreed internationally.

Once the debts of bank creditors are written down in proportion to their seniority and residual bank losses have been realised, the banks would need to be recapitalised. Unfortunately, the banks most in need of recapitalisation often have the highest levels of their national government debt. Forced transfers between Eurozone creditor and debtor countries, and their banks, seem inevitable (after the September 2013 German elections!). Charles Calomiris also made this point last year.

Clas Wihlborg had some additional observations regarding the proposed Banking Union. Separate supervision of large and small banks might be sensible, but banking market competition distorting national supervisory favouritism and regulatory capture should be avoided. Regulatory capture of the ECB by big banks should also be guarded against.

Harmonising regulatory procedures might prove to be easier than supervisory practices and both needed to be embedded in legal systems. The logic of the EU's Liikanen Report (EC, date) and the UK's Independent Commission on Banking report (ICB, date) and recent US policy initiatives for the restructuring of banks into separately capitalised subsidiaries, at home and abroad, is that separately capitalised subsidiaries can be allowed to fail in a banking resolution process. Separation of deposit taking from investment banking and trading activity (the 'Volcker Rule' in the US and the ICB 'ring-fencing' and Liikanen proposals) helps safeguard deposit protection schemes, which even if funded and underpinned by depositor preference, are ultimately underwritten by taxpayers.

Under the proposed European Banking Union, there would be a pooling of national deposit insurance schemes, leading German taxpayers potentially to pay out to depositors of banks in other countries; a *de facto* fiscal transfer union. Strong prudential bank regulation and supervision is thus remains essential to protect depositors and taxpayers from abuse by risk prone banks (and their shareholders).

Clas Wihlborg is an advocate of regulatory competition, believing it can lead to a 'race to the top' rather than a 'race to the bottom', if implicit taxpayer guarantees, especially of the larger ('too big to fail') banks, can be eliminated using credible resolution regimes incorporating 'bail-ins' of creditors and depositor preference.

Richard Werner, the last panellist to speak, argued that a separately identifiable bank lending channel of the monetary transmission mechanism, in response to a change in interest rates, was a misconception because monetary policy *always* works directly through the quantity of bank lending, there is no separate interest rate channel.

Banks are special because they create the vast bulk of the money supply (97 per cent) by advancing loans which create deposits. Hence regulatory liquidity requirements have an important role to play, as Leonardo Gambacortahad argued, and Bob Diamond had emphasised in his keynote speech. Richard also favoured the simpler and more direct 'credit guidance' procedures because they are, in his view, the only bank credit regulatory measures with

a consistent track record of achieving the set objectives; such as avoiding asset price bubbles and financial crises.

Richard's proposal for restoring bank lending is to clear non-performing loans from bank balance sheets, at zero cost to tax payers and society at large, through central bank purchases of impaired bank loans at face value. This would not amount to 'printing money', he argues, since through this book keeping exercise the central bank is not injecting any money into the economy (defined as the bulk of the economy that cannot create money). Major central banks have, in Japan for example, have successfully implemented this policy before (Werner, 2009). Banks should then be encouraged to lend their excess liquid reserves to the national government under an 'Enhanced Debt Management Scheme', whereby the government stops issuing bonds and instead covers its public sector borrowing requirements by entering into loan contracts with banks. This would increase bank credit creation and hence stimulate new economic transactions without crowding out others, adding to the money supply and boosting nominal growth, and hence employment. He believed that this was an attractive proposition for countries such as Spain and Ireland.

Richard's basic point is that bank lending is beneficial to growth as long as the borrowing is put to productive use; and as long as there are borrowers willing and able to do so, bank lending for GDP enhancing transactions should be maximised and the central banks should supply the necessary liquidity cheaply.

In such a world, the demand for credit, or rather the supply of potentially productive investment opportunities, is a potential constraint on the ability of banks to expand the credit supply productively. Nevertheless, there is a strong Keynesian case for the government acting as 'borrower of last resort' when bank credit is contracting, as in many Eurozone countries currently. Richard's 'Quantity Theory of Credit' (Werner, 2013), however, envisages an endless stream of potentially productive investments as he argues that human ingenuity has always delivered new productivity-enhancing technologies and innovations.

Discussion and conclusions

The discussion following the presentations included responses by the presenters to the comments of the others and comments and questions from the audience.

Incentive compatible solutions, ideally in the form of contractual obligations, were necessary to stop 'risk shifting'. 'Market capital' in form of the hybrid debt/equity instruments and contingent convertible ('co-co') bonds was advocated.

There was discussion of the advisability of the structural separation of retail, trading and investment banking activities, given that, if there were significant economies of scale and scope, it might introduce inefficiencies. It was observed that after all, the subprime crisis was a commercial banking problem aggravated by securitisation and derivatives, not a problem with investment banks *per se.*

There was agreement with Andrew Haldane's view that Basel II and III relied on over complex risk weighting systems based on the big banks' own models and that Basel III was already being 'gamed' by the banks. Leverage ratios are therefore needed as a backstop.

Concern was expressed that the addition of supervisory powers to monetary policy responsibility at the ECB will give it too much power. Similar concerns have been raised about the accumulation of power at the Bank of England. Against this, the US Federal Reserve has considerable powers, and the GFC had made clear that macro prudential policy involves interaction between prudential regulation and supervision and monetary policy.

One member of the audience, Dominique Lacoue-Labarthe (University of Bordeaux IV), informed us that an EU agreement had been reached overnight on credit burden sharing using creditor 'bail-ins' in cases of insolvent banks; in light of the Cyprus experience and the preceding 'bail-out' (nationalisation) of the fourth largest Dutch bank, SNS Reaal, in February 2013, by the government of the Netherlands.

The question raised by the Panel was: *what does 'restoring' the bank lending channel mean?* It was clear that the panellists did not envisage restoring bank lending to pre-crisis levels, because the run up to the crisis had entailed relaxation of credit standards in pursuit of historically high returns on equity by banks, egged on by their shareholders. As the credit cycle had reached its peak, leveraging reached record levels and capital to asset ratios had declined. A tax system that allowed tax deductibility of interest payments on debt, especially by banks at the fulcrum of credit creation, had incentivised this.

The 'new normal', to which currently restrained lending should be raised, would be set in the context of risk based lending underpinned by adequate capital ratios. The debates about: how adequate is adequate, and what is the role of risk weighting based on banks own models are on-going. Banks should also make 'forward looking' provisions against bad and doubtful debts, accounting standards permitting.

It was also noted that loan guarantees are widely used to reduce credit rationing; particularly as regards SME lending; for which credit rationing is judged to be more acute due to greater information asymmetry, lack of collateral, and the fixed cost of lending problem.

A number of countries, including the USA, Switzerland and the Netherlands allow income tax deductibility of mortgage interest payments, and the US has made extensive use of mortgage (home loan) guarantees in the post war period.

...continued on p.24

Teaching evidence-based economics

Readers of this Newsletter *will know that the crisis of 2008 (and its consequences) has provoked a great deal of discussion of the nature of economics education and the possible need for reform.*[1] *In this article, Michael Joffe of Imperial College London argues that several of the recommendations that have been forthcoming amount to the need to teach economics with a much stronger focus on evidence.*

Since the crisis of 2008, there has been much discussion of the future of economics, and especially the future of its teaching.

Several themes have emerged that apparently command wide support in many quarters, including prospective employers of economics graduates. Among these is a group of inter-related topics that could be seen as addressing the need to pay more attention to reality:

- better connection with the real world, including familiarity with economic history;
- ability to handle data, and knowledge of data sources;
- ability to synthesise evidence, and more broadly an emphasis on the application of economics.

Drawing these themes together, they can be expressed as the importance of a solid grounding in evidence. This includes some understanding of the way that it is obtained, as well as possession of substantive knowledge. It also encompasses evidence both descriptively on the main features of the economy and how they change over time, and mechanistically on what brings about those features and changes, i.e. how the economic system works.

Underpinning this approach is the fundamental principle that everything that is taught should be defensible in factual terms. Not that it is necessarily 'true', as that would greatly limit the scope of the discussion, but rather that there is evidence for and (probably also) against. The corollary is, *things that are known to be untrue should not be presented as fact*. It may seem odd to emphasise this, but it is motivated by the observation that some elements in the standard curriculum, and in textbooks, are incompatible with the evidence. Not merely oversimplified; false. I return to this issue below.

Plurality of types of evidence

In the past twenty years, economics has seen a huge growth in empirical research. Much of this is on practical issues, such as the influence of class size on educational attainment, and of educational investment on future earnings. These are important policy questions. In teaching, however, one needs to prioritise. The types of evidence that are most relevant are (a) those relating to the broad features of the economy, both descriptively and mechanistically; and (b) evidential support for (or against) the major economic theories, e.g. each of the components of the *General Theory*.

Evidence can be of many kinds, and different types of course have different requirements. Business schools need an emphasis distinct from that of economics courses (and may currently be better in this respect). For economics, data handling has featured prominently in the discussions; in addition, it is important for students to have an appreciation of where data come from, and how this may affect their quality — the strengths and weaknesses of key datasets. In substantive analyses attention should be directed more at what is driving the data, causally, than on quantification of estimates.

There are important sources of evidence other than statistical data, for example surveys, qualitative as well as quantitative.[2] Evidence need not consist only of generalisations; specific events and case studies can also be instructive.[3] So can descriptive studies, including on how particular sub-systems of the economy work. [4]Secure knowledge comes from bringing different approaches together, and if necessary addressing any inconsistencies.

Behavioural economics is now part of the mainstream. This signifies a shift in emphasis towards how things actually happen, away from a focus on how they might happen in an ideal world. If one of the frequent criticisms of the curriculum is that it needs to move closer to reality, this is a good opportunity for teaching (and modelling) to be founded on real behaviour patterns, and on acknowledging that causation in economics involves multiple causation not determinism. Behavioural postulates based on imaginary axioms may be able to generate precise predictions, but this is of little value if these are wrong — accuracy should take precedence over precision.

Economic history is substantively important. It is the indispensable record of how economies actually behave, the particular structures they have, and how they change. In addition, economic historians pay a great deal of attention to the above-mentioned issues such as data quality, and the discipline encompasses specific events

and narrative as well as quantitative methods and consideration of general historical processes. Importantly, the comparative method is very strong, and provides insight — although not necessarily decisive conclusions — into the process of long-term change.[5] It is very important not to be centred on the experience of only one country, e.g. the UK or the US (or even both), but to have a broader global perspective. This gives a sense not only of what happened in a particular economy at a particular time, but also of what did not happen.

If it's untrue, don't teach it

The reader could be forgiven for responding that all this is straightforward commonsense. However, there is a problem. The RES Steering Group propose many elements that should be added to the economics curriculum, but are silent on what should be removed. Moreover, its recommendations begin with asserting the strength of mainstream economics, albeit hedged with stressing the need for humility and for honesty about its limitations. The unfortunate truth is that 'mainstream' economics still contains elements that are contradicted by the evidence, but which are presented as if they were true. I will focus on just one example, the shape of the firm's average cost curve.[6]

It has been known for over 60 years that in manufacturing at least, the U-shaped average cost curve is rare - estimates range from 5 to 11 per cent of firms. Nevertheless, it is ubiquitous in textbooks, and presented as a general truth. Unfortunately, the historical discussion of this issue became diverted into whether or not this finding 'invalidated marginalist theory', which is odd given that the theory is tautologously true. We ought to stop teaching the U shape as the typical relationship between costs and scale, for the simple reason that it is false.[7]

Falsity is not the same as simplification. For specific modelling purposes, a particular assumption may be useful, even though it is known to be a gross over-simplification. The classic case is rationality: it is clear that economic behaviour does not always accord with the tenets of classical rationality, but there may well be situations in which the rationality assumption is both useful and harmless. In such cases, it would be explicit that its inclusion is justified pragmatically, and should not be taken to imply that it is a realistic description of the actually-existing psychological process.

In such a situation, the importance of the distinction between the model and the reality it sets out to represent becomes crucial. We need to encourage an attitude in our future economists that they are as aware of the many features and forces of real situations as they are of the simplified, and hopefully elegant, model. Thus, if a macro model omits the financial sector, implicitly assuming that it plays only a passive role, then this omission would be visible. Students need to have a broad and multi-faceted understanding of the real situation, so that they can see which elements have been selected for the model, and which have been omitted. Again it is a question of being able to see what is not there.

A good model for how to do this is biology. Whereas in economics we tend to rely on rather sparse 'stylised facts', biology has progressed by building up from multiple descriptions (including of what is obvious to the observer), moving on to empirical generalisations, and then to attempts at explaining established patterns. This process leads to empirically-based theories that can subsequently be subjected to testing/refinement/rejection.

Currently, prestige is attached to the more abstract parts of the division of labour within the economics profession — and the model of general equilibrium is indeed a beautiful creation. For the curriculum, however, a better balance is needed. In particular, the mutual dependence of theoretical categories and evidence should be emphasised. The discourse should focus less on competing theories and models in the abstract, and more on the relation between each of these theories/models and the evidence. Students should be judged as much on knowledge of the real world as on knowledge of models.

Notes:

1. The list includes 'What the use of economics?' (Oct. 2012); 'Teaching economics after the crisis' (Apr. 2013); 'Rediscovery of Classical economics' (Jul. 2013).

2. An example of a survey that is useful for quantitative analysis is the Michigan Survey of Consumers [http://www.sca.isr.umich.edu/]. A more qualitative example is Blinder AS, Canetti E, Lebow D and Rudd J (1998) *Asking About Prices: a New Approach to Understanding Price Stickiness*, New York: Russell Sage Foundation. The methodology can be criticised, but in the current state of knowledge it is still able to generate important information.

3. For example, a highly instructive (if idiosyncratic) collection of single-country studies can be found in Rodrik D (ed.) (2003) I*n search of prosperity*, Princeton: Princeton U P

4. See for example, Ryan-Collins J, Greenham T, Werner R and Jackson A (2012) *Where does money come from*? London: the new economics foundation.

5. The reason for the wealth of some countries and the poverty of others has been a particularly rich topic. Important contributions include Landes D (1998) *The wealth and poverty of nations*, WW Norton & Company Inc; Pomeranz K (2000) *The great divergence*, Princeton: Princeton University Press. The diversity of views in this literature shows that some controversies are not easily settled. A different topic, the growth of the state in the past 200 years, has been forensically analysed in a comparative perspective by Lindert P (2004) *Growing public*, Cambridge U P.

6. I am abstracting from distinctions such as that between short- and long-term, and that between the firm's perceptions and reality, in order to emphasise the main point. Note that this is part of micro — indicating the inadequacy of the widespread view that the only problems are in macro and finance.

7. Eiteman, W J and Guthrie, G E (1952) 'The shape of the average cost curve', *American Economic Review* 42, 832-38; see also Blinder *et al., op cit.*

DEE Conference

...continued from p.14

The keynote address was given by leading UK economist and patron of the Economics Network, John Kay and was entitled: The map is not the territory: how to make economics relevant. John addressed the use of models in economics and emphasised the need to consider the relevance of models when applying them. This tied in well with the plenary and panel sessions on the second day of the conference. First, Paul Ormerod gave a talk on networks and economic theory, in which he highlighted the importance of network theory in forming a more realistic view of behaviour, again arguing that models alone cannot give the full picture. This was followed by a panel session on the future of macroeconomics education with Charlie Bean (Bank of England and EN patron), Peter Howells (University of the West of England), Giuseppe Fontana (University of Leeds) and Jack Rogers (University of Exeter).

Overall, the conference was a great success and showed the committed engagement of the economics community to delivering high quality teaching. The ideas, both research and practical methods, presented at the conferences were extremely interesting and innovative and will hopefully have influenced delegates. The feedback received by the Economics Network for the conference has been outstanding and includes:

'Very worthwhile two days, exceeded my expectations'.

'Most enjoyable and intellectually stimulating in every respect; thanks to all who contributed to its delivery'.

'This is an excellent conference to validate research into pedagogy and classroom innovation'.

'Interesting combination of papers and workshops'.

'Very engaging and wide-ranging sessions'.

'It is wonderful to attend a conference that was so inspiring'.

The Economics Network would like to thank the Royal Economic Society, the Scottish Economic Society and subscribing economics departments for their ongoing support of the DEE conference and the Network as a whole.

Restoring bank lending

...cont from p.21

The UK government revised its loan guarantee scheme in response to the Credit Crunch and has introduced a 'Funding for Lending' scheme to provide banks with access to cheap funding for SME and mortgage lending. It has proved successful in stimulating mortgage lending, but not SME lending and so a state backed Business Bank is being created. The UK government also introduced a 'Help to Buy Scheme' to help first time buyers with small deposits to buy new homes, and, in mid-2013, it extended the scheme to provide US-style guarantees for mortgage lending to people seeking to buy older properties, but who can only afford small deposits. The IMF has since warned that the UK government risks stoking up a new UK housing bubble by stimulating sub-prime lending!

The supply of funding for non-productive, speculative, asset price inflating and bubble creating 'investments', and purely financial trading, should however be curtailed; as part of macro-prudential policy, perhaps. A change in Keynesian 'animal spirits', combined with increased public sector led, perhaps via European Investment Bank, infrastructural project lending, can bring forth loans in response to a flow of good, productive, project proposals from SMEs. The on-going process of disintermediation will lead larger firms increasingly to fund themselves 'directly' via the capital markets, as in the US. Smaller firms will increasingly find alternative sources of funding from the true new challengers in banking, over the internet.

Notes and references:

1. Particular thanks are due to Christian Aubin of CRIEF (Centre de Récherche sur L'Integration Economique et Financière) who led the conference organising committee along with Raphaelle Bellando and Jean-Bernard Chatelain.. It has now become a tradition for the MMFRG to organise an event at the GdRE's annual international conference, and vice versa.

2. University of Bournemouth. (amullineux@bournemouth.ac.uk)

Gambacorta, L. and Marques, D. (2011) 'The Bank Lending Channel: Lessons from the Crisis', *Economic Policy*, April 2011 (also published as BIS WP 345/2011, Bank of International Settlements, Basel).

Mullineux, A.W. (2013a), 'Escaping the Eurozone's Doom Loop'. *Revue Francaise d'Economie,* January.

Mullineux, A.W. (2013b), *The Eurozone Crisis: Lessons from Sub-Saharan Africa*. Report for the African Development Bank, April 2013

Werner, R.A. (2012). 'Towards a New Research Programme on 'Banking and the Economy': Implications of the Quantity Theory of Credit for the Prevention and Resolution of Banking and Debt Crises', *International Review of Financial Analysis,* 25, 94-105.

Werner, R. (2013), 'Towards a More Stable and Sustainable Financial Architecture: A Discussion and Application of the Quantity Theory of Credit', *Kredit and Kapital,* 46(3), 353-389.

RES news

Election to the RES Council

The RES elections for Council will take place during October. The first online election process in 2012 resulted in a doubling of the number of ballots received and therefore this process will be continued this year. It is important for all RES members, where possible, to register a correct email address to their membership profile via the RES website and we urge members to please check that their details are registered correctly now. If you do not have an email address registered we will contact you by postal ballot to your registered postal address, but if your email is incorrectly registered we will not know and you could not receive a ballot for this or future Council and Presidential elections.

More details on how to register to the RES website or correct your membership details online can be found on the RES website registration page:
http://www.res.org.uk/view/registration.html and the election process is detailed on the RES Council election pages.

If you have queries about your membership, please contact the Membership department at cs-membership@wiley.com or telephone 01865 778171

Nominations for next year's Council Elections

Members of the Society are reminded of their right as members to propose names to be considered for election to the RES Council each year.

The formal procedure is that the Nominating Committee, which meets early in February, considers all such names and puts forward to Council a list for approval. This is then the subject of a ballot of all members of the Society in the autumn. The successful candidates join Council after formal adoption at the following AGM.

Any member of the Society who would like to make a nomination may contact the Secretary General at royaleconsoc@st-andrews.ac.uk or by post to the offices of the Secretary General, School of Economics & Finance, University of St Andrews, St Andrews, Fife, KY16 9AL. In addition to the name(s), there should be either a brief CV or a link to one. As the process needs to get underway in early February, we would be grateful to receive any nominations by **31st January 2014** at the latest please.

This year's RES Annual Public Lecture

will take place on 26 November at the University of Sheffield (6-7pm) and 28 November at the Royal Institution in London (5-6pm) where Tim Harford, author and 'undercover economist' for the *FT* will explore our understanding of macroeconomics in a lecture entitled 'How to run - or ruin- an economy'. Entry is by ticket only; the London event is already fully booked.

NEW: This year the Royal Economic Society has invested in widening its outreach of this popular event by offering groups or individuals to participate in the London Annual Public lecture by registering for a remote interactive link. This will allow you to watch the event live, connect with others in the audience and engage with the speaker and others in the ongoing conversations around the lectures topics. The full lecture will also be available to download after the event. We hope that schools, university student societies and any of our individual members will take the opportunity to try this exciting and convenient way of participating in one of our most popular events. See www.res.org.uk for details on how to register or contact the RES office (royaleconsoc@st-andrews.ac.uk).

RES PhD Presentation Meeting & Job Market

The 9th RES Postgraduate presentations meeting will take place at University College London during 10-12 January 2014. Registration details will be posted to the RES website during October or you can contact the organiser Professor Martin Cripps for more details m.cripps@ucl.ac.uk .

The event consists of two days of students' presentations and poster sessions. Participating institutions attend these presentations and are also allocated space at the conference site in order to arrange individual appointments with participating students. Participants should note that presenting a paper at the Meeting does not guarantee attention of potential employers: most participating institutions meet job candidates only at interviews arranged in advance and attend only presentations of those candidates. Institutions who wish to book a place for interviews should contact the RES office (royaleconsoc@st-andrews.ac.uk).

2013 Junior Fellowship Scheme Award Winners

Each year the Society invites UK universities to nominate economics students for up to ten one-year junior fellowships. The amount of the fellowship was increased in 2013 to £9,500 (£12,500 in London).

Candidates have completed at least two years' work towards a doctoral thesis when they take up an award. Those awarded Fellowships submit a report to the Secretary-General of the Society at the end of the academic year and are now also invited to submit a research paper to the RES Conference Programme Chair for possible inclusion in a special Junior Fellows conference session.
The Society has awarded eight awards under this scheme for the 2013-2014 academic year. Congratulations go to:

- Saleem Bahaj (University of Cambridge): The macroeconomic implications of Fiscal Policy
- Georg Graetz (London School of Economics) : Essays in labour economics
- Reka Juhasz (London School of Economics): The interaction between growth and trade: the cotton industry in continental Europe during the French revolutionary and Napoleonic wars
- James Lomas (University of York): Econometric modelling of healthcare costs
- Giulia Lotti (University of Warwick) : Economics of Education

Young Economist of the Year 2013 —Results

This competition invites school students to write an essay of between 1,000 to 2,500 words, on a subject set by the President of the RES, calling on key elements of their A Level or International Baccalaureate courses, examples from the world around them and imaginative discussion.

Charlie Bean (RES President and Bank of England), Professor Tim Besley (LSE) and Stephanie Flanders (BBC) selected four winners this year from over 1000 entries and awarded the title of the Young Economist of the Year 2013 to **Ellie Heatherill of Runshaw College**, Leyland, Lancashire who presented the essay entitled 'Does the international mobility of talent make it impossible to tax the rich?' Ellie's very lively, well-written, essay unearthed a wide range of relevant evidence and showed independence of thought in considering the underlying economics of her examples.

1st runner up was **Tom Rutter of Bishop Wordsworth's School**, Salisbury, Wiltshire for his essay on 'Must quantitative easing end in inflation?' There were many strong essays on this topic, but Tom's distinguished itself by the clear structure of its argument and its use of an example drawn from the world of video games. Joint 3rd place was awarded to **Georgina Evans** (Perse School Cambridge) and **Holly Metcalf** (St Paul's Girls School, London) both of whom addressed the question 'Should the experience of China silence those who think democracy is good for growth?' All the essays and the judges' report can be read on the website.

The winner's trophy and prize cheques for £2000 will be presented at the Society's Public Lecture in London on 22nd November 2012. We hope you will read these essays on the website: follow the links to the essay competition.

Support to Members (and other regular items)

Please see the website.

Conference diary

2013

october

CALL FOR PAPERS
2014 Annual Conference of the Royal Economic Society, Manchester, UK

Submissions are invited for the 2014 Annual Conference of the Royal Economic Society, taking place on **7th to 9th April 2014** at the University of Manchester. Submissions of papers and special sessions are invited in any field of economics and econometrics. The deadlines for submissions are as follows:

* submission of papers: **13 October 2013**. This must be done via the link available at www.res.org.uk/2014conferencehome.

* submission of special session proposals: **3 November 2013**. These should be sent to the Programme Chair at the e-mail address below and should include a short description of the intended session along with the proposed list of contributors (typically three/four, perhaps including the proposer) and indicative paper titles.

Further information: www.res.org.uk/2014conferencehome or contact Oriana Bandiera (LSE), Programme Chair RES 2014, e-mail: Res.Conference.2014@lse.ac.uk or Denise Osborn (Manchester), Local Organiser RES 2014, e-mail: res2014@manchester.ac.uk

October 31 — *Munich, Germany*

CALL FOR PAPERS

for **Conference on Social Economics,** organised by (Center for Economic Studies and Ifo Institute for Economic Research) CESifo to take place on March 21-22, 2014. The conference welcomes contributions to developments in social economics, a growing area of study that links economics with other social sciences. Specifically, the key questions include the role of culture, identity, altruism, esteem and status as competingwith traditional tangible and monetary motivation for behaviour. Deadline for submission of papers, or abstracts: **31 October 2013**. Preference will be given to complete papers. Submission via www.cesifo.org or contact office@cesifo.de

Further information: Senta Huber CESifo GmbH huber@cesifo.de

november

November 18-19 — *Mannheim, Germany*

Taxing Multinational Firms: Conference organised by Centre for European Economic Research (ZEW), University of Mannheim and Oxford University Centre for Business Taxation (CBT). This conference aims to foster discussion on this topical issue by bringing together various research approaches to the taxation of multinational firms.

Further information: http://www.zew.de/en/veranstaltungen/details.php?LFDNR=1822

November 22 — *London*

Regional Studies Association, **Mobilising Regions: Territorial Strategies for Growth.**

November 24-26 — *Tunisia*

The International Conference on Business, Economics, Marketing & Management Research (BEMM'13) is to bring together innovative academics and industrial experts in the field of Economics Business and Marketing BEMM'13.html

December 16 - 18 — *Los Angeles*

Regional Studies Asssociation, **Global Urbanisation: Challenges and Prospects**

Management with the primary goal of promoting research and developmental activities in Economics Business and Marketing Management Organised by the International Center for Science & Cultural Development (CSCD) bemm-conf@cier-pub.com
JEL Classification(s): A, D, E, F, G, H, J, K, M, N, O, P, R

Further information: http://cier-pub.com/

december

December 9-10 *London*

The Bank of England and LSE last year organised their first joint conference on Macroeconomics. Since then the Centre for Macroeconomics has been launched, and will be holding the second on 9-10 December 2013 at the Bank of England in London on the topic: **Understanding low growth.**Western economies have suffered from five years of stagnation, from which they may now be emerging. Was this just another recession, or was it characterised by self-sustaining low-level equilibria or traps? The keynote speakers are Paul Beaudry (UBC), Roger Farmer (UCLA) and Jaume Ventura (CREI and Universitat Pompeu Fabra). There is no conference fee. Applications to attend are invited, although numbers will be limited. For confirmed programme and to register an interest in attending see:
www.bankofengland.co.uk/research/Pages/conferences/1213.aspx

2014

january

16 January *Paris, France*

ICCM 2014 - International Conference on Commodity Markets. Energy issues are more and more affected by changes in commodities markets which have recently experienced huge price volatility, implying new challenges for practitioners and policy makers. This phenomenon could reflect: i) changes in traditional factors (supply, demand, and market structures); ii) a liquidity effect; iii) an increased role of complex financial products. In this context, the objective of this Conference is to address new analysis for commodities market, policies and supervision. Deadline for paper submissions: **October 31, 2013.**
JEL classification(s): E, F, G, Q

Further information iccm@esgms.fr

January 16-18 *Princeton, USA*

7th Annual Conference on the Political Economy of International Organizations. The conference brings together economists and political scientists to address political-economy issues related to international organizations such as the World Trade Organization, the United Nations, the International Monetary Fund, the World Bank, and the European Union, and also other international organizations that have as yet received less attention in the academic literature.

Further information: http://www.peio.me/

march

March 21-22 *Munich, Germany*

Conference on Social Economics, organised by (Center for Economic Studies and Ifo Institute for Economic Research CESifo) The purpose of the conference is to bring together international scholars working in this field and to stimulate research on this theme. The conference welcomes contributions to new developments in social economics, a growing area of study that breaches economics with social science. Keynote Speakers: Professor Frank Cowell from the London School of Economics and Professor Luigi Guiso from the European University Institute.

Further information: Senta Huber, CESifo GmbH
huber@cesifo.de

May 9-10 *Lisbon, Potugal*

The Welfare State in Portugal in the Age of Austerity
The conference will promote interdisciplinary academic discussion on the transformation of the welfare state in Portugal, in a time of financial austerity, economic crisis and rising social risks. We invite teachers, students and researchers who have been studying these topics to participate. Deadline for paper submissions: **December 15, 2013.**
JEL classification(s): D, E, G, H, I, J, K, L, O, P, Q, R, Z

Further information:
https://aquila.iseg.utl.pt/aquila/instituicao/ISEG/docentes-e-investigacao/conference-theme

june

June 6 - 10 *Jordan*

CALL FOR PAPERS

The 17th World Congress of the International Economic Association (IEA). Daily keynote lectures, numerous policy sessions and many invited sessions and the Congress will host the latest and most engaging research in any field in economics in the many contributed sessions. The Congress will provide an excellent forum to present research results.

Key dates:
October 31 2013 Paper Submission Closes
January 31 2014 Notification of Paper Acceptance
March 15 2014 Early Registration Deadline

Further information: www.iea-world.com

Membership of the
Royal Economic Society

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

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

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

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

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

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

• Discounts on registration fees for the Society's annual conference.

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

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

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

Membership rates for print and online for 2014 are £48 ($82, €57)*
Three year membership 'online only' membership is £100 ($170, €120)

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

A special 'online only' offer of three years membership (2014-2016 incl.) for the price of £17/ $29/€20 or one-year online only for £10/$14/€12 is available to full-time students.

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

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

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

.... in payment of my subscription for 2014.

Name:

....

Address:

....

....

....

Occupation...

Date............