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The government's spending cuts: playing dice with the economy?

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Last month, when the Chancellor of the Exchequer, George Osborne, presented his Comprehensive Spending Review, the single most essential ingredient needed for an economic recovery was missing.

It was economic growth.

The Chancellor's speech to Parliament on 20th October was striking for its proposed spending cuts, which are unprecedented in living memory because of their sheer magnitude and the speed with which they are to take effect.

Yet these dramatic and severe measures were accompanied by almost no policies or ideas for ways to stimulate the economy. For instance, around half a million public sector jobs are to be eliminated, but surprisingly little thought seemed to be devoted to coming up with incentives for the private sector to create the jobs that will make up for these losses or lead to growth.

A few days after the unveiling of the spending review, Prime Minister David Cameron scrambled to address this vacuum. Though his speech focused on economic growth, there were no specific policies or proposals on what the government will or will not do to support and enhance the private sector and the markets.

Too much attention, time and effort have gone into spending cuts compared to the matters of job creation in the private sector and economic growth more generally. Yet, these matters will be the essential foundations of the nation's economic recovery. The government ought to turn its attention to these matters and soon.

An effective strategy for government would be to look for two main pathways to growth. The first would focus on finding ways to avoid interfering with potential economic expansion. The second would find ways to enable and facilitate job creation. To help create private sector jobs, the government must see what it can do to reduce the overall *cost* to businesses of employing people. Government needs to seek ways to cut red tape and taxes related to employment. A bold step – though perhaps not as bold as the Chancellor's spending cuts –would be to abolish the planned increase in employer National Insurance in 2011, because it is, essentially, a tax on jobs.

The government should aim to tackle other job creation costs. In the face of far too much employment regulation, a moratorium on new employment laws for, say, three years would provide a powerful incentive for businesses to create jobs. Slashing corporate taxes and looking to simplify the tax code would be beneficial as well.

Policies and commitments to promote and support the private sector are much needed. The government cannot just rely on macroeconomic measures such as quantitative easing (i.e. printing money to buy government bonds) or on the emerging economies to drive our economic growth. Since Keynesian-type fiscal expansion is not being pursued (due to the structural deficit), labour market policies need to be considered along the lines briefly noted above.

The thrust of the spending review is that total government spending is to be cut by *circa* £80 billion by the end of the current parliament. This is to be secured by an average cut of 20 percent in each Whitehall department's budget. Is this warranted? While the main driver for the proposed spending cuts put forward by the Chancellor is to eliminate the structural deficit that characterizes the public finances, one may wonder whether another agenda lies behind these tough and challenging measures.

The government has explained the spending cuts by the need to confront the structural deficit, but another reason may be a philosophical desire to significantly reduce the size of the state. The coalition ought to be upfront about moving towards a smaller state and make the argument why that is good for economic growth and prosperity, for social well being and much more. I haven't seen any such argument from the coalition government.

In the end, the government will be judged on whether it succeeds in "persuading" the private sector to create jobs and drive our economic growth. This needs to happen soon, as the cuts start.

We can but wait and watch.

Rethinking England's economic past

Living standards in medieval England exceeded those in poor nations of the 21st Century, according to research by **Stephen Broadberry, Bruce Campbell, Alexander Klein, Mark Overton and Bas van Leeuwen**.

Living conditions in England during medieval times were far better than previously has been believed, with average incomes twice those of people in the world's poorest nations today, our recent research shows.

Our work, which sheds new light on the British economic past, reveals that per capita incomes in medieval England were substantially higher than the "bare bones subsistence" levels experienced by people living in poor countries in our modern world. The majority of the British population in medieval times could afford to consume what we call a "respectability basket" of consumer goods that allowed for occasional luxuries. By the late Middle Ages, the English people were in a position to afford a "respectable lifestyle," with a varied diet including meat, dairy produce and ale, as well as the less highly processed grain products that comprised the bulk of the "bare bones subsistence" diet.

Our research provides the first annual estimates of GDP for England between 1270 and 1700 and for Great Britain between 1700 and 1870. Far more data are available for the pre-1870 period than is widely realised. Britain after the Norman conquest was a literate and numerate society that generated substantial written records, many of which have survived. As a result, our research was aided by a wide variety of records – among them manorial records, tithes, farming records, and probate records, all of which can be used in an economic framework. Our team used these records and compared them with modern national accounts to reconstruct the path of per capita income over most of the second millennium.

Living standards in medieval England were far above the "bare bones subsistence" experience of people in many of today's poor countries.

In addition, our research shows that the path to the Industrial Revolution began far earlier than commonly has been understood. A widely held view of economic history suggests that the Industrial Revolution of 1800 suddenly took off, in the wake of centuries without sustained economic growth or appreciable improvements in living standards in England from the days of the hunter-gatherer.

By contrast, we find that the Industrial Revolution did not come out of the blue. Rather, it was the culmination of a long period of economic development stretching back as far as the late medieval period. Our findings paint a picture of a Western Europe that was on a very different path of development from Asia long before the Great Divergence of the Industrial Revolution. By 1700, the structure of the Western European economy had shifted away from agriculture towards industry and services, and living standards were twice as high as in 1270.

How should we interpret the approximate doubling of per capita income between 1270 and 1700? Gains in food consumption per capita over this period were relatively modest, at least measured in terms of kilocalories. The gains in material living standards should thus be seen as arriving more through the consumption of industrial goods and services. This shows up in the path of average wealth at death and the growing urbanisation of the British economy.

It is instructive to consider Britain's historical economic experience in an international perspective. The figure of $400 annually (as expressed in 1990 international dollars) commonly is used as a measure of "bare bones subsistence," and is seen in many poor countries in the late 20th and early 21st century. As expressed in 1990 dollars, English per capita incomes in the late Middle Ages were on the order of $1,000. This is an amount well above the widely accepted per capita income estimate of $400 for English per capita incomes in the year 1000. Even on the eve of the Black Death, which first struck in 1348/49, we find per capita incomes in England of more than $800 using the same 1990 dollar measure. Estimates for other European countries also suggest late medieval living standards well above $400.

Although agriculture was the largest sector in 1381, it was not as dominant as has often been imagined. By 1700, industry already accounted for a larger share of the economy than agriculture. The British economy seems to have been stimulated by the growing population density in urban areas. This promoted infrastructure projects in urban areas and raised productivity by permitting the reorganisation of agriculture in the counties surrounding London.

Ultimately, we are interested in what happened to GDP per capita, the most widely accepted indicator of material living standards over the long run. English per capita GDP grew at an annual rate of 0.20 per cent between 1270 and 1700, which resulted in an approximate doubling of per capita incomes. However, growth was episodic. GDP per capita grew substantially during the Black Death crisis of the mid-fourteenth century, when almost half the population was wiped out by the plague. Per capita incomes then remained on a plateau between 1450 and 1650, before resuming growth during the second half of the seventeenth century.

England's economic breakthrough, the Industrial Revolution, took root far earlier than commonly had been believed.

Our findings help us to understand why some parts of the world are far more developed than other parts. They show that the roots of this divergence lie much further in the past than people suppose.

Publication details

This summary is based on a preliminary research paper, "British Economic Growth, 1270-1870." The paper is part of an ongoing project looking at historical patterns of development and underdevelopment. It is among the first projects undertaken by Warwick University's Centre on Competitive Advantage in the Global Economy (CAGE). The full paper is available at:
http://www2.warwick.ac.uk/fac/soc/economics/staff/academic/broadberry/wp/britishgdplongrun8a.pdf

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Guns 'n' roses

Research from Kenya's flower fields reveals the economic toll that ethnic violence takes on businesses. **Christopher Ksoll, Rocco Macchiavello** and **Ameet Morjaria** consider the policy implications for violence-plagued regions.

Elections in Africa are often dangerous times. Two out of 11 African presidential elections in 2007 and 2008 generated large-scale violence and in the others, the risk of violence was a focus of media coverage. Adding to the human tragedies unfolding in these countries are the economic consequences on businesses, a little-studied subject.

Our research examines how a short, intense period of violence affected firms in Kenya's flower industry. Our results have broad implications, offering new insights into connections among firms, industry associations, and international trade flows in the face of sporadic ethnic violence. The research also sheds new light on policies and practices that may reduce the violence or mitigate its negative economic effects.

Relatively few studies have focused on how ethnic violence affects firms, largely because of the enormous research challenges inherent in such situations. Certain characteristics of the situation that unfolded in Kenya allowed us to overcome some of the most daunting impediments. The sporadic locations of the violence and the detailed record-keeping that is a hallmark of its export-oriented flower industry allowed us unusual opportunities to gain insight about the economic dynamics at work.

With its location on the equator, perpetual sunshine and variations of altitude, Kenya is endowed with many of the natural conditions necessary for growing flowers. In slightly more than a decade, the country has become one of the world's largest flower exporters, overtaking such traditional leaders as Israel, Colombia and Ecuador. The flower industry is now one of Kenya's largest foreign currency earners, alongside tourism and tea.

Jobs created by flower firms are valuable and seem to have discouraged participation in the ethnic violence that ravaged Kenya.

The industry is labour-intensive and employs mostly low-educated women in rural areas. Flowers are fragile and highly perishable, and, as a result, post-harvest care is a key determinant of quality. Workers, therefore, receive significant training in harvesting, handling, grading and packing, and they acquire skills that are difficult to replace in the short run. Flowers are exported from Kenya either through auctions in the Netherlands or through direct sales to wholesalers and specialist importers.

Kenya's fourth multi-party general elections were held in late December 2007, and three days later, the incumbent president Mwai Kibaki was declared the winner over Raila Odinga, the opposition candidate who had been leading in published polls. Within minutes of Kibaki's swearing in that evening, a political and humanitarian crisis erupted. Targeted ethnic violence began then and ended in late February 2008. In its wake, an estimated 1,200 people were killed and more than 300,000 others were displaced. Financial losses to the economy reached approximately £145 million, around 1 percent of gross domestic product.

The violence took place in certain regions where flower businesses are located and spared others – thus, opening a window of opportunity for our empirical research. One of the most difficult aspects confronting empirical studies in this situation is to provide what is called the counterfactual, in our case, a valid assessment of what would have happened to the firms affected by violence if the violence had not taken place. The geography of the Kenyan violence unwittingly offered the perfect counterfactual.

Another empirical challenge is gathering detailed information on the operations of firms exposed to violent conflict. Again, the features of the Kenyan flower industry provided a way to overcome this hurdle. Flowers in Kenya are produced by about 120 established exporters exclusively for foreign markets. As a result, administrative records for all firms in the industry include extensive daily data on production and sales. In addition, shortly after the violence, we were able to conduct surveys in the field with firms about the channels through which the fighting affected the firms' operations. As a result, our case study allows us to examine the microeconomic effects of the outbreaks of violence with a remarkable degree of detail.

During a two-week episode of intense violence, export volumes and revenues of firms located in affected regions dropped by 38 percent relative to comparable firms in regions not affected. This effect can be separated into two distinct components, a 31 percent drop in export volumes, mostly associated with missing workers, and a 9 percent drop in the likelihood of exporting in a given day, mostly associated with transport problems.

These average figures, however, conceal substantial differences in both firms' exposure and response to the violence. In particular, large firms, firms with stable contractual relationships in export markets, and firms affiliated with the industry association were better able to handle the difficult situation. They were able to take a wide variety of measures – some cheap but others costly – such as hiring extra security for transportation and setting up camps and temporary accommodation for workers, to encourage them to come to work rather than stay on guard at home, for instance. On average, operating costs for these businesses grew by 16 percent.

Firms affiliated with the industry association suffered lower reductions in export volumes, presumably because the association provided the necessary help in coordinating transportation issues.

There is no evidence that foreign-owned firms or firms more closely connected to local politicians suffered differentially because of the violence.

The firms best able to handle the crisis were large, export-oriented and affiliated with an industry association that could provide help.

The jobs created by flower firms are valuable and seemingly discouraged participation in the violence. Kenya is an ethnically fragmented country, and the violence in the wake of the elections pitted members of certain tribes against others. Most flower firms have ethnically diverse workforces, composed of labourers from tribes that were in conflict with one another. Yet no violence was directed towards flower firms, and no episode of violence was recorded to have happened on firms' premises.

The export-oriented nature of the industry further contributed to stabilising the situation, because firms sought to find ways to fulfil contractual obligations with foreign buyers. As a result, policies directed at upgrading agricultural products towards commercial exports might have beneficial side effects in mitigating the risk and consequences of violence.

Publication details

This article summarizes "The Effect of Ethnic Violence on an Export-Oriented Industry" a working paper by Christopher Ksoll, Rocco Macchiavello and Ameet Morjaria. The paper can be accessed at:
http://www2.warwick.ac.uk/fac/soc/economics/staff/academic/macchiavello/gnr.pdf

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The election connection

Reports of crimes against women soar after females are elected to office in local governments in India, research shows. The finding is good news, reflecting women's greater willingness to tell authorities about the crimes rather than an increase in actual incidence, **Lakshmi Iyer**, **Anandi Mani**, **Prachi Mishra** and **Petia Topalova** report.

In 1993, India ushered in a radical political reform by introducing a mandate that women hold one third of all seats in its system of local government, called the Panchayati Raj.

Our research examines a 22-year period before and after these political reforms, which brought women into local government to an unprecedented degree, and the possible impact on crimes against women.

We find that the presence of female leaders in local government leads to large and significant increases in reported crimes against women. Our research shows that this is not because of an increase in the rate of crimes against women, but because of an increase in the willingness of women to report such crimes.

Overall, reports of crimes against women grew by 36 percent when female elected leaders were present in elected political roles, even when their roles had nothing to do with government response to crime. Having female leaders in local government triggered a 19 percent increase in reports of rape, and a 13 percent increase in reports of kidnapping of women. Arrests for these crimes also rose commensurately.

Our findings suggest that the political reforms lend women a stronger voice in society, as evidenced by their greater willingness to come forward to report such crimes.

The presence of female leaders in local government triggers a 36 percent increase in reported crimes against women

We believe our project is the first to examine this link between political representation and crime against groups of people who have been traditionally under-represented in the political sphere.

Violent crime against women is a subject of particular interest because it offers a useful barometer of women's socio-economic status and level of empowerment in broader society. It also suggests the extent to which the presence of political leaders of under-represented groups can lead to changes in attitude toward the group.

Our analysis includes results from the 17 major states of India, covering more than 97 percent of the population, over the period from 1985 to 2007. For various practical reasons, the timing of the implementation of political reforms across Indian states differed. These states also had different pre-existing levels of crimes against women and other minorities. These differences in timing of reform implementation and in pre-existing levels of crime allowed us to identify the impact of the reform across areas with and without female leaders.

In analysing the overall effects of such policies on the incentives of criminals and victims, we considered several opposing forces that could be at work. On the one hand, criminals may be deterred because of the increased likelihood of facing punishment for their actions as the result of elected political leaders perceived to be more sympathetic to their victims. But on the other hand, victims may be encouraged to report crimes more often for these same reasons. In addition, the police may be more inclined to record crimes against women when a woman is in elected office.

While our research found a spike in reported crimes against women, we found no significant effects whatsoever on any categories of crime not specifically targeted against women, such as kidnapping of men, crimes against property or crimes against public order.

As a result, we believe that our evidence makes a strong case for the view that the growth in crimes against women was the result of increased reporting rather than an increased incidence of such crimes, and that the increased reporting stemmed from changes in political representation.

We should note that the constitutional amendment that mandated women's elected seats did not give local bodies any real control over the law-and-order machinery, and therefore is unlikely to have an effect on crime through channels other than politicians' identity.

However, state office holders do play a role in determining punitive action for crimes. Our research finds that having a woman as the head of a state government, rather than a local council, creates a substantial reduction in the actual rates of crimes against women. We speculate that these contrasting effects of having women in state or local elected positions stem from the stronger power to take punitive action vested in an office holder at the state level.

Publication details

This article summarizes a working paper, "Political Representation and Crime: Evidence from India's Panchayati Raj." The article is available at:
http://www2.warwick.ac.uk/fac/soc/economics/staff/academic/mani/immt_crime_oct2009_neudcfull.pdf.

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