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insight.

Edinburgh University Economics Magazine

Transition

The Folly of Fools

Obsolete Innovation

The Fate of Wildness

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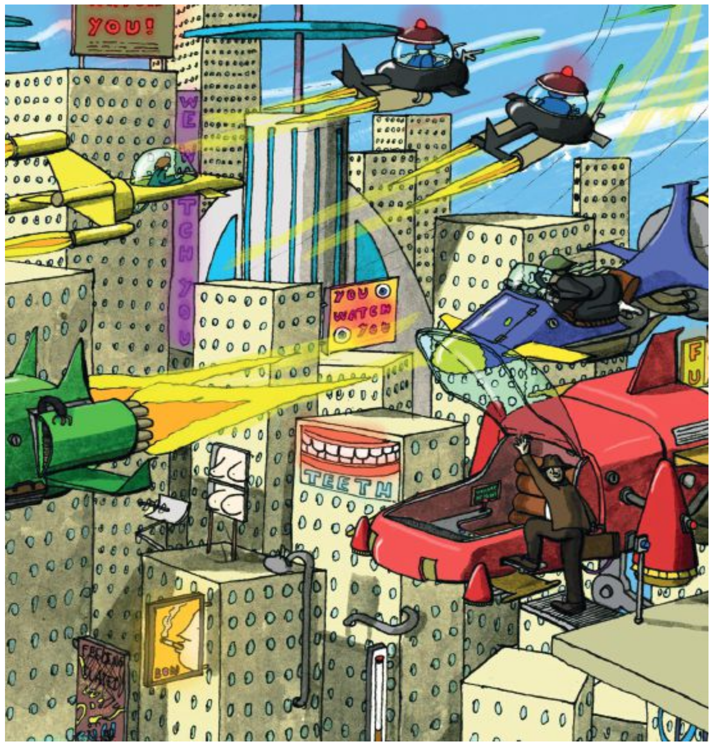

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Editor's Note

Welcome to this semester's offering of *Insight*, which is based on the theme of 'Transition'. The combined ills of recession, unemployment and falling incomes have dominated newspaper headlines since the decade began, and rightly so. A consequence of our myopic desire to kick-start the ailing economy, however, is that discussion surrounding the sort of system that we really want – one that can combine prosperity for all whilst promoting the interests of future generations – has been severely curtailed. This issue asks you to consider again how we get from our current state of social and economic malaise to that once promised brighter future.

The Transition section begins and ends with passionate and level-headed calls for a radical rethinking of how we conduct our lives, interact with our fellow human beings and regard the natural world. In between, our writers consider issues as diverse as long-term banking reform, development in Africa and innovation in China. Although tackled in a distinct fashion, perhaps such topics are much more interconnected than we might at first think. To round off the theme, the magazine ends with a review of a proposed "Great Transition". What future will you choose?

Our Comment section continues by offering an array of economic analysis and polemical argument. Articles on the music industry, gender inequality and football are complemented by considerations of international finance and critiques of French and German politics. My personal highlight comes in the Academic section, in which the University of Edinburgh's very own Martin Chick discusses his work as an Economic Historian.

I would again like to extend my thanks to the entire editorial team, the writers and illustrators on whose hard work this magazine depends. The Economics Society and the School of Economics have once again been our faithful partners, whilst the Illustration and Design Editor have combined to produce the amazing finished product you read before you. Special thanks must go out to our new Online Editor, who has been instrumental in setting up our new website provided on the opposite page.

In keeping with the theme of this semester's issue, *Insight* itself is now entering a transitional period. All of this year's editorial team will be graduating, and so the search for new editors, writers and illustrators begins now. If you'd like to get involved, or if you have any feedback on this issue, please get in touch – an email is provided on the opposite page. On behalf of the entire *Insight* team, to readers old and new, thank you for reading.

Evan Williams
Editor-in-Chief

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Focus: Transition

Beyond the Economics of Fantasy

Nick Dowson makes the case for a radical economic transition

The dream of endless economic growth, that much sought after panacea of much of the economic discipline, is a fool's folly, like the inventor's dream of a perpetual motion machine, or the alchemist's quest for gold. Infinite growth on a finite planet is an unattainable – perhaps oxymoronic – ideal, and even Adam Smith predicted that economies would eventually reach a 'steady state'. And this is to say nothing of the desirability of continued growth. I argue that continued growth is undesirable, and moreover that market mechanisms and a myopic focus on economic value hinder the fulfilment of human needs and desires. I will look firstly at why continued economic growth may be impractical, before discussing why market mechanisms and the profit motive may be an obstacle to human development.

The first reason why we should be sceptical of the dominant economic paradigm of striving for continued growth is an environmental one. As Tim Jackson notes in Prosperity Without Growth, our impact on the planet can be expressed through a simple formula, the Ehrlich equation: I = P x A x T. According to this, human impact (I) upon the environment is the product of population size (P), affluence or income per person (A), and a technology factor (T). Scientists now accept that we need to cut carbon emissions drastically to avoid catastrophic climate change, and the Intergovernmental Panel on Climate Change (IPCC) has agreed targets for the minimum emissions reduction needed. Unfortunately, however, the Ehrlich equation suggests that with current rates of population growth (0.7% a year) and global income growth of 1.4% a year, technology (T) will have to become more efficient at a rate of *7% a year* if we are to meet these targets and be in with a chance of avoiding global catastrophe.

If we also want developing countries to catch up with western levels of affluence and do not want draconian population control measures, technological efficiency must improve yet faster. But historical improvements do not suggest this is likely; statistics suggest efficiency improvements of only 0.7% a year. While this historical trend does not rule out the possibility of both economic growth and overall emissions reductions in the future, those who support continued growth must explain how the exceptional technological advance this would require is to take place.

In addition to the problems with growth, the dominant economic model relies on the pursuit of monetary and material gain, and on market mechanisms of exchange. However, both on paper and in practice, these conflict with optimal outcomes and with basic human morality. On paper these incompatibilities – such as the market-hastened depletion of shared resources – are termed 'market failures'. But to term them market failures suggests that better government regulation or tweaks to the 'rules of the game' could iron them out; rather, we should see them in many cases as 'failures of the market'. Where this is the case, we should look to non-market forms of social organisation for the solution.

The practical evidence of the limitations of the current system go beyond a few bad eggs such as the corruption of Enron, the greed of bankers bonuses, or the corner-cutting that has lead to environmental catastrophes such as the Gulf oil spill. In reality, there are pervasive and damaging effects of market dominance. Markets alone do not provide any answers to society-wide problems, whether clinical depression or environmental degradation; nor can they give us many of the things vital to a good life: friends, quality time with family, personal satisfaction in our daily pursuits. Instead, the continued drive for 'more' leads to stress and overwork, and important life decisions and career choices are made for reasons of finance, not fulfilment. Whence the cliché Hollywood image – the top investment banker or businessman whose private life is disintegrating despite their supposed 'success'.

The limitations and failures of much of mainstream economics demonstrate the need of both society, and the economics discipline, for a transition: away from growth as a goal, and markets as a mechanism. Although many alternatives are available for those willing to look beyond current economic (and political) orthodoxy, suggesting a comprehensive alternative is beyond the scope of this article – I will however sketch out two simple proposals which could move us in the right direction.

The first is a ban on advertising. Unregulated advertising should be rejected by economists working within the current paradigm as an example of 'market failure' – advertising is by its nature biased information and often appeals to non-rational impulses, and is therefore likely to lead to inefficient outcomes. But advertising should also be rejected for encouraging unsustainable material consumption and perpetuating growth, and diverting individuals from more fulfilling activities than consumption. Centralised directory and comparison systems – not necessarily state run – would encourage better decision-making. Although laissez-faire economists might protest state regulation of advertising, it is important to remember that it is state force and law that creates the property rights and intellectual property necessary for 'free markets'. Indeed, it's already been done: São Paulo in Brazil, as well as the US states of Hawaii, Alaska, Vermont and Maine, have all banned outdoor advertising with great success.

The second suggestion is the implementation of a 21-hour working week that, although would require a considerable transition period and increases in the minimum wage, would have important benefits for individuals and for society. It would lead to a fairer distribution of work, benefiting the overworked as well as the unemployed and underemployed; it would allow individuals more time for care work (offering a solution to some of the issues associated with changing demographics and ageing populations) and for leisure, and would lead to vast improvements in mental health. Increasing free time would also lead to more arts, music, volunteering and engagement with civic life in general – a 21-hour working week would be a concrete measure towards an actual 'big society', rather than David Cameron's empty, rhetorical one. What is more, a 21-hour working week would help rebalance society – away from seeking happiness in material consumption and instead encouraging social activities – with a side effect of this being a reduction in material consumption and its associated environmental impact.

Tackling the issues facing society and the environment requires that we go beyond the grey economic orthodoxy of growth and markets and embrace a blue sky thinking which recognises the complexity of societies and human nature. Which will you choose?

Multi-Handed Colonialism

Alina Mika reassesses economic change in West Africa

In 1972 Walter Rodney asserted that 'colonialism had only one hand – it was a one-armed bandit." The Guyanese historian and activist's widely acclaimed book, *How Europe Underdeveloped Africa*, sharply criticised Europe's economic policies regarding various parts of Africa in the past three centuries. The publication contributed to a gradual shift in the understanding of colonial history. Previously, much attention was given to the benefits of the opening up of the economies to the outside world influenced by the colonial powers.

Yet, the analysis of the economic transition of West Africa after European colonisation is not one, or even two-handed. The difficulty of precisely accounting for the European legacy lies in the absence of a point of comparison. It is impossible to know the counterfactual, what could have or would have happened had the course of history been different. Moreover, rising indices of GDP and trade are not always accurate indicators of increases in the wellbeing of the country's citizens, and therefore the country's overall development. One could question to what extent material possessions and rising incomes make individuals better off. However, from a strictly economic perspective, it can be said that the transition was a complex picture of immediate benefits carrying significant future costs.

The biggest change fuelled by the Europeans was the opening up of the region to trade, which sparked record levels of economic growth. According to some calculations, British colonies in West Africa experienced an average 1600% increase in the value of their exports since 1852 to 1912. The rate of growth of the value of exports in the Gold Coast (now Ghana) is particularly noteworthy because despite specialising largely in one commodity, cocoa, the country experienced a rate of growth of 2335% over the period. These high levels of trade growth illustrate the British mercantilist mindset, as well as its demand for West Africa's groundnuts, cocoa beans, and palm oil. In light of this, some aspects of the rise of these economies appear to be a by-product of British economic policy, rather than its direct target. Nevertheless, a trade-oriented economy meant development of an appropriate infrastructure and increases in factors of production.

The introduction of a unified currency was another impetus to growth.

Helga Pavelkova

The barter system, and the numerous local currencies that existed alongside, were replaced by the British pound, which facilitated domestic and international trade. At the same time, the establishment of a stable banking system increased the availability of capital and encouraged higher levels of investment. Surely, these institutions were beneficial to Europeans in the region, but they were also available to some West Africans involved in the formal economy; those involved in trade could also take up loans to fund their entrepreneurial endeavours.

Foreign investment, furthermore, increased the amount of available capital. It is estimated that after the Colonial Loans Act of 1899, over 50% of the British Colonial loans were aimed at West Africa. More than half of this money went to the development of transportation systems, including harbour improvements, road building, and – most importantly – extensive railway construction. The increases in the export capacities of the countries improved drastically, which had a significant impact on the volume and patterns of trade; a railway system from Lagos to Northern Nigeria, for example, increased the volume of groundnuts exported from 790 tons in 1905 to 127,226 tons in 1925.

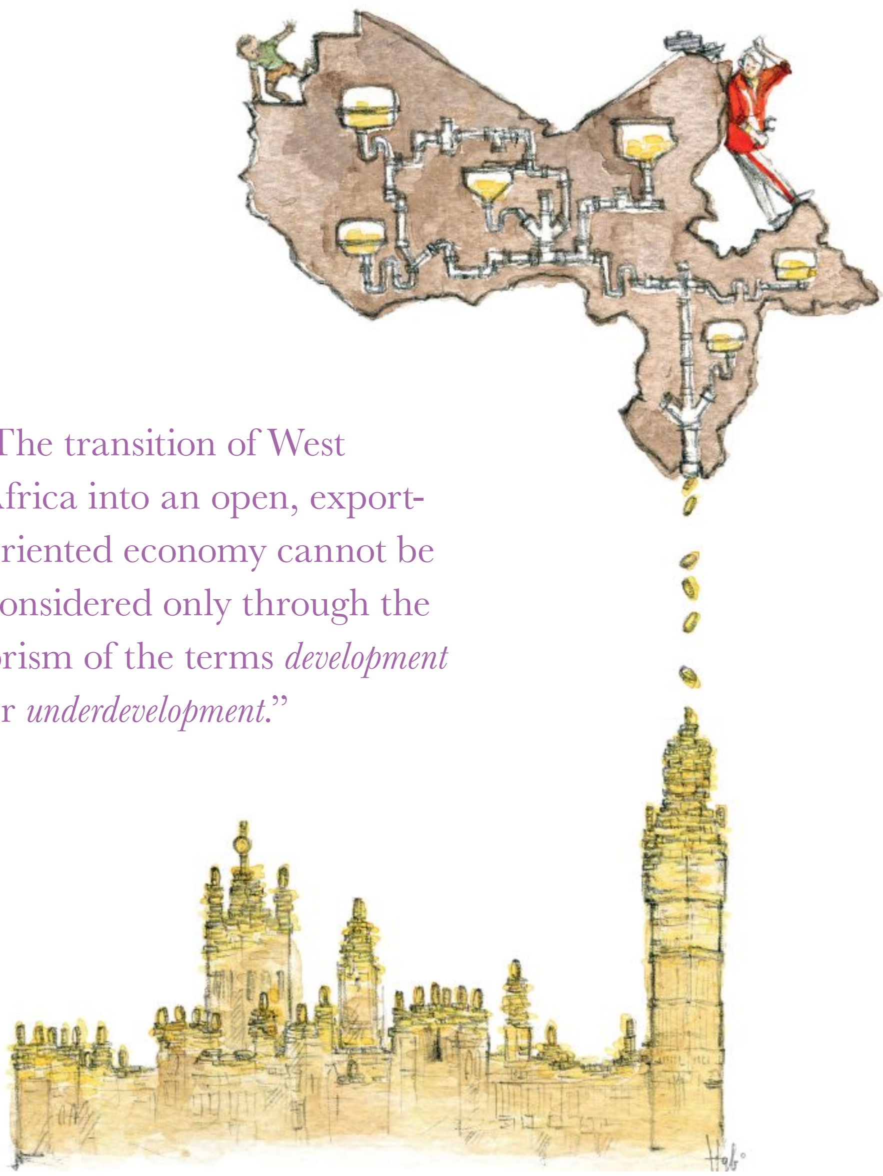
The British focus on developing colonies' trading capabilities meant that the colonies were made to specialise rapidly. Decisions on which goods to produce were made according to the profit they could bring with little regard for the needs or customs of West Africans. In fact, cocoa was entirely alien to the Gold Coast before colonisation, yet the rising demand for chocolate products in Europe meant that its entire colonial economy was centred around cocoa. Similarly, in the pre-colonial period Gambia had significant numbers of rice farms, yet due to their specialisation in groundnuts, they were forced to import rice to prevent widespread famines. Specialisation in a few agricultural products lead to dependence on external demand

Hannah Botma

for a small number of commodities, as well as lack of progress in other sectors of the economy. This meant that in times of crisis, such as the Great Depression and World War II, the economies were hit hard; demand for, and thus prices of, their exports fell and large parts of the countries' revenue was suddenly gone.

Improved infrastructure was a significant driver of growth, but the extent of its effectiveness on long-term development is disputed. Upon the countries' independence from the British around 1960, transportation systems were still very limited. Virtually all roads and railways in West Africa led to the sea. This illustrates the region's long-term dependence on overseas trade; lack of road access limited inland trade between African countries, and meant that large parts of the region did not become integrated into the economy. The effects of these policies are still visible today as transportation costs between African countries remain high and levels of interstate trade are still comparatively low.

The transition of West Africa into an open, export-oriented economy cannot be considered only through the prism of the terms *development* or *underdevelopment*. Whilst British rule arguably did catalyse economic activity in the region, it also limited the scope of how future growth could be achieved. Examining this transition helps us to understand the roots of the prevailing economic problems in the West Africa region and serves as a lesson to policy makers about the importance of sustainable development, not only fast rates of growth.



"The transition of West Africa into an open, export-oriented economy cannot be considered only through the prism of the terms *development* or *underdevelopment*."

Hannah Botma

Basel Recommends

Vainius Glinskis considers the potential impact of new international banking regulations

The financial crisis that began in 2007 was global in nature and is still affecting people around the world. Although it is not the first international economic crisis, it has spawned the strictest global regulation for banks the world has ever seen. Regulators have realised how interconnected the world has become in the 21st century. A transition to macro-prudential regulation has become necessary to ensure future stability in the financial markets.

The Basel Committee on Banking Supervision (the BCBS, or the Basel Committee) has central bank representatives from over 25 nations and provides frameworks for international banking regulations. They have already created Basel I and II proposals in the past, but their new Basel III proposal builds on the old micro-prudential regulations by requiring higher capital levels. A new macro-prudential element, furthermore, includes a counter-cyclical buffer and universal leverage ratio to address systemic risk in financial institutions around the world. In 2010, member countries of the G20 officially endorsed the new recommendations.

The BCBS outlined two goals for Basel III: "To strengthen global capital and liquidity regulations with the goal of promoting a more resilient banking sector" and "to improve the banking sector's ability to absorb shocks arising from economic and financial stress, which, in turn, would reduce the risk of a spillover from the financial sector to the real economy." They try to meet these goals mainly with capital and liquidity reform.

So what does Basel III actually propose?

Firstly, it raises the capital requirement that banks need to have on hand from 2% to 7%. Not only do banks need to have more capital, but the capital itself also has to be of better quality. This means it will be mostly made up of common equity. A buffer of 2.5% can be made up of lesser quality capital, like preferred stock, in case the bank faces heavy losses and dips into this buffer range and needs more capital to stay solvent. When in the buffer zone, supervisors will have to reign in bonuses and halt the payment of dividends. If banks become insolvent then some of their assets might be written off, meaning investors will take the hit when a bank fails instead of taxpayers. There will also be a new countercyclical capital buffer. It requires banks to put up extra capital of up to 2.5% in good times when there is an abundance of cheap credit to dampen the damage of credit bubbles. For systemically important banks (SIBs or 'too big to fail' banks) there will be additional capital requirement of 1-2.5% composed of common equity. This will hopefully make it harder for large banks to become even larger whilst attempting to make them more solvent. All of these changes require banks to be less leveraged and along with better capital to cover capital requirements, will make it harder for banks to fail. Even if a bank is hit with heavy losses, then investors and employees will face the consequences instead of the taxpayer, which addresses the moral hazard problem that supervisors face.

> "Regulators have realised how interconnected the world has become in the 21st century. A transition to macro-prudential regulation has become necessary to ensure future stability in the financial markets."

Another macro-prudential aspect that Basel III incorporates is the issue of liquidity. Just because one bank looks safe because of the highly rated assets on its balance sheet does not mean it is so. Just take a look at the recent crisis when most banks had AAA rated securities that subsequently turned sour when many banks tried selling them at the same time. Basel III includes a 30 day system-wide liquidity shock 'stress test' that banks must be able to pass. It also includes a provision for a stronger liquidity profile made up of assets that can be sold off more easily in case of a crisis.

Basel III also addresses the problem of too high leverage ratios. The BCBS identifies a problem with how the ratios are calculated. During the crisis many banks showed strong capital ratios when only compared with risk-weighted assets, but were still found to be grossly over leveraged. Basel III has a new leverage ratio, common equity to 'total exposure', which includes more than just risk-weighted assets.

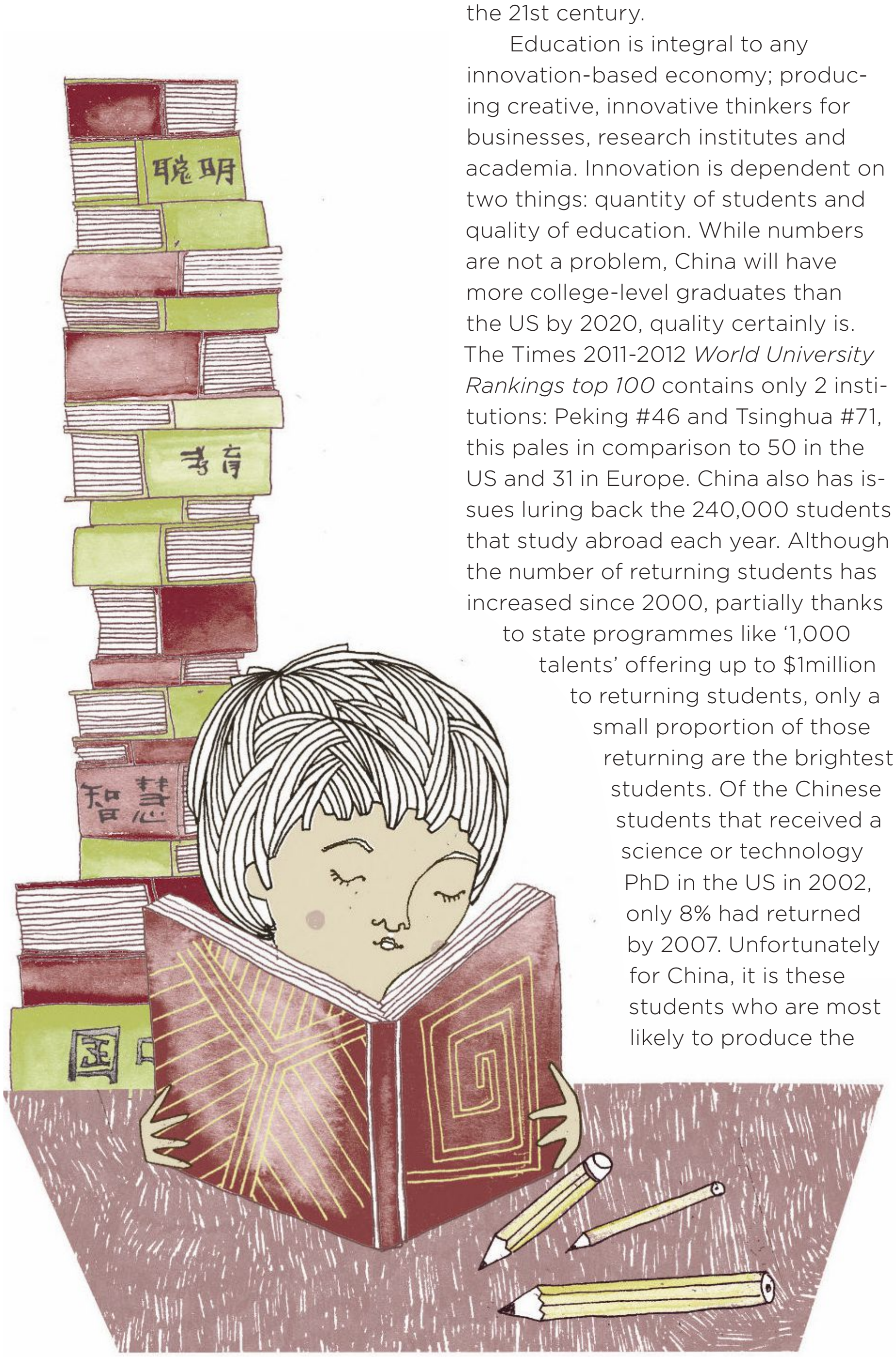
Although many of these reforms seem great as they will reduce the riskiness of banks and hopefully prevent the next financial crisis, or at least mitigate its effects, there are critics who are dismayed by the economic toll more stringent regulation will have on the global economy. Indeed, even the BCBS estimate a loss of 0.2% in GDP for every percentage point increase in a bank's actual common equity capital ratio. The BCBS also report, however, that an increase from 7% to 8% of the banking sector's common equity ratio reduces the probability of a crisis by 1% per annum which implies an expected increase in annual output of 0.2% to 0.6%. In any case, reduced risk of economic crisis is appealing in itself since it implies an avoidance of increases in the number of unemployed and hurt to the future prospects of a nation's youth that cause emotional disturbances that cannot be monetised. The slow phase-in of these reforms, furthermore, also helps to dampen the negative effects the new regulations will have on the overall economy.

The shift towards tighter financial regulation will hopefully mitigate the financial crisis. Just as the financial sector has changed over the past few decades with new financial instruments like credit default swaps and collateralised debt obligations, regulation will also have to morph and change over time to keep in line with the businesses they are overseeing. As time passes and regulators become better at their job the hope is that we will see fewer and smaller crises in our lifetime.

The Chinese Innovation Puzzle

Ian Billett examines China's pursuit of economic modernisation

China is reaching a pivotal moment in its transition to a modern economy, as it can no longer depend on low skilled manufacturing to sustain GDP growth. The government's recent 12th five-year plan acknowledges this, with a focus on rebalancing China's economy through increased domestic consumption in order to reduce its reliance on exports. The important question is: how quickly can China do this? Labour costs have been rising between 15-20% each year since 2008 and China's dominance in the low wage sector is slipping away. In order to ensure continued prosperity China needs to improve education and intellectual property rights, which will create an environment in which innovation can flourish. This will move China up the supply chain, creating greater value for the economy. Whether China is able to achieve this goal depends on the ability of the government to create optimal innovation conditions and it will dictate how China develops into the 21st century.



Eilidh Muldoon

Education is integral to any innovation-based economy; producing creative, innovative thinkers for businesses, research institutes and academia. Innovation is dependent on two things: quantity of students and quality of education. While numbers are not a problem, China will have more college-level graduates than the US by 2020, quality certainly is. The Times 2011-2012 *World University Rankings top 100* contains only 2 institutions: Peking #46 and Tsinghua #71, this pales in comparison to 50 in the US and 31 in Europe. China also has issues luring back the 240,000 students that study abroad each year. Although the number of returning students has increased since 2000, partially thanks to state programmes like '1,000 talents' offering up to $1million to returning students, only a small proportion of those returning are the brightest students. Of the Chinese students that received a science or technology PhD in the US in 2002, only 8% had returned by 2007. Unfortunately for China, it is these students who are most likely to produce the innovative ideas that will drive future growth.

Wen Jiabao, Premier of the State Council (China's highest administrative authority from 2002-2012) said that the ability of the Chinese education system to enhance economic competitiveness will depend on fostering creative, independent thinking. Such attributes are suppressed in a one-party dictatorship and are not encouraged in the state education system. The prime example of this is the old imperial exam previously used for entry to the Communist party. Candidates were required to memorise Confucian texts of up to 400,000 characters then recite multiple pages at a time. Although this was phased out in the early 20th century, the modern equivalent of A-levels/Scottish Highers, Gaokao, bears resemblance to the imperial exam and is indicative of an education system that fails to foster creative, individual thought. Furthermore, universities and higher education institutions are subject to intense scrutiny by state censors for any material detrimental to the party. Angering the omnipresent state censors has serious implications for the perpetrator; discouraging students from joining academia, the sector in which there is most potential to add value to the Chinese economy. This begs the question: can a nation vehemently oppress free speech and still foster creative, individual thought essential to innovation? The answer is uncertain, but judging by western standards, no. Therefore, until the government changes its policy on free speech, creative and independent thought – an integral part of the innovation puzzle – will be discouraged and innovation may be stifled.

The protection of intellectual property rights is another integral aspect of the innovation puzzle. Traditionally, intellectual property (IP) infringements have been endemic – even encouraged – as foreign firms flocked to China. Volkswagen is the prime example of this. They are currently embroiled in legal battles with former Chinese partner MAW over transmission technology theft. IP litigation has been characterized by; meagre finan-

Eilidh Muldoon

cial penalties, estimated at an average of $30,000; and a judicial system with questionable integrity, Huang Songyou, the former Supreme Court Vice President, was jailed for corruption. However, signs indicate that China is moving in the right direction on this issue. Commerce minister Chen Deming has pledged to "do more" to protect intellectual property and the Ministry of Industry and Information Technology has plans to establish a digital dispute resolution centre.

Whether through legal means or not China has greatly benefited from access to advanced foreign technologies, allowing it to skip many stages of development in a phenomenon known as 'the leap frog effect'. However, as this benefit dwindles, China has to start innovating to add more value to the economy and ensure further growth. Recent statistics from the World Intellectual Property Rights Organisation suggest that this is beginning to happen. The number of patent applications rose from 93,000 in 2005 to 415,000 in 2012, overtaking the US in 2010 to become the world's largest filer of patents. More interestingly, intellectual property infringements filed by Chinese plaintiffs at Zhejiang court increased from 20 in 2004 to 200 in 2009. This suggests the Chinese are taking IP laws more seriously while creating ideas worth fighting to protect. The need for a reliable, dependable system is greater than ever to create the right environment for innovation to flourish and lure back the most talented students from abroad. The question still remains whether this can happen before the negative effects of a more expensive labour supply and a rapidly ageing population slow GDP growth, only time will tell, but attitudes are certainly moving in the right direction.

As the old model of growth becomes obsolete, the leaders must implement new policies to solve the Chinese innovation puzzle and allow China to prosper into the 21st century. Education and intellectual property rights are integral to fostering indigenous innovation and encouragingly this is recognised in the 12th five-year plan. Although the protection and enforcement of IP rights in China has previously been an issue of concern, attitudes are changing and the importance of these rights in creating a prosperous innovative environment is proliferating through the middle kingdom. Education proves a much more difficult obstacle. Censorship and the inadequacy of higher education institutions suppresses intake into the fields that are most likely to create innovative, growth enhancing ideas. Reform and change is sorely needed to combat the intrinsic clash between the oppression of free speech and the need for creative, independent thinking. The solutions are clear, but it remains to be seen whether the Chinese government can solve the innovation puzzle in time to ensure prosperity for the next generation.

Overdrawn: The Plan to Fix Banking in Europe

Andrea Schmidtová discusses the future of bank regulation in the euro zone

The European Central Bank (ECB) was created in an attempt to ensure price stability across the euro zone. A target was set at 2% inflation, to be achieved through manipulating the ECB's base interest rate, and for a long time this target was met successfully, helping to reinforce a cycle of low inflation. Controlled and predictable inflation is crucial in an economy because it reduces uncertainty, and through this it boosts investment and confidence; two key drivers of growth.

In the pre-crisis period credit in the markets was rapidly expanding, and leverage of both private and public sector debts increased as credit quality standards were loosened and asset price bubbles inflated. When the US subprime mortgage bubble burst in 2007 panic quickly spread across the Atlantic and, as a result of the interconnectedness of modern financial markets, credit in the euro zone became scarce. Much of this crisis has been blamed on the increased deregulation of financial markets and the leniency in supervision from central banks. Initially the ECB supplied liquidity to the financial markets by decreasing the base lending rate, launching long-term refinancing operations and widening the range of eligible collateral.

In the short term, this action tamed the markets, but it became increasingly obvious that structural changes needed to be implemented in order to restore the confidence in the system. Consequently, the European Union leaders created a framework that would gradually give the ECB responsibility not just over price stability, but also over the banking sector and the financial markets. This model of pan-European banking supervision consists of three main components: a single supervisory mechanism, a common resolution structure, and shared deposit insurance.

The rationale for a supranational bank supervisor that sits outside of national bias is the aim of cutting the link between banks and governments. As identified by Vítor Constâncio, the vice-president of the ECB, bond yields of banks are closely related to the sovereign debt yields of the country in which the bank is based. Thus, if a government runs unsustainable deficits and public finances are quite shaky, its yield/bond spread increases and consequently makes the cost of capital to particular banks much higher than their fundamentals would suggest. In addition, national supervisors tend to be more lenient towards their 'own' banks, especially if those have high stakes in the national debt.

The concept of the financial 'Trilemma', furthermore, implies that only two out of three of the following objectives may be achieved: financial stability through fixed exchange rates, financial integration represented by capital mobility, and monetary autonomy reflected by national financial policies. When a country joins the European Monetary Union, the first two points are satisfied and so the third one is sacrificed in order to ensure stability of the financial system. Thus, a common regulatory approach is needed to speed up the convergence of national financial markets into a homogeneous block, in which the yield spread and access to market funding is equal for banks on the centre and periphery of the monetary union.

Mario Draghi, the president of ECB, has also argued that there are significant benefits from integrating functions into one body. The ECB is already a firmly established international body with a track record of credibility, something crucial for a supranational supervisor. In addition, 15 years of functioning has allowed the Bank to build up significant expertise on European financial markets and to demonstrate its efficiency as an organisation. Most importantly, economies of scale come into play and information acquired about financial institutions may be pooled between the micro-prudential control of individual banks and macro-prudential assessment of overall systemic risk. The common resolution and homogeneous supervision would create a level playing field and also reduce the compliance costs for international banks which operate in more than one country in the euro zone.

However it must be remembered that implementing such a framework will be a complex and nuanced affair. First of all, conflicts of interest may arise if the ECB is forced by circumstance to prioritise one of its functions at the expense of the other. Of course, it could be argued that these measures are too restrained as they do little to tackle the problem of banks being 'too big to fail'. This is, however, a somewhat weak criticism; reality has shown that smaller banks can be just as dangerous, as many engage systematically in the same type of behaviour. Spanish local savings banks – so-called 'cajas' – have been the major driving force behind the real estate bubble in the country, whereas large banks such as Santander were not excessively involved. A more valid criticism is that day-to-day supervision of the majority of the 6,000 euro zone banks will be conducted at a national level; this begs the question of how significant the proposed change really is. In addition, a question of actual enforcement powers of ECB as a bank regulator arises; the only known sanction for disobedience is being cut off from euro liquidity and this seems both extreme and unlikely to be enforced. Finally there is the logistical problem enacting the changes: they require agreement across all the euro zone governments, and possibly also other member countries of the EU.

The future of bank regulation in the euro zone is not a question of *if* but *how*. A framework is scheduled to come into force in 2014, but this timetable may underestimate the difficulty of securing unanimous member agreement on a treaty which centralises significant powers, all at a time when European politics is highly charged. International banking sectors desperately need reform, but it's a long road ahead for the European reformers.

Transition to a New Energy Future

Briana Pegado looks at the feasibility of Obama's green economy agenda

After President Obama's Second Inaugural Address, headlines were splashed with claims that his second term would prove to be what "the President liberals have been waiting for." Sound-bites from the address insinuated economic recovery and job creation would be the product of increased support for the environment exemplified by a commitment to a new green economy. First, the rules of the game would be addressed; "together, we discovered that a free market only thrives when there are rules to ensure competition and fair play." Second, sustainable energy sources would be harvested; "we cannot cede to other nations the technology that will power new jobs and new industries, we must claim its promise." Third, Obama stressed the country would experience a difficult but necessary transition; "the path towards sustainable energy sources will be long and sometimes difficult. But America cannot resist this transition, we must lead it."

Obama made it clear that the United States could sustain economic growth whilst preserving its "national treasure." A tactful way to frame the environmental debate, the President highlighted the importance of economic development in environmental preservation. "That's how we will maintain our economic vitality and our national treasure – our forests and waterways, our crop lands and snow-capped peaks." Economic development and sustainable development are woven into the fabric of national identity and consciousness in these statements. The question is whether or not these statements continue to be empty promises or feasible alternatives to an economy in crisis. By critiquing whether the statements in Obama's second inaugural address hold to current policy initiatives and by examining the facts surrounding the US economy and energy sector, this article will explore whether Obama's new green economy agenda is feasible.

The fact remains that oil and natural gas production have increased in the past two years in the United States. The practice of fracking, or the method of applying pressurised fluid to rock layers to extract gas and petroleum from rocks, is also a focus of the Obama Administration. Depictions of the contentious issue are perfectly presented in January's cinema release The Promised Land starring Matt Damon. Indeed, the White House verifies this; over 2 billion barrels of American crude oil were produced in 2011, which was the highest level of crude oil production since 2003. Crude oil rigs in operation are increasing. It seems the Obama Administration has gone to lengths to acknowledge the increase in the production of oil and to explain that increased production does not lower gas prices, allowing companies to profit. This rhetoric sets up the discussion and lobby for a renewable energy agenda. At least, we can argue the Obama Administration has created the language, evidence, and backing for the renewable energy transition.

On 13 February 2013, President Obama gave his State of the Union address; one of the most crucial speeches for an American President since it lays out the agenda for the administration and the President's vision for the country. It is subject to overwhelming criticism by any entity that has any relationship with the government. In the event, Obama's speech could have been more accurately renamed to the State of the Economy Address. He addressed the rising production of oil and natural gas, increasing efficiency standards for cars, wind and solar energy increasing American job production, lower energy bills due to renewable energy sources, and falling carbon dioxide emissions in the past four years. Ultimately, Obama proposed a "market-based solution" to climate change to "speed the transition to more sustainable sources of energy." These statements can be sourced back to the 'US Energy 2030 Plan', a vision that was created with input from the Scottish Government and our very own Edinburgh Centre for Carbon Innovation (ECCI). Funded in part by the University of Edinburgh, Herriot Watt, and Napier Universities, ECCI is an initiative dedicated to creating a low-carbon economy. The plan calls for the United States to double energy productivity by 2030 and create an energy efficiency "Race to the Top"; a competition for states to increase their energy efficiency articulated by the Alliance to Save Energy Commission and Board.

Recent statistics on US economic growth suggest unemployment is at a 4 year low and the economy has added nearly 6.4 million private sector jobs over 36 straight months; 236,000 jobs were added in February alone and unemployment fell to 7.7%. Against this backdrop, the 'US Energy 2030 Plan' aims to ensure that the transition to a sustainable energy economy will create jobs. However, environmentalists are concerned about the proposed "market-based solution" to climate change, since consumerism and consumer behaviour drive climate change and threats to the environment. Lack of public understanding of how our consumption practices deplete resources encourages unsustainable behaviour. Market-based factors are only part of the solution. As Obama states, we cannot resist the transition. The Scottish Government has set the most ambitious carbon emissions reduction targets and has some of the most progressive environmental policy in the world. Hopefully, the United States and other countries alike will learn from Scotland's example. The 'US Energy 2030 Plan' is only a small step towards that process.

Josie Vallely

In Wildness is the preservation of the World

Katie Roberts links our fate to the preservation of the natural world

The majority of us are increasingly aware of the vast and drastic impacts human societies are having on the natural world on which we live and rely upon. To name but a fraction of the destruction we leave in our wake, our mania for growth is causing climate change, ocean acidification, deforestation, habitat loss, polluted aquifers and ground water systems. Without change, we will cross a threshold by the end of 2016: an invisible line of probability where we will have less than a 50% chance of staying below a "safe" and relatively stable global temperature rise of 2 degrees (according to the new economics foundation). Business as usual is not an option.

Our "cultural dice is loaded in favour of consumption for its own sake", as Andrew Simms argues. We are ignoring the cost of the means, and have lost sight of the ends. We must challenge the mantra of free markets and endless economic growth, as they will only result in our destruction. We need to choose new measures of progress that lead us in search of prosperity rather than blind accumulation. Our generation must step up to the great calling for creative and innovative thinking to collectively navigate the seemingly divergent problems we face. We'd do well to learn lessons from our past: we need to abandon our compartmentalised understanding of the world and learn to think holistically; we must learn to attribute value beyond the limited and short-sighted arena of the market place; we must understand ourselves as part of nature – and respect that our future and fate are intimately bound up with the more-than-human (i.e. natural) world.

> "Our 'cultural dice is loaded in favour of consumption for its own sake', as Andrew Simms argues. We are ignoring the cost of the means, and have lost sight of the ends. We must challenge the mantra of free markets and endless economic growth, as they will only result in our destruction."

Currently societies insist that we 'scientifically' separate the world into its parts, both in terms of our thinking and understanding, but also the way in which we have approached conservation. But these parts interact and affect each other. Neither the natural world nor the pollution we expel will respond to the arbitrary boundaries of 'protection' we draw – the Great Barrier Reef, a marine park and world heritage site, is besieged by mining pollutants and agricultural run-off, whilst rising water temperatures are being to lead to coral bleaching. Likewise, existing covenants to stop the hunting of whales were futile when a sperm whale washed up on the Spanish coast last month. It had swallowed 17kg of plastic, discarded into the ocean by farmers growing tomatoes and other vegetables for British supermarkets, which clogged its stomach and killed it. These are only two of endless examples of the ways in which the effluent of our lifestyles are fouling all corners of the world. In order to protect the magnificent coral, the awe-summoning rainforest or the magical ecosystems of the deep oceans, or even the subtler webs of British wildlife, we need to go beyond protected areas and fundamentally change our relationship to the earth.

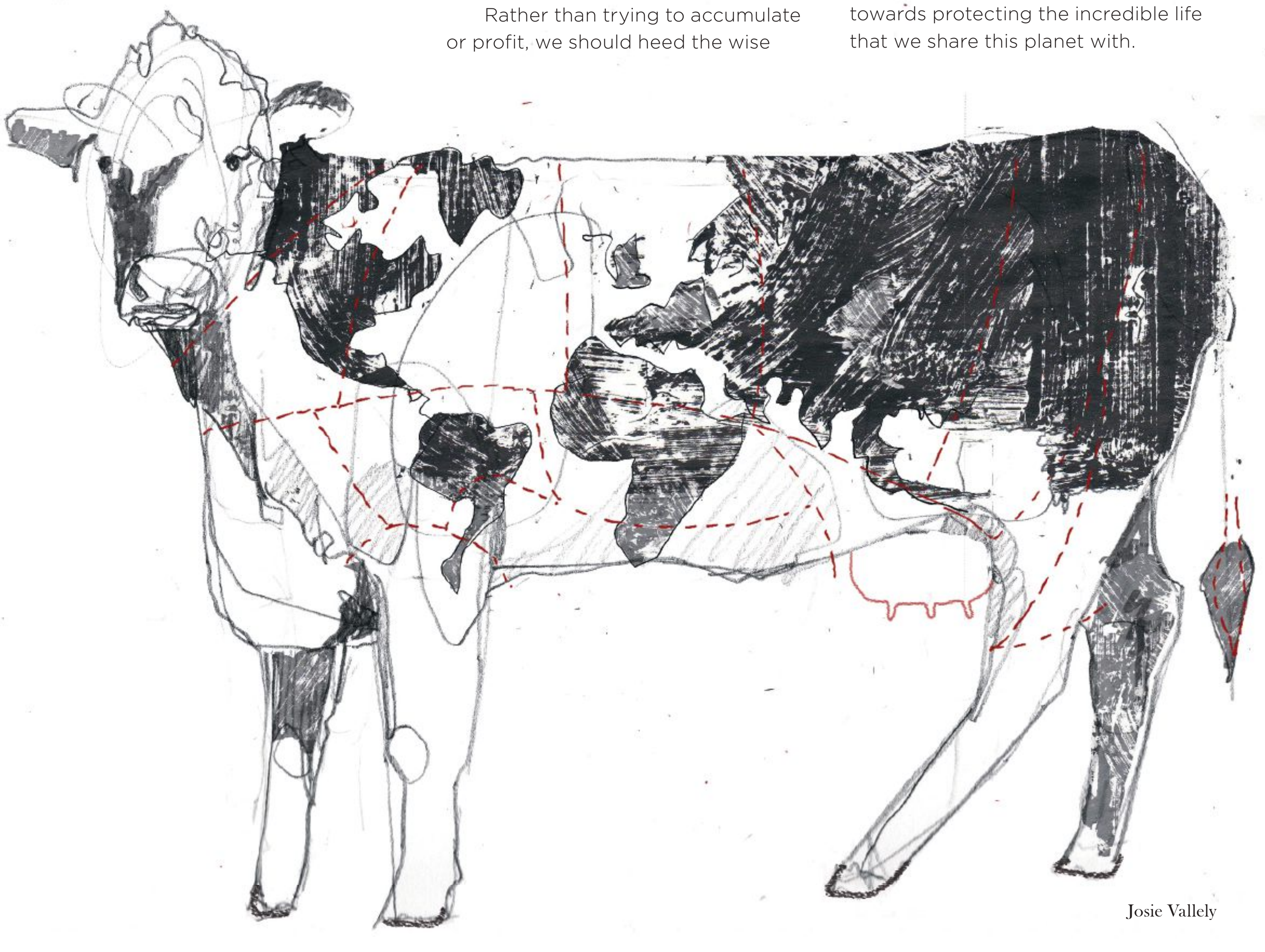
We must learn to attribute value beyond that which is monetary. Focusing on the profitability of natural resources is part of the same mentality that says that only when something can be proven to be economically viable is it worth saving – even in the emergent carbon markets, ecosystems worth are measured by the amount of carbon they will absorb. It is a dangerous game, based on impossible assumptions, played with flexible rules and underhand players. The ecological and social costs are perceived to be irrelevant as long as the carbon spreadsheets are balanced. This offsetting mentality has meant that the destruction of habitats have been justified by the protection of others. For instance, the World Wildlife Fund gave its support for the construction of a series of World Bank funded dams along the Thai Mekong River, leading to the submersion of vast tracks of low-lying tropical rainforest. These were "exchanged" for new protected areas in the highlands that will safeguard both the watersheds and the valuable biodiversity therein. Equally, two recently established national parks in Cameroon are considered as compensation for damage caused by the Chad-Cameroon oil pipeline. Those with 'pragmatic' mindsets might argue that at least some good could come of the damage – but then they assume that the destruction was necessary and have forgotten that this planet is finite. Slaves to the market mantra, we are prioritising the wrong type of wealth.

This same compartmentalised

thinking that seeks solutions in market incentives is reinforced by mainstream conservation strategies such as WWF – go to "how can you help" and you are asked to donate, adopt, fundraise, leave a gift in your will, or sign a petition – this is part of a mentality that primarily sees consumers in the concerned public – it does not help draw the links of the ways in which we are implicated in the wider destruction of the planet and facilitate a transition to a more sustainable future. It asks principally for our money, and only if we have it can we care about the planet. This ecological consumption conceals the ecological connections of people's daily consumptive practises, absolves people of their responsibility for them – and provides individual solutions that don't seem to quite measure up to the scale of the problem.

Equally, mainstream conservation's focus on charismatic mammals such as the elephant, tiger and rhino – and using tourism to generate revenues to manage their parks – can be hugely problematic. In some places it paradoxically facilitates the destruction of the roots of the ecosystem, from which the marvelled canopy of animals draw nutrients. Through interviews I conducted in the grasslands of Assam in north-eastern India, it became clear that the lucrative tourist industry's intent on providing exciting safari trips was corroding the foundations of the fragile grassland ecosystem. The grasses grow so high, at points up to 11m, that tourists in their 4X4s are unable to see the elephants, rhinos or tigers rustling deep within. Uncontrolled fires are often lit, engulfing swaths of the national park, devouring reptiles, small mammals and devastating the diverse underlayers of plantlife, in order to restore human sight, as Goutam Narayan from Ecosystems-India explained. Narayan argues that if any animals are to be the focus of conservations attention then sensitive animals, such as the pygmy hog, would be more effective in protecting biodiversity as their well-being are indicators of the wider health of their ecosystems.

Rather than trying to accumulate or profit, we should heed the wise words of Henry David Thoreau, that "in wildness is the preservation of the world"– our fates are after all intimately bound up with that of the natural world. "In this light, the great discovery of the modern era is not how to make nuclear fire, or alter our genes, or communicate 24/7 at the speed of light but, rather, the discovery of our interconnectedness and implicatedness in the web of life", as David Orr argues. At the moment we are steering wildly through stormy seas, without direction or clear intent, swinging the helm in desperate hope that our vessel stays seaworthy. We, the rising generation, must take hold of the helm and restore the natural capital of soils, forests, watersheds, and wild areas; purge sites of pollution; and learn to power our societies on current sunlight. We can move beyond the drudgery of the past and the energy-intensive, destructive industrial and agricultural systems of our present, by developing creative systems of 'permaculture' that mimic evolved intelligent natural systems that have no concept of waste or 'away'. Only then will we make real progress towards protecting the incredible life that we share this planet with.



Josie Vallely

Comment

The Triangular Course of History

Alina Mika examines the 'Trilemma of International Finance'

At times economic theory can seem detached from real life. In their captivating paper, Maurice Obstfeld and Alan M. Taylor challenge this stereotype by applying the theory of the 'Trilemma of International Finance' to the economic history of the past fourteen decades. "Globalization and Capital Markets," a chapter in Bordo, Taylor, and Williamson's book Globalization in Historical Perspective demonstrates that patterns of globalisation in the modern world can be explained by the choice of international policies pursued at the time.

The 'Trilemma of International Finance' model dictates that countries face a choice between perfect capital mobility, control over monetary policy, and a fixed exchange rate regime. Each of these policies is desirable; perfect capital mobility allows the free movement of capital, control over monetary policy allows the government to adjust the interest rates in response to economic conditions, and a fixed exchange rate brings stability and certainty. However, empirical data confirmed that policy makers are constrained to only two out of the three policies

According to Obstfeld and Taylor, history since the 1860s can roughly be divided into four periods characterised by the choice of these policies. Most attention was given to the extent of capital mobility, which on a larger scale implies globalisation. When capital is free to flow between borders, countries become more integrated with each other. This is reflected through price convergence, which is believed to be one of the measures of globalisation.

The first period runs from the 1860s until 1914. At the time, international commodity trade was booming and globalisation was progressing at a vigorous rate. This was facilitated by the gold standard, an exchange rate system based on the convertibility of currencies to gold. However, the gold standard encouraged the convergence of interest rates across countries as way of maintaining a fixed peg to gold. The analysis of the interwar period, as often in economic history, is rather problematic. Overall, the biggest priority for all countries was regaining control over their monetary policies to control their wartime debt and to pursue country-specific macroeconomic objectives. The choice of which of the two remaining objectives to pursue fluctuated and varied across the world. Some countries, like Britain, temporarily suspended the gold standard between the wars, but then returned to the peg. Overseas investment and capital flows were also suspended or limited for some countries, but they appear to have increased for others.

The situation transformed once again after 1945. In this third period, the Bretton Wood years, most countries introduced floating exchange rates pegged to the US dollar while the United States maintained their peg to gold. This was done because of the fear of a damaging effect of letting the exchange rates adjust freely, such as drastic depreciations that would challenge the countries' position in international markets. At the same

Helga Pavelkova

time, countries pursued independent monetary policies to pave a way of recovery after the war. The International Monetary Fund thus saw it necessary to control capital flows in order to allow a degree of flexibility of interest rates without introducing the risk of serious currency crisis. After 1971, with the introduction of a floating exchange rate system, capital controls were loosened. So began the fourth and latest period of another globalisation which continues today.

Clearly, there are important limitations to the theory, mainly associated with aggregating the experiences of various countries. In addition, there are significant obstacles encountered in proving the theory empirically, because of the difficulties of measuring the extent of capital mobility and interest rate convergence. Nevertheless, Obstfeld and Taylor have successfully managed to generalise across the recent economic history of industrialised nations and demonstrate the importance of applying economic theory in policy-making.

Understanding the implications of financial policies is crucial in analysing governments' policies. During the recent elections in the United States, the Republican Party suggested the creation of a commission to evaluate the idea of reintroducing the gold standard. Among others, this policy was advocated by Newt Gingrich, one of the candidates for Republican Party presidential elections, and contemplated by vice-presidential candidate, Paul Ryan. The gold standard was explained as a way to stabilise the economy and protect it from damaging effects of inflation. It has been feared that the Federal Reserve's policies of quantitative easing, pumping more money into the economy, would eventually lead to significant increases in the price level.

The gold standard is a good way of containing inflation, however in light of the trilemma it would mean losing a degree of control over monetary policy. If the model is correct and if history really does repeat itself, the reintroduction of a fixed exchange rate system would restrict the Federal Reserve's ability to manage the money supply, creating a different problem. Thus, in the absence of damagingly high inflation maintaining status quo seems as the best way to avoid problems of the past. So far the model has stood the test of time. Nonetheless, it will be exciting to observe whether history have truly led us to the optimal point within the trilemma, and whether we will ever break away from its constraints.

Maid in India

Akanksha Middya examines the economic impact of gender inequality in India

In the case of the Delhi gang rape of 16th December 2012, it took the death of a victim to attract worldwide media attention. Sadly, this particular attack is just one of thousands of cases of 'violence against women' in India, the vast majority of which go unnoticed and unreported. Official crime statistics estimate that a woman is raped every 28 minutes in India, with 'cruelty by husbands and relatives' as the second greatest source of gender-based violence. Furthermore, these figures are under-reported due to the social stigma associated with such violence in Indian culture. Following this recent incident, one in three women in the Delhi-NCR region have either quit work or reduced their working hours, drastically impacting labour productivity in the area. India has had an impressive growth rate, but the mentality of the general public appears not to have caught up with its economic transition. Apart from having obvious social implications for women, could gender-bias be one of the reasons for India not reaching its true economic potential?

One of the key channels through which gender inequality can impact economic growth is in education. According to the latest *Gender Gap Report* by the World Economic Forum, India ranks a poor 121 out of the 135 sampled countries for gender-bias in educational attainment. Gender-bias in education has several direct and indirect economic implications. Firstly, theoretically speaking, if women and their male counterparts are assumed to have identical innate abilities (a reasonable assumption to make), underinvestment in women implies that resources are being misallocated, as men who might have a lower ability than some women are being given disproportionately high opportunities. This directly impacts the efficiency of human capital which, in turn, affects economic growth.

Secondly, there are said to be higher external effects from investing in women in terms of child education and health. For example, a 1999 study by Berhman showed that children of literate mothers in India study almost 2 hours more per night than those of illiterate mothers. Such positive externalities aren't merely felt by children of educated women but also brothers of educated sisters and husbands of educated wives, contributing to an improved household environment and a higher standard of living.

Thirdly, an increase in female education also has the effect of decreasing fertility rates, as educated women tend to get married later and have longer gaps between pregnancies. This phenomenon was termed the "transition demographic effect" by Bloom and Williamson. The advantage of a lower fertility-rate is two-fold. Firstly, it lowers the youth's dependency, which leads to increased savings and secondly, a higher working-age population leads to higher economic growth and investment demand. In the case of India, lower fertility itself would be directly beneficial to the economy because, unlike ageing population issues in Europe and Japan, uncontrollable population growth is a key issue.

However, education is just one of several areas where gender-bias is felt. For example, female infanticide is also a big problem for countries like India and the gender-bias in employment earnings distorts the incentives of female employees. There are numerous econometric studies that show a statistically significant correlation between gender-bias and economic growth, though investigations into whether there is a causal link are inconclusive. However, this is no excuse for India not to implement policies that could both reduce gender-bias and in doing so, help sustain economic growth. If India wants to continue being known as one of the fastest growing economies, it has to utilise its human-power to its full advantage.

An End to Broadband Blues

Clem Manger contemplates recession, modern technology and the music industry

"We're happy to talk with you, we're glad you find our technology interesting and we just want to figure out internally who are the right people to sit down with you". This was the affable greeting sent by Shawn Fanning, one of the creators of Napster, in response to an e-mail from the head of the Recording Industry Association of America's antipiracy division. It perfectly communicates the youthful lack of experience or managerial clout that must of gone a long way to convincing the incumbent Music industry of their entitlement; these guys must be pushovers.

Emily Cullen

As it turned out, Napster was just the tip of the iceberg. The ensuing litigation coincided with the beginning of a fourteen-year recession from which the music industry is only set to emerge this year. With retrospect, this was inevitable after decades of growing fat on bottleneck technologies and £16 LPs. 'Everything is worth what it's purchaser will pay for it'- a 1st century BC maxim which seems to have inspired a lot of the price driving that took place in the 80s and 90s. But what the record industry (and the Assyrians who originally coined the phrase) failed to predict was the impact of the internet.

The internet was a focal point in the proverbial 'perfect storm' of technologies that would shake the accepted practicalities on which the music industry was founded. Physical copies of music were rendered obsolete by the fact that music could be coded down and exist purely as pulses of light in fibre optic cables. Whilst the internet was engulfing the world in information, the means to store this information was being miniaturised. Hard drives have doubled in potential storage density every 2-4 years since their invention, a relationship known as Kryder's Law. Distribution was not the only arm of the music industry to be radically changed by technology; the advent of multi-track editing software such as ProTools meant that anyone armed with a laptop could perform tasks that previously required large and expensive equipment.

It has taken years for the full implications of these new technologies to be realised, but there has been a slow but steady sea-change in the mentality of music and media industries. Consumers began to realize the insubstantial nature of current music storage hardware; those who had dedicated time and money building an impressive music collection found themselves unstuck. The true nature of their collection as only so much plastic became apparent when anyone with an internet connection could conjure up the same music at lower cost and with greater ease: no need to dig around amongst cases or worry about scratches. Alongside disillusionment came apathy: in the past a consumer's attention could be directed easily by media outlets such as television and radio – short of changing the channel, the target audience would play a relatively passive role in what they were enjoying. The internet changed this entirely with search engines such as YouTube and Google knocking down the walls between markets and allowing consumers greater choice in an ever more competitive market. Within marketing circles the field of 'Attention Scarcity' has emerged to examine this phenomena, and to consider how best to attract and hold the attention of consumers. Returning to our example of the music industry, the entertainment market has broadened in diversity, with easier access and lower charges leaving the music industry one of many options vying for a consumer's time. In this atmosphere record labels need to address both long over-hiked prices and out of date delivery mediums.

From a business cycle perspective it seems paradoxical that the rapid introduction of efficiency enhancing technology should induce a recession. A better angle is to look at the idea of long term creative destruction; those who were previously employed in the technically cumbersome task of recording and hammering out record deals are freed to work in other areas. With technical simplicity comes cost-effectiveness, thereby decreasing what the industry can expect to charge for a record. Gone are the days of the £16 LP, and good riddance. We have reached the stage now where the market for an album basically has three price points: paying £12 for a hard copy of an album, paying £7 for a digital copy, or enduring 30 seconds of advertising. It goes without saying that this is an ideal change for those with a factor endowment that is relatively abundant in disposable time.

So what has given the music industry reprieve? The simple answer is that the technology is becoming less volatile; Sony, one of the great record industry titans has just unveiled their online 'Music Unlimited' service. The industry has until recently been uncomfortable shifting their business model to embrace these new bleeding-edge technologies, precisely because (as the name might suggest) they had not been honed to the point where they could be depended upon. The two main business models that have seen rapid expansion recently are on-demand subscription services, such as Pandora and Netflix, and the ad-revenue model found on platforms such as Google and YouTube. These two have now been meshed into one model known as Freemium, which is found on Spotify. Having said this, these services are still in their infancy and have yet to post significant profits of the like Sony would want. The key here is that a long overdue shift in the attitude of suppliers has finally taken place: the emphasis from record labels is on income from individual song downloads and more live events. Suppliers have caught up to what consumers actually want, as opposed to trying pressure consumers into what they 'should' want.

Of course this process is not complete, and there remains a certain closed-mindedness from suppliers who feel trapped by technology and a fickle consumer-base. Thomas Hesse, Sony's head of Digital Corporate Strategy, represents this attitude well when he took aim at the industry's other remaining foot and announced that "Free doesn't make any money". Well actually it does, it just doesn't make as much as £17 for a 9 track CD used to.

Bidding Central Bank Independence Adieu

Amy Read discusses the murky relationship between monetary and fiscal policies

A keystone concept in western economics is that of central bank independence from political pressures. Premised on a basic model of time inconsistency, the logic is to prevent banks from encouraging surprise inflation and prompting economic cycles that would harm an economy's long-term health. A central bank's independence is seen as vital to its credibility in setting targets and undertaking open market operations in the course of carrying out monetary policy measures. This notion has been taken as gospel by western financial markets as the best solution to keeping politicians' hands out of the national treasuries. Indeed, the Bank of England – a blueprint for the central banks of many developed countries – is an ardent adherent. Free market economies the world over have enshrined this belief by codifying the separation of monetary and fiscal policies in law, and by infusing it into the design of their government institutions.

However, over the last two decades we have seen central banks of countries professing this belief act in ways which call into question their independence. Regulators have justified subtle shifts in policy-making as necessary to alleviate periods of economic distress in their respective economies. This is sensible in light of the co-dependency between monetary and fiscal policy but presents a policy trade-off: is it better to risk minimising the potential effectiveness of economic policy or to risk a lack of monetary credibility?

A prominent example of this independence trade-off behaviour is quantitative easing – the practice of purchasing gilts in the open market so as to inject money into an economy. First introduced in 2001 by the central bank of the deflation-afflicted Japan, following the 2007 – 2008 financial crisis the US Federal Reserve, the Bank of England, and the European Central Bank have all employed quantitative easing. Despite years into these schemes, their economies remain riddled with negligible growth and high unemployment. Nominal interest rates have been kept at historical lows – for example, the United Kingdom's repo rate hovers at a mere 0.5% – and thus, the UK, US, Japan, and European Union all find themselves in varying degrees of liquidity trap. With nominal interest rates hitting the zero lower bound and still failing to rouse the much-sought-after growth, it would appear that traditional monetary policy has been exhausted. Has it? If so, where to go from here?

> "Monetary and fiscal policies have always been thinly divided at best, and pressure from the current recession has further blurred this already fine line."

Before attempting an answer to this question, one should note that western regulators have until quite recently steadfastly denied that any activities undertaken under the marker of 'quantitative easing' are even in the ballpark of straight monetary financing. Monetary financing refers to funding – via the printing of money – by a central bank of government (public) debts in order to provide more favourable payback terms and flexibility with fiscal policy whilst underwriting broader economic liquidity (and hence inflation). Accounting-wise, it also means transference of some portion of public liabilities onto the central bank's balance sheet. Why should we be concerned about this? Shouldn't we be encouraged by regulators' proactivity and exhaustive efforts? Perhaps. But western central bankers have due cause to so adamantly deny policies even resembling monetary financing, if for no other cause than observance of historical ideology. Whilst Fed Chairman Bernanke made restrained references to monetary financing in his 2002 speech on deflation, he – as well as the heads of the Bank of Japan and ECB – has not joined the UK Financial Services Authority's Lord Turner in endorsing this option with specific regard to present times. During the past year, the Bank of England was accused of executing monetary financing numerous times, most notably in November 2012. Here the central bank moved £35bn worth of interest payment streams on government debt purchases to the Treasury's balance sheet, rather than its own. Monetary and fiscal policies have always been thinly divided at best, and pressure from the current recession has further blurred this already fine line.

In a highly controversial February 2013 speech, Lord Turner expressed confidence in the ability of monetary financing to accomplish what more conventional monetary policy has not. Still further, his remarks approximate the notion that central bankers are rather obligated to avail themselves of even this most drastic, hotly contested option – compromising independence for coordination in times of trouble – to affect change. Whether financing government debt or giving money outright to citizens, he proposes the deliverance of what Friedman originally called "helicopter money" for those countries around the world still suffering from stagnation.

Assuming government debt financing, Ricardian Equivalence says that when a government runs a policy of budgetary deficit, consumers will react by saving more in anticipation, as said government is likely to finance those borrowings with future tax hikes or drops in public spending. But how would consumers respond to debt financed by the central bank, i.e. newly printed money backed by nothing but the good faith and credit of the government?

Furthermore, what would be the impact on private sector investment? The classical 'crowding out' effect advances the belief that large, sustained fiscal deficits result in the reduction of investment in the private sector. However, as monetary financing results in no new publicly issued, interest-bearing debt, there is no overhanging debt to be paid off in future years. Thus, theoretically no Ricardian Equivalence or 'crowding out' effects should be at play. Nevertheless, surely there must be some downside? Indeed, there is. Of the many costs of inflation for consumers, perhaps the worst is the decrease in real wealth over time. As inflation tends to act as a tax on investment returns, consumers react by reducing their investment levels, which reduces capital stock in an economy. Amongst others, Cooley, Hansen, and Benabou – In a 1991 study – found that over time this reduction of investment and consumption leads to less labour put forth by workers. It follows, then, that a reduction in both labour and capital will, in turn, reduce an economy's overall output.

Large fiscal deficits essentially leverage up the public sector. At some point, however, high levels of leverage become unsustainable, and at such a point, this sort of trend might well undermine government creditworthiness. This would have adverse effects, at the very least, reducing market demand for sovereign debt and hence raising the state's cost of borrowing. Bearing this in mind, a government would do well to promote deleveraging throughout an economy, not merely from the private to the public sector. Of additional concern are the possibilities that monetary financing, and the soft-budget constraints it creates, will encourage a culture of fiscal irresponsibility in the long-term and that, if not properly constrained, it could even lead to hyper-inflation, the hazards of which are well documented in the examples of the former Weimar Republic and

Morag McClenaghan

the Republic of Zimbabwe.

Whilst monetary financing is largely uncharted territory, we do have a few successful examples: for one, a large portion of the US deficit accumulated through the 1940s until 1951 was repaid through such means. In this case, the US Federal Reserve was able to transition back to traditional monetary policy following the aforementioned period. Should central bankers formally enact this policy, will they too find their way back to traditional monetary policy? A number of prominent economists, such as HSBC's Stephen King, respond emphatically in the negative. In fact, King wrote a Financial Times editorial arguing that "the era of independent central banks is over." I tend to agree. Central bankers seem increasingly disposed to taking fundamentally political decisions, effectively using monetary policy as a wealth redistribution mechanism.

Despite the long-standing murky relationship between monetary and fiscal policies, and the sometime ventures of central banks into questionably independent waters, the formality of policy separation upheld has served many functions. If policy separation is officially abandoned, a vast array of implications arises, not least of which will be the potential for a greater level of market volatility faced by investors. At its heart, this is a question of whether independent credibility or policy coordination induces higher potential economic gains, and if the latter, over what horizon. Despite much investigation into the matter, as of yet there is no clear answer.

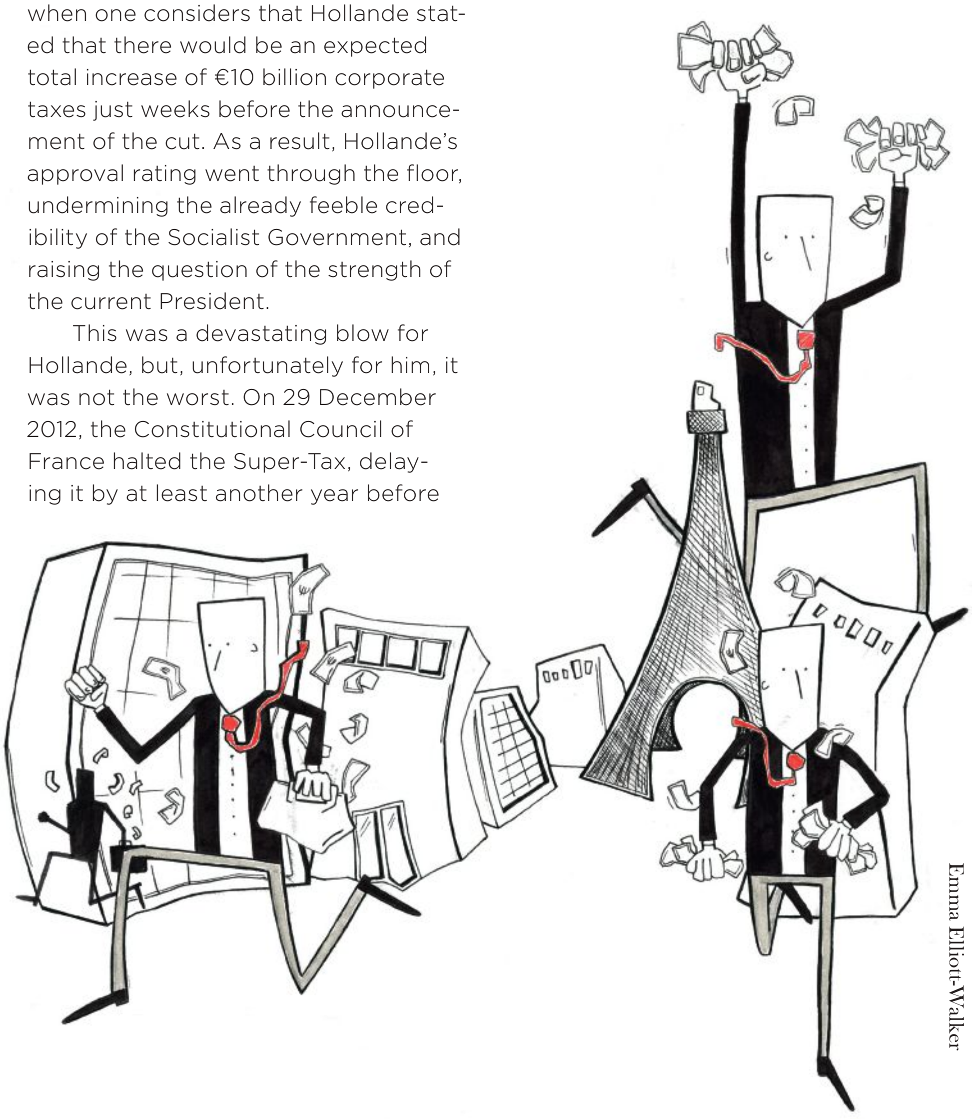
Mort de la Bourgeoisie

Nikita Chuyko assesses Hollande's idealism

Even the most optimistic economists bitterly agree that the world has not completely recovered from the devastating effects of the Financial Crisis of 2007. In this turbulent time, an effective reform aiming to reduce the large budget deficit and to establish the security of home industry seems to be the top priority for many governments. France is no exception to this rule. During his election campaign, Francois Hollande has pioneered significant increases in income and corporate taxes to tackle the issue of the budget deficit. Perhaps the embodiment of the new French economic approach was the idea to introduce a 75% tax for those individuals whose annual income exceeded €1 million (the so-called Super-Tax). It has been advertised as "symbolic" and "patriotic" by Hollande's office, which claimed that this "exceptional effort" is an absolute necessity. Hollande has been in office for 9 months. Where exactly has his idealism taken France?

It appears that Hollande's grand speeches are inconsistent with his achievements. In November, he gave in to pressure from the French business sector, cutting corporate taxes in an attempt to boost the French economy. The official statement said that "company taxes would fall by €20 billion a year by 2015". From an economic perspective, it was a sound, if not the only right, decision: the tax cut promoted stability, and lowered the leverage of French home producers. To put things in perspective: according to corporate lobby organization MEDEF, investment was collapsing from 2010, foreign and domestic capital was fleeing, and industrial jobs were declining at a rate of 60,000 per year. Without this tax loosening measure, the French economy would be facing even greater risk. The political outcome, however, is best summarised as "the most humiliating U-Turn in French Politics since Mitterrand". This does not seem so harsh when one considers that Hollande stated that there would be an expected total increase of €10 billion corporate taxes just weeks before the announcement of the cut. As a result, Hollande's approval rating went through the floor, undermining the already feeble credibility of the Socialist Government, and raising the question of the strength of the current President.

This was a devastating blow for Hollande, but, unfortunately for him, it was not the worst. On 29 December 2012, the Constitutional Council of France halted the Super-Tax, delaying it by at least another year before the second hearing. Their reason? It was aimed at "individuals", not "households". What this means is that if there were two individuals in the household who earn €990,000 each (total income of €1.98 million) they would not be affected by the tax. If, however, one person in the household earned €1.2 million and other one earned noth-



Emma Elliott-Walker

ing, the income of this person would still be taxed. It was decided that the tax "failed to recognize equality between public burdens", and on these legitimate constitutional grounds, tax reform could not be accepted. As a result, Hollande's government has seen one of the most humiliating defeats in the country's recent history.

So what went wrong? Well, a lot of things. First of all, it is the ease with which the tax reform was turned down: there was no heated debate, protests or unrest, just a poorly written proposal. This mistake is akin to a middle-school pupil handing in rushed and poorly written homework: mistakes like this cannot and should not be tolerated at the economic minefield that is the euro zone. Secondly, the economic benefits that could be reaped from this tax are incompatible with the political problems that would follow. If the tax reform were passed, expected tax revenue would be €450-500 million out of the total planned tax increase of €20 billion. What about the cost of this gain? Intuitively, those with the highest income (and usually, the highest amount of wealth) would attempt to leave the country, or transfer their assets elsewhere. Consequently, France would lose a lot more from this flight than it would gain from the taxation of those who decide to stay.

An additional problem is that, by not being able to carry out his most basic election promises, Hollande has created a vortex of uncertainty: it is becoming harder and harder to make accurate predictions about French Fiscal Policy. This is perhaps one of the most worrying signs for foreign investors and big businesses, but instead of mitigating this disaster, Hollande has managed to worsen the situation tenfold. If he is determined to stick with his promises and push the Super-Tax forward, he needs to be wholly aware of its formulation. If the initial threshold of households and not individuals were taxed, then it would have raised the expected number of those taxed from 2,000 to over 10,000. Truly, although very beneficial for the tax revenue, that would be the end of Hollande. The alternative of raising the tax 2 million does not seem adequate either: this raise would reduce the expected tax revenue from approximately €200 million to €500 million. Ultimately, it is difficult decision, but in order to prove that he is not an incapable amateur, Hollande needs to fix this problem; otherwise, he may be forced to step down.

> "Even considering the little support that the Socialist Government has, Francois Hollande is doing a good job in becoming one of the most hated politicians of our time."

Even considering the little support that the Socialist Government has, Francois Hollande is doing a good job in becoming one of the most hated politicians of our time. This, however, is in no way the final sentence for him. From an economic point of view, his top priority has to be the careful construction of the budget, which will deal with the budget deficit and problems with all three economic sectors at home, but will not scare off foreign and domestic investors. From a social and political point of view, he needs to become the strong and patriotic leader he claimed to be in the election campaign, avoid taking poorly planned judgments, but also be able to stand his ground when the decision has been taken. France needs a structured and targeted transition that will allow them to stabilize the economy and reduce unemployment, which has been consistently rising for the past 21 months. So far, Hollande has shown only a chaotic mixture of patriotic naivety and ill preparation. Will he be able to turn things around? Qui vivra, verra.

Pleased to Michu

Ben Cassidy looks to the future of the beautiful game

The culture of money in football isn't a new one. Ever since BSkyB and other television corporations realised the potential in broadcasting live matches to audiences, top flight teams have been earning sizeable revenues. What changed was the advent of Big Money buyouts – Arsenal, Manchester City, Chelsea and even Manchester United have benefited from massive cash stimuli from owners and stakeholders alike. With Big Money came the ability to tempt the better players away from their teams, giving the spenders an obvious advantage over their competition. This led to near-militant escalation, as bigger sums of money were bandied about building ever more intimidating squads. Today, Premier League clubs collectively spend hundreds of millions of pounds annually, most of it made up by the big teams mentioned. By attracting the best players, the Premier League certainly produces 'efficient' football. On the other hand, given that a layman would struggle to name more than a quarter of the teams in the league, it doesn't necessarily produce equitable sport.

Essentially, this set of circumstances arose due to what might be termed a 'relative oligopoly'. Under a regular oligopoly, a small set of firms have distinct market power due to owning a disproportionate share of the market as a whole – consider Samsung, Apple, Nokia and HTC in the market for smartphones. Under a relative oligopoly, a small set of firms differentiate the market by price – by outbidding their competitors they can corner the supply of premium players, in essence creating two distinct markets. In doing so, players up to a price tag of £10 million are open season for all teams, but players attracting £20 million and above for their services are in the domain of only the teams that can afford them. Teams like Chelsea, Manchester City, or Tottenham.

None of these teams are contesting for this season's League Cup. Arguably, with other tournaments like the FA cup, the Europa league and the Champion's league, the major teams simply have bigger fish to fry. Regardless, Bradford, one of the finalists, isn't from the Premier league at all, but hails from league two – the lowest tier of (professional) football in the country. The fact that


Amy Wedge

they defeated Arsenal along the way doesn't do much for the giants' case. The fact that they did it without one of the crucial ingredients of modern football – money – outright buries it.

Though this may be the most striking example, there are other promising trends in the sport away from Big Money primacy. While Swansea may be better off than Bradford, one of their key acquisitions this season, Miguel Pérez Cuesta – known by the moniker 'Michu' – has scored 18 goals to date for the club for the relatively low price of £2 million. No doubt that Laudrup, the club's manager, is more than happy with his prudent purchase that has frustrated big clubs all season and is now rumoured to be worth almost 6 times the price he was bought for. David Moyes of Everton has made a career out of intelligent, under the radar acquisitions – his anticipation of the fall of Glasgow Rangers to acquire Nikita Jelavic and Steven Naismith are testament to this, but he certainly gains a massive surplus from his retention of Leighton Baines – a left back of equal quality and lesser controversy to Ashley Cole. Even Lionel Messi, considered the best player in the world, didn't cost Barcelona a penny to acquire.

So, it is clear that the teams that live within their means seem to get along just fine. But what is the benefit of big spending to the big teams? Take this season's acquisitions, which

> "With Big Money came the ability to tempt the better players away from their teams."

include Robin Van Persie moving from Arsenal to Manchester United for a rumoured £24 million, Eden Hazard's transfer from Lille to Chelsea for £32 million, and Oscar dos Santos' £25 million move to Chelsea from Internacional (Chelsea, by the way, spent an accumulative sum on transfers to the tune of £80 million).

What did these purchases buy them? Hazard has been providing plenty of both goals and assists for his team, with 7 a piece of each – not bad for a playmaker. However, Chelsea still seem to be floundering despite all their quality, having been knocked out of the Champion's League at the group stage and with maximum aims of a top 4 finish in the Premiership their only realistic goal. The reason? Positional saturation. Of the £80 million that Chelsea spent, over £64 million was invested in attacking-midfielders. With Eden Hazard, Juan Mata, Oscar, Marko Marin, Yossi Benayoun and Victor Moses all capable of filling this role, Chelsea has a lot of talent that they will never use all at once. Even Van Persie, who has been scoring goals left right and centre for United this season, has a dubious return. If United win every competition that is available to them this season, the competition prizes won't barely cover the Premium paid for the Dutch Striker in both transfer value and cumulative wage expenditure, and certainly won't cover the rest of their transfers as well. You may wish to add to this debate factors such as ticket sales, sponsorships and merchandising, but all of these are influenced by the success of the club – which boils back down to the money that was spent on the players. If you add in to this debate Premier League flops like Fernando Torres (£50 million) and Andy Carroll (roughly £30 million), the case for Big Money looks ever flimsier.

Association football has become a war of financial attrition, but perhaps it could take some notes from its American counterpart. With the NFL draft system, each team takes turns picking new prospects to sign for their squad (not unlike the system we all know from high school PE classes). The teams pick in reverse order compared to their position at the end of the previous season, so that the worst performers last year get the best pick to improve their team for the next season. In this way, every team in the NFL can remain competitive and theoretically challenge for play-off positions. But given how ingrained are Association football teams not only competitively but culturally, such a revolution would be a pipe dream at best.

With the recently announced financial fair play rules limiting wage expansion to £4 million per season for European clubs, teams will no longer be able to aggressively expand as some of their competitors had. Though this does little to limit the already big clubs, it is certainly a step in the right direction. A taste of financial prudence might be just what is needed for owners to stop throwing about money, and get on with enjoying the beautiful game.

Angela Merkel: The Saviour of Europe?

Mohammed Anas Irfan evaluates the Machtfrau's step-by-step approach

Ambitious, bold, slow, weak, cautious, strong, stubborn, persistent, authoritative, tempered, harsh – self-contradictory as they may seem but these are some of the words ascribed to the German Chancellor, Angela Merkel, who is currently one of the most influential people on earth. In 2012, Forbes ranked her as the most powerful woman in the world for the second consecutive year; her significance is not about to die any time soon.

Merkel's political journey began at the Christian Democratic Union (CDU), which she had joined after gaining a doctorate in physics; her scientific approach is clearly evident in her work with one of her favourite sayings being "step-by-step". Known to be highly cautious, reserved and authoritative in nature, Merkel's rational and considered approach has allowed her to dominate the politics of Germany and the EU as a whole. Considered as the de facto leader and head of the crisis management team of the EU, Merkel assumed the central yet pivotal role of saving Europe from the crisis that has engulfed the region since 2009. For Merkel, this involved making several concessions and sacrifices that might have put Germany's ruling coalition at risk. However, whilst initially criticised from many quarters for bringing Europe towards the brink, she is now lauded for being its saviour.

Merkel's plan for resolving the crisis has been one of implementing measures of austerity and fiscal integration. To achieve this, she has tried to persuade other European countries to give more power to Brussels, but has refused to accept any plans to federalise Europe. This would be like forming a United States of Europe, which would require creating a central Treasury to run Europe's finances and give Brussels much more power. This would involve, furthermore, things such as a banking union, mutualised debt and a permanent EU rescue fund called the European Stability Mechanism (ESM). Under the proposed scheme, countries like Spain would shift the responsibility of recapitalisation of their banks to the ESM, a plan that Merkel opposes as it would make German taxpayers jointly liable for the mistakes of other nations.

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Merkel's approach has brought her sustained criticism from within Germany and across Europe. Ultimately, however, she has had the tough role of balancing the interests of her own country with the interests of Europe and, if truth be told, she has done a remarkably fine job. Merkel has refused to make any half-baked short-term decisions and despite stern criticism from her counterparts such as Sarkozy, she did not agree to a speedy action to bailout Greece. At the same time, while Merkel was clearly trying to protect Germany and its economy, she has also strived hard to keep Greece within Europe and has also steadily increased the package of bailout funds and loan guarantees for the troubled European economies.

While Merkel never conceded to any major changes for Europe, she has been much more amenable to agree on small issues. While very reluctant initially to lower euro zone interest rates and to bailout the affected euro zone banks and nations, she became more lenient with time as the severity of the crisis became known. Eventually, she allowed direct funding from the ESM to the affected European banks on the condition that firm control over these banks would be established through the creation of a central supervision authority under the ECB. Similarly, she also allowed the bailout of individual countries once proper oversight and control over these countries was established. Steps such as the formation of a banking union and schemes such as controlled recapitalisation of affected euro zone banks, debt mutualisation, deposit guarantees, and an "outright monetary transactions" scheme, which implies potentially unlimited bond buying by the ECB, have all been agreed in principle by Merkel – a major transition and shift away from her position in 2010.

Further still, it appears that Merkel's approach towards Europe has finally started to pay dividends. In recent times, there is a renewed feeling of optimism in the financial markets and the same critics who were accusing her leadership abilities are now praising her policies. Despite initial criticism for being slow, Merkel's scientific step-by-step approach is now being widely praised and she secured re-election last year.

Nevertheless, many major challenges remain. Although Germany's budget deficit is reducing, its GDP growth is falling and its government debt is expected to reach 82% of GDP in 2013. Hitherto, Germany has avoided the circumstances that have befallen many of its fellow nations in the euro zone, but analysts expect Germany to officially go into recession in 2013. This potential outcome intensifies the need for things to keep improving on the European frontier; any further claims for debt write-offs and emergency EU bailouts would put intense strain on Brussels. The problem for Merkel is that her plans for greater European fiscal integration require more time and while recent reforms from the ECB and the affected euro countries have bought her this much needed breathing space for now, it remains to be seen whether this is enough.

For many, Merkel's austerity regime is self-defeating since austerity would further depress the euro zone and thus rekindle the crisis and risking the break-up of the euro. Previously, it was thought that Merkel was willing to consider having Greece ousted, but now she has realised that the cost of this would be far too great. For one thing, Merkel wants to avoid the situation of a debt union wherein Greek debts would essentially be assumed by Germany. The possibility of plunging countries like Spain into turmoil, furthermore, would require Germany to issue euro-bonds to protect these euro zone countries.

With all these issues, the euro zone crisis is by no means over and the present optimism may only be the calm before the storm. Whether Merkel's step-by-step approach is really solving the problems for the euro zone or is merely an attempt to kick the can down the road before meeting it again in the future, only time will tell. Whatever comes to pass, Merkel's reputation has been established as one of unrelenting persistence.

Giving Wings to the Careers of CEOs

Alfio Puglisi discusses the impact of the recession on CEO career paths

The current economic situation is still not great. Recent measures adopted by the European Central bank and by national governments are helping to overcome the euro zone crisis and improve labour market conditions. Although the euro zone is concentrating on growth and social cohesion, the light at the end of this recession tunnel remains hidden. In the short term, this reality highly influences your chances of finding a job. This in particular affects recent graduates entering the labour market for the first time and it impacts on the type of employment that you will eventually find. There is, however, another implication of recessions that is less well known: the fast career path of the CEO and its effect on executive labour market conditions.

According to a recent study by Schoar and Zuo for the MIT's Sloan school of management, *Shaped by booms and busts*, in the period between 1992 and 2010 both the labour market and the management style of managing directors changed. The results are surprising. Individuals who entered into the labour market during a recession period became CEO faster than their colleagues, but were more likely to end up in charge of smaller firms, receive a lower income and make fewer career changes in the climb to the top, both in terms of companies and areas worked within firms. One possible explanation is that the fact of entering the world of work in times of crisis reduces the bargaining power of managers in the early stages of their career, an effect that persists over time.

What it is more interesting is that starting work in a recession period shapes the CEOs management style, tending to make them more prudent and less risk loving. Such CEOs generally invest less in capital, research and development, seek to avoid debts, pursue a diversification strategy and are careful at managing costs. This clearly implies that the labour market conditions in which a new graduate is looking for jobs will greatly influence, in the long term, their career-path.

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The following question rises spontaneously: why does the condition of the labour market in an individual's early career have such a persistent effect on their managerial behaviour when CEO?

There is no definitive answer to this question, but one of the possible reasons is that new employees during economic recessions or booms have to develop particular skills and capabilities suitable for that job. In other words, this means that starting work for a company during a recession period will influence you in your management style and help you to deal with limited resources. On the other hand, it is also necessary to recognise that a selection process could be applied inside an organisation, in which young managers with a prudent management style are quickly promoted. The empirical evidence, nevertheless, shows that the first explanation is more likely; many results show that CEOs performing in the current labour market actually reflect the economic trends registered in the past.

Finally, managers when dealing with difficult current economic situation should look at their past experience and benefit from it. This kind of study shows that the disciplinary barrier between the business and the economics sphere needs to be linked again. A profitable exchange of ideas between these two subjects may help the economy to perform smoothly. Moreover, according to Scholar and Zuo, after a long time of economic growth there are managers who have managed growing companies, so there is a shortage of managers who know how to deal with distress economy and vice versa. This trend can lead to a mismatch of the economic conditions. It is really important to understand how executive labour market works and how it interacts with the hard task of selecting the best manager for a given vacancy.

The Spectre of Immigration

Sara Baratto makes the economic case for immigration

Despite the high profile of the debate around immigration, public understanding of the economic fundamentals underlying the issue at hand is limited, a fact which has been exploited by politicians and media sources alike. The tabloid press is rife with hysterical allegations of immigrants being responsible for unemployment amongst British nationals, organised crime and for exploiting the welfare system. Although the UK is bound to an EU agreement where it will have to open its borders to remaining E20 countries on the 1st January 2014, the nation is debating whether it should tighten immigration control on Romanian and Bulgarian skilled workers coming early next year. The Home Office is also exploring ways of discouraging potential immigrants from coming to the UK, such as an ad campaign in Romania seeking to portray life in the UK in a rather Cimmerian light, standing in stark contrast to the vibrant 'Great Britain' marketing of the UK during the Olympics.

Given the UKs experience of immigration following previous EU expansions, the public is perhaps right to be anxious about the numbers of immigrants that might arrive. In advance of the 1st May 2004 EU expansion to include the 'A8' countries (Poland, Czech Republic, Hungary, Slovakia, Lithuania, Latvia, Estonia and Slovenia), the Home Office estimated between 5,000 and 13,000 Poles would come to work in the UK every year. In fact, within two years 264,000 had arrived, and by the end of 2010 the number had almost tripled to 776,000. Although the government has refrained from publishing forecasts for 2014, MigrationWatch has predicted around 50,000 Romanian and Bulgarians will arrive to the UK over the next five years.

What the British public may not be so aware of are the positive economic influences that immigration has on a nation. For example, immigrants from A8 countries are less likely to claim benefits and less likely to be living in social housing than those born in the UK. Out of 776,000 Polish immigrants, for example, only 6,390 claim Job Seeker's Allowance (according to the Centre of Research Analysis of Migration). A comparison was also made regarding net fiscal contributions of EU8 immigrants and individuals born within the UK and found that the EU8 immigrants made a positive contribution per annum to public finances despite their relatively low wage position in the UK labour market. These immigrants paid 37% more in direct or indirect taxes than was spent on public goods and services which they have received.

Regardless of this, David Cameron promised to bring net migration to below the figure of 100,000 a year by 2015. This will have an impact not only on migrant workers but on international students as well; somewhat ironic given the pride the UK takes in being a global leader in the education industry. For example, the number of study visas issued has fallen by 20% over the year ending March 2012 according to the Office of National Statistics. This illustrates a way in which the government limits the free movement of labour to low-wage jobs and discourages potential free-thinking entrepreneurs from bringing their talent to the UK.

It is unfair to view immigrants as though they only impose costs. Clearly, they represent a net economic benefit, meeting the needs of the labour market and adding to demand for goods and services. Moreover, the UK is able to capitalise on the skills and labour of the incomers without paying for their education or training. The Economist has suggested "maybe immigration is more a problem of perception than of reality", a problem of perception that cynical politicians have been keen to perpetuate. Of course, not all immigrants will be ideal citizens and unfortunately at some point or other we will come across one we could do without, but tabloid-driven hysteria distracts from the economic issues and facts by which a prudent and forward-thinking immigration policy should be informed.

Josie Vallely

Academic

An Insight into Obsession

Georgina Allen talks to Dr Martin Chick, a reader in Economic History at the University of Edinburgh, discussing government capital investment, the value of human life and the economists who influenced him.

Hi Martin, could you please tell us a bit about your current research?

I am working on two projects at the moment. The first is writing the final volume of the Oxford Economic History of Britain and that has led me to research Keynes and Hayek, the use of time and the approaches towards capital stock and capital formation from the 1920's up to PFI initiatives. Once I have finished this book I will return to what is essentially a study of harm and damage which looks at some of the main environmental ideas (fishing, whaling), but also looks at increasing concern with smoking over the 20th Century and the rising value of human life.

Sounds great, you mentioned writing about Keynes and Hayek in your book, what exactly are you discussing? Are you mainly looking at the differences in their theories?

Yes I'm looking at their row in the 1930s (in which Piero Sraffa was also involved) concerning Hayek's approach to how capital investment occurs, what the role of the rate of interest is and what the implications are of capital investment in trade cycles in general economic development; ideas which Hayek discusses in both *Prices and Production* and *The Pure Theory of Capital*. This is compared to Keynes who, in the *General Theory*, puts to the fore the marginal efficiency of investment and the likely returns on investment. Keynes was actually very rude about Hayek and his distinction between capital and consumer goods. I argue that whilst they agree on much more than is commonly understood these issues comprise a major difference in their approach, but that neither Keynes nor Hayek anticipated that the state would then nationalise much of the capital stock. What I then look at is the state's withdrawal from public investment steadily from the mid-1970s, such that by 2000 public sector net investment is 0.5% of GDP (IFS). I am interested in why the state comes so heavily into capital investment and why it then wanders away.

What do you see as the key reasons why the state moves away from capital investment, was it all political?

It's political in that there are particular programmes which lead to lower capital investment for example council house sales which is not only a transfer of capital stock from public to private, but there is also restriction on the state's ability to reinvest the proceeds of that sale back into council housing. Another interesting point is that within public expenditure the health and social security budgets rises from 1975 seeming to squeeze out investment. There is definitely a change in view of the willingness to put up-front financing of investment onto the public books, PFI is a good expression of that. The concern with PFI is the way in which the risk factors on finance, management and provision of services are all bundled up in a single risk figure, which then helps to determine the price you pay for the stream of services. Now that seems to me a strange decision.

What capital investments do you think the governments should make in order to rejuvenate the economy? And what do you think about the current debt over fiscal stimulus vs. austerity?

The problem for the government is that it is now difficult to make incremental additions to the existing capital stock. I think if you still had a council house programme, even nationalised industries (I'm not saying you should!), it would be easier to start making incremental improvements to capital investment. That said, what is striking is in the initial 2008 post-crisis budget cuts so many of them fell on local authorities capital investment programmes. That is consistent with policy from the mid-1970s and I would argue is almost the antithesis of what is required. When you think about the few projects the state does back it seems there is a proclivity to invest in "exhibition investments", such as high speed trains, the benefits of which are I think dubious and in terms of what else you might have done with that money, questionable in terms of rejuvenating the economy. I would be spending lots of money on lots of small projects on local roads, because it seems to me you need dispersed spending which does not have high multiplier leakages. You want to give money to people down on the ground, rather than to large German companies. In terms of rejuvenating the economy I think there needs to be more spending on capital investment, which is not quite the same as fiscal stimulus. Keynes in the General Theory talks about a socialisation of investment. I suspect there is a case for that. I would prefer that route to one of a more vague fiscal stimulus.

You also mentioned work on the rising value of human life. How are you looking at this?

I was looking recently at road accidents archives and the interesting shifts which occur in the 1960s between the ex-post treatment of fatalities in crashes and ex-ante prevention of fatalities. When thinking about people that have died you calculate the value of the output you have lost, you then subtract the consumption which they no longer undertake. If you think about the value of a life you have saved you calculate the output you have not lost, but you then add the consumption, because the person clearly derives utility from consuming. The minute you move to ex-ante valuation of preventing fatality you then come to distinguish between the value of the lives you are saving; so you began to think about people of working and non-working ages. In towns you noticed pedestrians were either very young or old people, whereas people in cars (who might be the safest of all) and certainly motorcyclists might be of working age. So theoretically and in practise you probably did more to look after those on the roads than on the pavements, creating problems because pedestrians then take preventative actions which masks the potential for accidents and gives a strange orientation to traffic policy. This movement in time forward means you start the process of the individualisation (nasty word!) of benefit. You start to apportion benefits forward in time to individuals which leads to quite a discriminatory resource allocative model.

What do you feel is the importance of your work and what do you find most rewarding?

Well selfishly – and it is entirely selfish – I just love what I do. I both love the process of sitting down reading and writing and the freedom you essentially have to decide what you research. So it's a completely selfish occupation, which I am lucky enough to find someone willing to support me in; if it benefits others that's great, but that is not my main motivation. I am of course therefore delighted to talk to people and teach people about the things that interest me and I really enjoy teaching. Is it of any use? Well if History is of any use, people should try and do it as well and as honestly as they can and I do think there is a lot of danger in people writing biased or poor history. I think the past matters and history may be important for exploding a few myths and so it matters that it is researched properly. Economic history is important as the memory, particularly of economists, can be very short. So I think there is some value in having some repository of the past walking around from time to time saying 'ah yes, we've seen these issues before although maybe in a different context'. What I do think about economics is that both the theory and the implementation have to be contextualised and I think they don't make much sense unless you know the problems out of which they have emerged and the likelihood of them being implemented at a particular time. Economics is fundamentally an empirical subject based on observation; it tries to make sense of what people observe and therefore it has to be ultimately a contextual subject.

Who would you say are your main influences?

3 economists! I can't say any historian has ever influenced me, the only exception might be when I was 14 and I read Christopher Hill, a Marxist historian, who wrote a very short book which I bought in a jumble sale called "The English Revolution" .It was about the English civil war 1642-49. I thought it was a gripping read! But historians per se – no! When I was writing the book on the Attlee government I came across James Meade and he has been very influential. He was very interested in national income accounting and welfare economics, but he clearly had the economist's interest in the efficient use of resources, rather than simply making money and he seemed to be relatively free of material interests. I believe he kept his money in a post office savings account! Then when I went to France in 1998 I discovered Allais who was actually very similar to James Meade in that he had a tremendous interest in the efficient allocation of resources based around the notion of the marginal approach. But in contrast to Meade, Allais had a tremendous impact upon the decisions made in the French nationalised industries, particularly energy, and in government. There is a paradox there in that Meade (until recently) was the better-known economist, but arguably in policy matters Allais was much more influential. The third who is of abiding interest to me is John Hicks. I just enjoy reading Hicks, he writes so well. He used to be a colleague of Hayek and although people say he gave us the Keynesian IS-LM curve he didn't really, that was Hanson. Hicks did become more of a Keynesian, but he retained his Austrian interest in time and capital. And in his book, Capital and Time: a Neo-Austrian Theory, written in 1973 he is still talking about Austrian economics and I find that persistence of the issue of time interesting, sitting alongside what were then notions of market efficiency.

You mentioned Allais's influence over French government policy; do you think that economists have a bigger role to play in current policy decisions?

Oh yes of course! And I think it's a shame that whenever they now interview economists on the telly, they are not economists, they are city financiers. The problem with this is there are fundamental differences in that economists are interested with the efficiency with which resources are used and business necessarily is interested in making a profit and they are not always the same thing. They can coincide, but they are different intellectual starting points. Economists should have a larger say in how the world is run.

Finally, do you have any advice for young budding academics?

I think I would give the advice that John Morrill, a historian at Cambridge, gave me when I asked him about academia. He said: "this is not a rational decision, if you have the bug go and do it, because you're going to need to have the bug to get through it." It is an obsession and if you're not obsessed it's probably not the job for you.

Review

Waiting for the Great Leap Forwards

Kati Venho reviews the new economics foundation's *The Great Transition*

Climate crisis, financial crisis and energy crisis are among the most serious economic challenges of the 21st century. Something needs to be done but we seem to be in a gridlock where all actions – taxing carbon, controlling risk-taking or reducing consumption – will inevitably lead to a deep recession and soaring unemployment. Are we trapped on a path to self-destruction or can we still reach a state of human and ecological prosperity?

The new economics foundation (nef), a London-based think-tank, claims we can solve these problems but recognises the need for a complete economic restructuring and change in the way we live our lives. They present us with an idea of how we could reorganise our economy to address the numerous problems that afflict modern societies, in a vision they name *The Great Transition*. The 120-page report suggests a number of changes, for example revaluating and relocalising production, as well as redistributing economic resources.

By 'revaluation' nef refers to internalising externalities in market prices. The need to capture externalities related to production has long been recognised, and promoted by groups such as those advocating a carbon tax. An externality is an outcome of production not captured in the market price, such as carbon dioxide emissions; the most evident externalities indeed are ecological. However, nef argues taking into account a wider scope of externalities, including social impact and human relationships. Taxation is seen as the key solution to revaluing the productive activity in our economy: essentially we should tax what is environmentally or socially 'bad' and subsidize production that has ecologically or socially beneficial consequences.

Taking externalities and other aspects related to production methods into account, nef sets out to challenge the widely held belief that production at the largest possible scale is most efficient. When we take into account environmental and social externalities, economies of scale are often reached at smaller levels of production. Consequently, *The Great Transition* puts forward the idea that production should be relocalised where appropriate. It clearly doesn't make sense for each town to be producing everything themselves, so things such as electronic devices, vehicles and infrastructure would still be produced at a national or continental level. But products such as food and furniture and services such as construction, repair and maintenance would have greater social and ecological value if supplied at local or regional level.

Taxation can also be used to reverse the trend of the past decades towards increasing inequality. nef endorses the findings of Wilkinson and Pickett's comprehensive study on wellbeing and inequality – that more equal societies are happier societies. To address wealth inequality, capital gains tax and inheritance tax could be increased to fund universal benefits such as the 'Citizens' Endowment' – £25,000 upon their 21st birthday for young people to invest in their future. nef, nevertheless, recognises the limits of the conventional 'tax and spend' approach. Ideally, redistribution occurs prior to taxation, so redistribution of work as an indirect method of income redistribution is advocated. People would engage in paid work between 20 and 30 hours a week, which would ease the chronic situation of simultaneous overwork and unemployment. In addition, more time is released for people to spend on relationships, leisure pursuits and on improving their communities.

Essentially, the aim of *The Great Transition* is to empower individuals and communities through political and economic autonomy. It might mean we no longer produce stuff cheaply, but on the other hand we are likely to be more connected to each other and the environment around us. Further still, more localised markets and systems of production would make our economies more resilient and thus reduce the frequency of economic shocks. Most importantly, the problems associated with recessions, such as soaring unemployment and social malaise, could be mediated.

The Great Transition thus portrays a message of hope; that the restrictions that the current economic system places upon us should not be viewed as inevitable. The current economic system can be thought of as operating like a giant machine, in which each individual must, like a cog in the machine, find their place in the mechanism and learn to do their part as efficiently as possible. When the mechanism changes, or the system experiences a shock, some cogs are no longer needed. If the cogs have been forced into a fixed shape by society, it might be difficult to fit them in elsewhere in the machine. Just consider, for example, how people in the UK ended up in long-term unemployment following the offshoring of the manufacturing sector. If people are treated as creative beings with multiple interests and skills, however, they are much better equipped to adapt to changing conditions.

One would like to believe in the ideal system described in *The Great Transition*. But what they do not address is how we get there from our current situation. How can people actually regain power back from whoever at the moment is controlling resources and production? How can governments enforce an inheritance tax of 67% when, according to a recent issue by The Economist, £20 trillion of global wealth is offshored in tax havens? Surely it is unrealistic to hope for change fuelled by people's cooperation and sacrifice.

Despite its great insights and ideas, *The Great Transition* is not really what it claims to be. It does not actually address how we get from here to this state of economic and social harmony, which without doubt is the hardest part. But without a vision one cannot strive for change, so in that regard *The Great Transition* is a good start.

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