FINANCIAL STABILITY

OPINION: A different recession

ENERGY BILLS

INDEPENDENT REGULATORS

PENSIONS

SCOTTISH CURRENCY

SMALL BUSINESSES

ENERGY SUPPLIERS

ROBOTS

FIGURES: Weekly spending habits
RISKY BUSINESS

In the wake of the global financial crisis, the world’s central banks and financial regulators are focused on ‘systemic risk’. Romesh Vaitilingam looks at how to create stability.
he world’s economy was on the brink of collapse in the autumn of 2008. Confidence, the lifeblood of the financial system, was evaporating at an alarming rate; financial institutions refused to do business with each other; people took their money out of banks; and it looked like the economy might be heading for a second Great Depression. Then, just as suddenly as the crisis materialised, thanks to the swift actions of the authorities, it seemed like it was over. Until recently, ‘systemic risk’ – the threat of such financial crises leading to serious consequences for both the functioning of the financial system and the wider economy – had been the purview of a few researchers and policymakers. The prevailing approach was to study the risk of the individual parts of the financial system separately, not in aggregate.

The latest crisis has demonstrated the folly of such thinking. When the individual parts of the system are interdependent, there can be a ‘fallacy of composition’ in which system-level risk is quite the opposite of the risks of the individual parts. And 2008 was not the first time we faced systemic risk: it has been present ever since the first financial system was created and it is an inevitable part of any market-based economic system. The key question for policymakers is how to limit the build-up of systemic risk and contain crisis events when they happen. To answer this, we need to understand the different aspects of systemic risk and identify the tools available to policymakers. These are the objectives of the new ESRC Systemic Risk Centre (SRC), led by London School of Economics researchers Jon Danielsson and Jean-Pierre Zigrand.

They argue that the recent crisis happened because we got complacent. Most people thought that because of recent advances in financial models and regulations, the problem of overseeing the financial system had been reduced to a well-understood engineering exercise. Just as we can make bridges safe so can we make finance safe. The financial regulations being implemented at the time represented this view. Some tinkering on the margins of the system might be necessary but basically all was fine.

What was forgotten is that finance is not like engineering: it is much more complicated. When engineers design a bridge, they have to contend with well-understood forces of nature and can tailor the margin of safety to the problem at hand. Engineers can generally rest safe knowing that an intelligent bridge does not conspire with nature to undermine their handiwork. That is not the case in finance.

On a general level, financial risk is the chance that something goes pear-shaped, but in practice that has to be translated into concrete terms. Unfortunately, there is no single formal definition of financial risk. Often, what is thought of as risk is shaped by current events. This gives rise to terms like ‘market volatility’.

Unfortunately, such concepts tend to capture the risk of major events only after they happen. The reason is that such measurements are often inherently backward-looking, not forward-looking. This is ‘perceived risk’ – the risk we see in the system at any given moment and which only reflects the risk of adverse events after they happen. But what really matters is the build-up of systemic risk before a crisis. At that time, all outward signs point to stability and low risk. The period before 2008 was even labelled the ‘great moderation’. But if we perceive the system as being safe, we are motivated to take on more and more risk, until the system becomes so fragile that a crisis is inevitable.

LESSONS FROM THE MILLENNIUM BRIDGE
To understand systemic risk, it is necessary to go beyond perceived risk and look at the underlying build-up of vulnerabilities. At the heart of SRC analysis is the idea of ‘endogenous risk’ – the view that risk is created by interactions of people within the system not by some outside force. To explain how this works, the researchers use the analogy of London’s pedestrian Millennium Bridge, the first new bridge to span the river Thames for a hundred years.
On 10 June 2000, the day the bridge was opened by the Queen, thousands of people used it. This should not have been a problem, as the bridge was designed to cope easily with such large crowds. But within moments of being opened to the public, the bridge began to wobble violently, and soon closed to the great embarrassment of the bridge’s designers – Arup and Lord Foster – and the authorities. In the process, it earned the nickname the ‘wobbly bridge’.

Every bridge is designed to move with the elements and the Millennium Bridge was supposed to sway gently in response to the Thames breeze. A gust of wind hit the bridge, causing it to move sideways and wobble. When this happens, a natural reaction is to adjust one’s stance to regain balance. By doing so, the bridge gets pushed back, making it sway even more, causing people to adjust their stance yet again – more and more at the same time – this time pushing the bridge in the opposite direction. As an ever-increasing number of pedestrians started to adjust their stance simultaneously, the bridge moved more and soon almost all the pedestrians joined in. This created a self-reinforcing ‘feedback loop’ between the synchronised adjustments of the pedestrians’ stance and the bridge’s wobble.

The financial system is replete with analogous processes whereby an innocuous shock akin to the first gust of wind has the potential to trigger a systemic crisis. Financial markets are examples of environments whereby individuals not only react to events around them but also by their actions directly affect market outcomes. The pedestrians on the Millennium Bridge were like traders reacting to price changes and the movement of the bridge was like price moves in markets.

**ENDOGENOUS RISK**

To understand systemic risk, we have to understand the interactions between market participants and the mechanisms inherent in the system that can amplify small events into a crisis or cause a large event to fade away. Just as on the Millennium Bridge, these interactions can create self-reinforcing feedback loops, both virtuous and vicious.

There is a myriad of amplification mechanisms, often created by formal or informal constraints on risk-taking – for example, the level of bank capital, leverage or marking to market. While each such constraint might be individually justifiable, they often have inconsistent objectives and interact with each other in unpredictable ways. This means that laws, rules, regulations and common practices may have the potential not only to mitigate the build-up of systemic risk but also to facilitate its creation. The SRC is therefore pursuing an interdisciplinary approach, bringing together economics, finance, law, political science and computer science to explore what shapes the vulnerability of the financial system.

**IMPOSSIBLE DEMANDS?**

It is not enough to understand the problem of systemic risk, we need to do something about it. The problem is that we want to have our cake and eat it too. We desire two incompatible things simultaneously: we wish the financial system to be safe; but we also want to finance risky economic activity, perhaps providing mortgages or lending to small- and medium-sized enterprises.

The two objectives of stability and risk cannot be fully satisfied at the same time. We have to give up some of the safety so that economic activity can be financed. The problem is finding the appropriate balance. That is one of the key challenges that the SRC will address. Its findings will inform decision-makers in financial regulation and supervision, in central banks and in the private sector.

www.systemicrisk.ac.uk

Romesh Vaitilingam is a writer and media consultant. He has an MBE for services to economic and social science. *Global Financial Systems: Stability and Risk* by Jon Danielsson (Pearson Education, 2013).
HOW HAS THE RECENT RECESSION AFFECTED INCOMES, PRODUCTIVITY AND THE PUBLIC FINANCES?

THE ECONOMIC SLOWDOWN of recent years has lasted for longer – and its effects on incomes, productivity and the public finances have been more marked – than in the early 1980s, the early 1990s and even in the 1930s. The economy is failing to bounce back as expected. Wages, employment, productivity, inequality, consumption and many other indicators are moving in unexpected directions. That inevitably creates uncertainty for households and businesses – and the implications for how we think about policy are profound.

The depth and length of the recession have had a severe impact on the public finances. Public sector borrowing rose above 11 per cent of GDP in 2009/10 – easily its highest level since the war – and remains at historically very high levels. National debt, which was comfortably below 40 per cent of national income before the crisis, is rising swiftly above 85 per cent of GDP.

This is the background to one of the other unprecedented aspects of the period: what’s happening to public spending. The real cuts in spending planned up to 2017/18 are deeper and more protracted than at any time in the last 60 years. In the face of the steepest and longest reduction in national income in many decades, one would expect a sharp rise in unemployment. But unemployment has risen by much less than in the shorter and shallower recessions of the 1980s and 1990s. Meanwhile, employment and hours worked are back at their pre-recession levels even though output is not.

INCOME INEQUALITY

This implies that productivity has fallen. The difference between now and previous recessions is remarkable. Output per hour started rising at a healthy pace very soon after the start of each of the last two recessions: within five years it had reached a level 15 per cent above its starting point. Yet at the start of 2013, output per hour remained lower than at the start of 2008. An important driver of this fall in productivity has been a substantial fall in real wages. Real wage levels were six per cent lower at the end of 2012 compared with the start of 2008.

Strong jobs performance and weak wage growth have played an important role in ensuring that income inequality has fallen since 2008. In 2010/11, inequality fell by more than in any single year in the 40 years for which comparable data is available. The latest data shows no increase from that low point.

This fall in inequality arose largely because benefits levels were rising faster than earnings.

As a result, up to 2011/12, there were increases in income – or only small falls – towards the bottom of the income distribution and much larger falls towards the top. But our analysis suggests that inequality will start to rise again: by 2015/16, it will be back at 2007/08 levels as benefits are cut and earnings start to rise again.

UNPRECEDENTED REVERSAL

The overall effect is likely to be that real incomes will have fallen by between four and six per cent right across the income distribution between 2007/08 and 2015/16. This will have been a bigger and more persistent fall in average incomes than in the recessions of the 1980s and 1990s. The fact that income growth was relatively limited during the 2000s also means that the income losses since 2008 have returned average incomes close to those at the turn of the century – another reversal that is unprecedented.

So this period really does look different. The loss of economic output has been greater and lasted longer than in the 1990s, the 1980s and even the 1930s. Household incomes have dropped more and stayed lower longer. Productivity has fallen dramatically. Yet employment levels have remained relatively high and unemployment has grown much less than expected.

Meanwhile, inequality has fallen as those in work have suffered real wage cuts while benefits have largely risen with prices – though that will change. The contrast with the 1980s could hardly be sharper.

www.ifs.org.uk/fiscalStudies/contents/6726
www.ifs.org.uk/comms/r81.pdf


**ENERGY BILLS**

**CHANGING BEHAVIOURS**

Which incentives work best for household energy use?

**GIVING HOUSEHOLDS** information about how their use of gas and electricity compares with their neighbours is an effective way of reducing consumption, according to research by the ESRC Centre for Economic Performance. And receiving an old-fashioned letter grabs people’s attention about average energy use in their respective neighbourhoods far more than an email. The study by Professor Paul Dolan and Dr Robert Metcalfe also finds that short-term financial incentives have a powerful impact on behaviour. Asking people to reduce their energy use by 30 per cent over two months with a £100 reward if they do so is the most effective way of getting people to cut their consumption – and the reductions are large and lasting.

**FINANCIAL REWARDS**

The researchers conducted two natural field experiments. The first was in Camden, with three groups of social housing residents who had gas meters installed. One group received a standard gas usage letter. Another received a usage letter with a simple chart demonstrating their usage in comparison with their neighbours – a ‘social norm’. And the third group received a usage letter with the chart, plus additional information on how to change their energy use.

The second experiment was with the private customers of First Utility who have electricity smart meters. Different groups of customers received social norm information in different ways: some online, some offline. And some were given a cash incentive to reduce their energy use.

In both experiments, simple information on the social norm had an immediate impact on behaviour – though online did not work nearly as well as offline. But offering a small financial reward was the most effective way to reduce energy use. The researchers urge governments to take both financial incentives and social norms seriously if they want to promote energy conservation to tackle climate change.

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**REGULATORS**

**Wake-up call**

How to ensure politicians build independent regulators and keep them that way

**TO REGULATE KEY** industries, such as energy and communications, politicians set up independent agencies, so that important decisions about prices and investment are taken out of their hands and aren’t made on the basis of short-term electoral concerns. But what’s to stop politicians going back on their word and interfering in the work of regulators like Ofgem and Ofcom when it suits them?

Dr Chris Hanretty of the ESRC Centre for Competition Policy has been exploring this question. “I have a problem. Each night, I mean to get up early next morning and clear my to-do list. Each morning, I prefer an extra hour in bed. I suffer from ‘temporal inconsistency’.”

**MAKING A COMMITMENT**

Politicians also suffer from temporally inconsistent preferences in many regulated industries. Incoming governments seek out fresh market entrants and encourage bold new infrastructure investments. But as an election approaches, governments squeeze consumer prices, holding them to levels that won’t cover capital maintenance let alone new investment. To deal with these inconsistent preferences, credible commitments must be made.

Hanretty continues the analogy: “I make a credible commitment to waking up early by setting my alarm clock far away from my bed – too far to let me hit snooze and give in to my new preference for an extra hour in bed.”

His research considers how politicians structure regulatory agencies. He examines whether ‘de jure’ independence translates into actual or ‘de facto’ independence across a variety of sectors and European countries. “Is it possible for politicians to suborn the mechanisms they create to bind themselves, in the same way that many of us repeatedly hit the snooze button on our morning alarms?”

**OBEYING THE LAW**

Fortunately, it turns out that higher de jure independence does lead to higher de facto independence. But the outcome depends on the strength of the rule of law. In many sectors, Greek, Italian and Spanish regulators score badly on Hanretty’s measures of de facto independence, which look at how often government changes are followed by changes in regulators’ leadership. This is because generally the law is obeyed less in these countries than in Britain or Sweden.

Within these countries, regulators with higher de jure independence generally have higher de facto independence – but they start from a much lower baseline. An Italian regulator would have to be designed in an exceptionally watertight fashion to compensate for the built-in advantage that any British regulator starts with in terms of the rule of law.

competitionpolicy.ac.uk
Women who are currently close to state pension age will, on average, see an increase in their state pension income if the reforms put before Parliament in 2013 pass into law. But Pensions Bill 2013 would reduce pensions for almost all women currently aged under 40.

These are among the findings of researchers at the Institute for Fiscal Studies (IFS). Their analysis shows that the proposed reforms to state pensions will require younger cohorts to save more privately for retirement and/or to work longer. Further increases in the state pension age planned from 2018 onwards are also likely to lead to them retiring later.

There has been considerable hype about the proposed ‘single-tier pension’, with some of the public debate implying that it will result in higher pension income for all. But IFS research by Rowena Crawford, Soumaya Keynes and Gemma Tetlow suggests that the financial gains from the policy are not so straightforward. Analysing data from the ‘English Longitudinal Study of Ageing’ – including linked administrative data on people’s national insurance contributions – they show that although nearly two-thirds of women approaching state pension age would be better off under the single-tier system, around one in seven would actually receive a lower weekly pension at state pension age. On average, women would experience a £5.23 increase in their weekly state pension income, but this average masks considerable variation.

Women gain in the short run (and to a greater extent than men) because the single-tier pension will provide retrospective credits for periods – prior to 2002 – when individuals were not in employment but were, for example, caring for children. This is relatively beneficial to older women. But in the longer run, virtually everyone will get a lower state pension income under the proposed system. This is because the current system already credits most new periods of paid and unpaid activities more generously than the proposed system will.

The single-tier pension proposals mark the latest step in a rather circuitous journey over the last 40 years. It began with the 1975 Social Security Act, which introduced the first significant State Earnings-Related Pension Scheme (SERPS) and also brought in the system of credit for periods of childcare. Subsequent reforms have gradually dismantled the earnings-related element and significantly strengthened credit for unpaid activities.

**Pressures on finances**

The single-tier pension, with its lower generosity for later cohorts, along with the increases in state pension age planned from 2018 onwards, go some way to addressing the long-term pressures on Britain’s public finances posed by our ageing population. But these changes will require younger people to save more privately for their retirement. On average,
Despite the forthcoming increases to state pension age under current legislation, the number of people of state pension age (SPA) is projected to increase by 28 per cent from 12.2 million to 15.6 million by 2035. This reflects the higher number of people born immediately after the Second World War and also those who were born in the 1960s ‘baby boom’ reaching state pension age within the 25 year period to 2035.*

The act was the first UK pension legislation. Prior to this, the Poor Law in force in the 19th century made very limited provision for retirement.

This first UK state pension was financed out of central taxation.

The pension was 5 shillings a week – the equivalent of about £19.30 a week today.

It was means-tested, with the full amount paid to those with incomes below £21 a year and reduced on a sliding scale for those with incomes between £21 and £31 and ten shillings.

Initially, people needed to have been resident in the UK for 20 years and there were behavioural tests. For example, people could be disqualified if they had made themselves poor in order to qualify, had been imprisoned or convicted under the Inebriates Act.

To be eligible a person needed to be at least 70 years of age.

Source: www.parliament.uk
BANKING ON SCOTLAND

What are the currency options for an independent Scotland that don't rock financial stability and how would it manage debt?

AS THE PEOPLE of Scotland consider which way to vote, one key question is the currency that would be used by an independent nation. According to research by Dr Angus Armstrong and Dr Monique Ebell of the National Institute of Economic and Social Research (NIESR), the share of the UK's existing public debt that an independent Scotland would inherit and how the new country would manage its debt are central to understanding its currency choices. The NIESR researchers are being funded by the ESRC Future of the UK and Scotland programme to look at Scotland's currency and fiscal options as part of an initiative to inform the referendum debate. Their first report looks at the three currency options for an independent Scotland: being part of a sterling currency union; adopting the euro; or having an independent currency. No currency option is the best when considered against all criteria, the research team finds. Therefore, making the decision requires deciding which criteria are most important. The researchers emphasise that delivering a robust or 'hard' currency arrangement (which is not vulnerable to disruption and the economic costs that follow) should be the prime objective. This in turn requires ensuring fiscal solvency – that a country can honour its debt obligations.

Dr Armstrong says: “Recent events in Europe have shown that fiscal sustainability and currency arrangements cannot be considered in isolation. We consider scenarios for how the existing UK public debt could be divided, and what they imply in terms of fiscal adjustment for an independent Scotland. Having a ‘hard’ currency, one in which investors are willing to hold long-dated Scottish government debt at a reasonable price, depends on both maintaining a reasonable debt burden and the choice of currency arrangement.”

MAJOR CHALLENGES
The team addresses two key issues: how much higher an independent Scotland's borrowing costs would be if it kept using sterling; and what fiscal policy would be consistent with debt stabilisation. The researchers estimate that an independent Scotland would face additional interest rate costs of between 0.72 per cent and 1.65 per cent above the UK’s borrowing costs for ten-year debt. They also estimate that Scotland would have to run a tight fiscal policy to achieve a sound debt level under those borrowing costs. Under their central scenario, Scotland would need to run primary or underlying surpluses (excluding interest payments) of 3.1 per cent annually to achieve a debt-to-GDP ratio of 60 per cent after ten years of independence. Given Scotland’s estimated average primary fiscal deficit of 2.3 per cent (including oil and gas taxes) over the period 2000-12, running a surplus of 3.1 per cent would represent a fiscal tightening of 5.4 per cent over the past 12 years.

Such a fiscal tightening would leave an independent Scotland with very little room for fiscal manoeuvre in the case of a negative shock, such as a drop in the oil price or a recession. That makes it important to have other policies available, such as interest rate or exchange rate adjustment. Among the currency options open to an independent Scotland, having its own currency would give it flexibility to respond to shocks. While there are significant transitional challenges, over the longer term, this would be more consistent with independence. The team propose a novel way of reducing the initial debt burden that would leave an independent Scotland looking more like the successful independent Scandinavian countries that also have their own currencies. An oil-for-debt swap – where the oil revenues would pass over to the UK in exchange for a large write-down of the debt that Scotland would otherwise assume – would greatly reduce the economic risks of independence.

Dr Armstrong concludes: “The greater the amount of public debt an independent Scotland assumes, the greater the importance of retaining some policy flexibility and the stronger the case for introducing a new Scottish currency.”

nie-r.ac.uk/research-theme/economics-scotland

A NEW CURRENCY FOR SCOTLAND? AN ISSUE FOR THE FUTURE

Apart from the Bank of England, these banks in Scotland can also issue banknotes: Bank of Scotland, Clydesdale Bank, Royal Bank of Scotland. These can be accepted all over the UK.

- All the above banks issue notes in the following denominations: £100, £50, £20, £10 and £5.
- Only the Royal Bank of Scotland continues to issue £1 notes.
- The Bank of Scotland currently has two series of banknotes in circulation: the Bridges Series and the Tercentenary Series.
- The Bridges Series was launched on 17 September 2007. The range of Scottish bridges portrayed represent the pioneering enterprise and heritage of Scotland.
- The Tercentenary Series of banknotes notes was issued in 1995 to coincide with the 300th anniversary of the founding of the Bank of Scotland.
- Sir Walter Scott figures on the front of all notes to recognise his defence of the Scottish £1 note, under threat from Westminster in 1826.

Source: ACBI, www.scotbanks.org.uk

niesr.ac.uk/research-theme/economics-scotland

48 BRITAIN IN 2014
Small business, big impact

What initiatives and support are available to help small businesses achieve sustained growth?

GROWTH IS TOP OF THE policy agenda, and, according to Professor Stephen Roper of the Enterprise Research Centre (ERC), if the past is any guide to the future, small firms will create most of Britain's new jobs over the next decade.

Research by his colleagues Michael Anyadike-Danes, Mark Hart and Jun Du highlights the remarkable growth in the importance of small firms. Over the last 20 years, the majority of new jobs in Britain have been created by small firms with fewer than 50 employees. And small firms have increased their share of total employment year-on-year so that by 2010, their share of all jobs was three times that of 1998.

But the researchers also note some 'brutal facts' about small businesses in Britain: around 75 per cent of new firms that start small stay small; and over a decade, around 75-80 per cent of all new firms will close. Entrepreneurs in Europe also have lower levels of ambition than their US counterparts: there are twice as many early stage entrepreneurs with high growth expectations in the US than in Britain, France or Germany. Indeed, ERC research by Jonathan Levie and Eriko Autio suggests that the share of entrepreneurs with high growth ambitions has declined in Britain since 1999.

NEW INITIATIVES
So how can small firms be supported in achieving their full growth potential? Government can play an important role through such initiatives as 'Growth Vouchers', 'Start-up Loans' and the 'Growth Accelerator'. Government also determines the regulatory environment within which firms operate and makes decisions about whether or not small firms need to comply with the same regulations as larger firms. In addition, government procurement decisions can help smaller companies to develop new products and services and enter new markets.

Other key issues for small businesses include the changing requirements for leadership and management as a business grows. ERC research suggests that external business advice, mentoring and coaching can be effective in helping small business owners overcome barriers to growth and develop the capabilities to achieve sustained growth.

Initiatives such as the Goldman Sachs '10,000 Small Businesses' programme and Kent Business School's Business Improvement and Growth (BIG) programmes, which match university expertise with entrepreneurial flair and ambition, are good examples of best practice. Other mentoring schemes - such as mentorsme.co.uk - which link new entrepreneurs with experienced business leaders, also play a useful role in supporting growth.

Small firms' difficulties in obtaining finance have attracted much discussion in recent years as Britain's banks have struggled to cope with changing market risks and new regulations. Early-stage venture capital funding also remains at a low level.

But issues about financing vary between different groups of small firms. For example, while businesses run by members of ethnic minorities are not facing direct discrimination by banks, they still experience more difficulties obtaining finance because of such risk factors as the age of their businesses and their financial track records. Businesses owned by women are also more likely to prefer to avoid borrowing, which limits their growth.

ERC studies have helped to highlight these issues of small business leadership and finance, and their implications for growth. The research is leading to conversations with government departments about the need for policy changes that can benefit small companies.

For example, research by ERC staff helped to shape the design of the GrowthAccelerator, which aims to work with 26,000 small firms. ERC research also provides support for hands-on initiatives such as the 'Enterprise and Diversity Alliance', through which ERC staff are working to promote better relationships between small firms led by members of ethnic minorities, large firms, finance providers and business support organisations.

ERC funding is provided by the ESRC, BIS, Technology Strategy Board and the BBA.
ENERGY SUPPLIERS

Positive discrimination

Initiatives to protect consumers who don’t switch energy suppliers distort the competitive process

BRITAIN’S REGULATOR of gas and electricity markets, Ofgem, demands that energy suppliers don’t charge different mark-ups in different parts of the country. Such ‘non-discrimination’ sounds like a good idea. But according to research by the ESRC Centre for Competition Policy (CCP) at the University of East Anglia, it may have done more harm than good, hampering competition and raising prices for everybody.

In reviewing the retail energy market in 2008, Ofgem found that while switching rates were high compared with many other products, a group of ‘sticky’ consumers (around two-fifths of the total) had stayed with the previous monopoly supplier (the ‘incumbent’) in each area. These incumbents were charging around ten per cent more to the sticky customers in their home regions than to those they were trying to entice away from other incumbents elsewhere. But were a disproportionate number of the ‘non-switchers’ getting poor deals disadvantaged or vulnerable customers?

Ofgem imposed a non-discrimination clause to prevent such differential mark-ups, hoping that companies would reduce the higher prices that they charged to the inactive customers. While such non-discrimination clauses are not necessarily anti-competitive, research by Professors Morten Hvid and Catherine Waddams shows that they are likely to dampen competition in the particular circumstances of the energy market. Each of the ‘big five’ incumbents serves the majority of its customers in its home area and makes most of its profits there. If it has to bring prices closer together, it will lose more profits by lowering them in its home areas than by raising them in other areas, even though such price rises will mean they recruit fewer new customers. Each company knows that all the others are in the same boat. Events seem to support the predictions of the economic analysis. Prices did converge, reducing the potential gains from switching to a new supplier and, unsurprisingly, switching has fallen dramatically. It is now at the lowest level in the ten years that it has been recorded. CCP research confirms that potential savings are the main incentive for switching suppliers – and if savings decline, so will switching rates. Meanwhile, company profits have increased since 2008, indicating that companies have raised their lower prices rather than reducing their higher prices. Stephen Littlechild calculated that the regulator’s intervention had cost an average of £400 for each household through higher prices.

IMPOSING LIMITATIONS

The non-discrimination clauses ended in 2012, but Ofgem is concerned about the falling switching rates. It is limiting how many different tariffs companies are able to offer. This should make it easier for consumers to compare offers, moving the market much closer to regulation than to a freely competitive model.

The dilemma is that while competition usually lowers average prices, there is no guarantee that it will lower every price so that each consumer benefits equally. By its nature, competition offers incentives and rewards to those who are active in seeking out better deals, and these people are rarely the most vulnerable.

As the effects of the non-discrimination clauses show, competitive markets cannot be manipulated to deliver benefits to particular groups of people without distorting the competitive process itself.

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GETTING RAILROADED?

A study by the ESRC Centre for Research on Socio-Cultural Change (CRESC) found that the privatised rail system relies upon hidden subsidies from the taxpayer and has failed to bring in private investment. Train-operating companies extract profits from public subsidy, through direct subsidies from the government, and also through an annual subsidy that is given to Network Rail (the quasi-public body that runs the infrastructure of the network). This means that the Treasury keeps many of the costs of rail off the public balance sheet and creates the illusion of profitability among train companies. The study found that Network Rail has lowered track access charges from £3.19 billion in 1994 to £1.59 billion in 2012. This hidden sum is nearly twice as large as direct government subsidies, and the cost of servicing this growing debt is now larger than the annual maintenance cost. So as well as paying to maintain the railways, the taxpayer is paying for some £30 billion of government-guaranteed debt on the balance sheet of Network Rail too.

www.cresc.ac.uk

Professor Karel Williams

SUPERMARKET SHAM

High-profile supermarket price-cutting campaigns obscure the real story on how much your groceries are costing, say researchers from the University of Warwick. A study of pricing behaviour by leading supermarkets over eight years, including the inflationary period of early 2008, reveals that while a great many individual prices fall, most consumer’s actually pay a higher basket price for their groceries. Although supermarkets may reduce the costs of individual items, they increase others so that the overall amount for the average shopping basket goes up.

www2.warwick.ac.uk/fac/soc/economics

Professor Michael Waterson

INITIATIVES TO PROTECT CONSUMERS WHO DON’T SWITCH ENERGY SUPPLIERS

Positive discrimination

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competitionpolicy.ac.uk

GETTING RAILROADED?

A study by the ESRC Centre for Research on Socio-Cultural Change (CRESC) found that the privatised rail system relies upon hidden subsidies from the taxpayer and has failed to bring in private investment. Train-operating companies extract profits from public subsidy, through direct subsidies from the government, and also through an annual subsidy that is given to Network Rail (the quasi-public body that runs the infrastructure of the network). This means that the Treasury keeps many of the costs of rail off the public balance sheet and creates the illusion of profitability among train companies. The study found that Network Rail has lowered track access charges from £3.19 billion in 1994 to £1.59 billion in 2012. This hidden sum is nearly twice as large as direct government subsidies, and the cost of servicing this growing debt is now larger than the annual maintenance cost. So as well as paying to maintain the railways, the taxpayer is paying for some £30 billion of government-guaranteed debt on the balance sheet of Network Rail too.

www.cresc.ac.uk

Professor Karel Williams

SUPERMARKET SHAM

High-profile supermarket price-cutting campaigns obscure the real story on how much your groceries are costing, say researchers from the University of Warwick. A study of pricing behaviour by leading supermarkets over eight years, including the inflationary period of early 2008, reveals that while a great many individual prices fall, most consumer’s actually pay a higher basket price for their groceries. Although supermarkets may reduce the costs of individual items, they increase others so that the overall amount for the average shopping basket goes up.

www2.warwick.ac.uk/fac/soc/economics

Professor Michael Waterson

The most vulnerable are rarely active in seeking out better deals
If the primary cause of job polarisation is routine work being done by machines, it seems likely to continue as computers become ever more powerful. But does that imply a dystopian future in which we are increasingly displaced by machines? There are good reasons for thinking that we are some way from that situation.

**WHO IS GETTING DISPLACED?**

First, while technology will undoubtedly continue to displace humans in some tasks, there is no reason to think that the jobs affected will always be the middling ones. If computers end up diagnosing illness and prescribing treatment more effectively than doctors, then demand for doctors, among the highest paid occupations, will fall. And not all middling occupations are being displaced: computer can’t yet replace nurses, who typically earn the average salary and for whom the ageing population is raising demand.

Second, there are things that can be done to lessen the impact of job polarisation. It is sometimes argued that the ‘hollowing-out’ of the workforce means that improving education and skills for all is a mistaken policy – that what is needed is a very high-quality education for young people destined for the high-paid jobs and only basic education for those who will be working in the low-paid jobs.

But while there is little point in equipping workers with skills for which there will be no demand, it is not true that increasing the level of education across the board is irrelevant. Imagine a situation where all the middling jobs disappear, leaving only high and low-skill jobs. The pay of the high-skill jobs relative to the low-skill jobs will be influenced by the share of the population who can do high-skill jobs: the higher this share, the lower will be inequality.

Aiming for equality in the distribution of human capital will be as important as it has ever been.

So while job polarisation continues to be an important feature of Britain’s labour market, there is little reason to believe that it will cause problems on an unmanageable scale. We cannot ignore it, but with sensible policies, we can manage it.


Professor Alan Manning is director of the labour markets and communities research programmes at the ESRC Centre for Economic Performance. ‘Lousy and Lovely Jobs: The Rising Polarisation of Work in Britain’ by Maarten Goos and Alan Manning, CEP Discussion Paper No. 604.

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**Lousy and lovely jobs**

Technical progress has replaced many routine jobs. How much should we all fear being replaced by machines?

THE OCCUPATIONAL structure of Britain’s labour market has changed markedly in recent years. There has been rapid growth in the employment share of high-wage occupations, such as managers and professionals, and more modest but still positive growth in the share of low-wage occupations, such as shop assistants and care workers. But there have been significant falls in the employment share of clerical and manufacturing jobs in the middle of the income distribution.

Ten years ago, Maarten Goos and I charted this phenomenon of ‘job polarisation’ over the period 1979-99 – and the evidence indicates that it has continued. The most compelling explanation lies in the nature of technical progress: machines come to replace people in routine tasks for which a software program of manageable length can be written to perform the task well.

For example, the job of a skilled craft worker in manufacturing involves precise work, but it is repetitive and relatively easy for a machine to replicate. Similarly, being a bank clerk used to require the ability to do arithmetic fast and accurately (so these were not low-skilled jobs), but computers can do the sums both faster and without error. So the demand for both types of jobs has been falling.

But, as yet, it is not easy to design a computer that will manage people and motivate them: management remains something in which people have a comparative advantage over machines. And jobs like cleaning, which we think of as being unskilled because they require no special aptitude, are currently beyond the capability of computers.

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It is not easy to design a computer that will manage and motivate
The biggest household expense: £19.10 is spent on buying a vehicle, £36.40 on operation of personal transport (petrol/diesel, repairs, servicing), and £10.20 on transport services (rail, bus, tube).

*From the latest figures, on main commodities and services in 2011. Source: From the Living Costs and Food Survey, ONS.

Excludes mortgage interest payments, Council Tax and NI rates.

Includes mortgage interest payments, Council Tax, licences, fines, transfers, holiday spending. Note: percentages have been rounded up/down where appropriate.

Average weekly spend
A £16 drop on 2008, where £471 was the average

£455

£58.40 Transport
Down 8% on the previous year

£57.90 Recreation and culture
Down from £60.10 in 2008

£57.30 Weekly housing, fuel and power
Up from £53 a week in 2008 as fuel costs continue to rise

INFOGRAPHIC: TIDY DESIGNS

WHERE DOES THE MONEY GO?
How are families spending their cash now, compared to when the recession hit?

£483.60 AVERAGE WEEKLY SPEND

FOOD AND NON-ALCOHOLIC DRINKS £14.40 was spent on meat and fish, £4.00 on fresh veg, £3.10 on fresh fruit, £4.50 on non-alcoholic drinks and £2.30 on chocolate and confectionery.

TRANSPORT
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EXTRA INCOME
£63.30

HOUSING, FUEL AND POWER
£63.90

RECREATION AND CULTURE
£57.90

TRANSPORT
£58.40

EDUCATION £7.00

FOOD AND NON-ALCOHOLIC DRINKS £14.40

RECREATION AND CULTURE
£57.90

TRANSPORT
£58.40

Other items £65.70

Health £6.60

Miscellaneous goods and services £38.60

Clothing and footwear £21.70

Miscellaneous goods and services £38.60

Housing, fuel and power £63.30

Spending habits in the recession
After the recession had started in 2009, how did people adjust their spending as austerity measures kicked in?

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