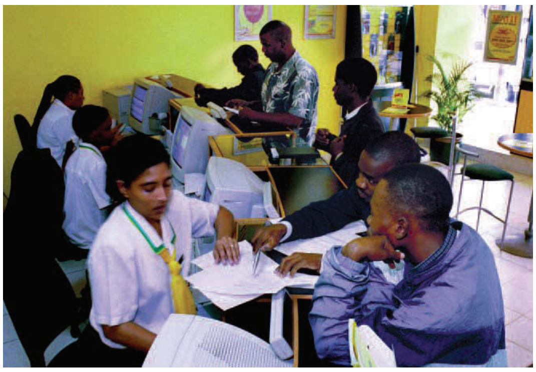
OXFORD ECONOMICS NEWS

Centre for the Study of African Economies 25th Anniversary

September 2011 **Issue 3**

The Centre for the Study of African Economies (CSAE) is celebrating its 25th Anniversary this year. The CSAE was established at a time when poverty in Africa was not simply extreme but its economies were experiencing sustained falls in incomes. In the period since then, the problem of poverty in Africa has risen dramatically up the international policy agenda. While Africa remains very poor, the last decade has seen a transformation in the economic performance of many of its economies. Ghana, Ethiopia, Tanzania and Nigeria have all seen sustained improvements in the management of their economies, due in part to the greater understanding by their governments and civil society of the consequences of their economic policies. The CSAE has been a part of the international research effort, both within and outside of Africa, which has brought to bear the expertise that has made this transformation in Africa possible.

From its beginnings as a small research unit, CSAE has grown to become a world leading research centre for the quantitative analysis of African economies, and a key participant in a wide range of networks of those interested in contributing to the issues posed by development in Africa and elsewhere. Alongside its research activities, CSAE has played a major role in training the next generation of development economists and policy-makers, contributing extensively to the Department's postgraduate taught and research degree programmes.



The CSAE's objective has been, and remains, to make a significant contribution to the transformation of African economic performance. Its approach is to conduct research that is potentially strategic, and to build networks that enable the ideas generated through this research to be seeded. By strategic, CSAE means research that has the potential for macro-significant economic change. The focus is both on the sustainable growth of incomes and on directly ameliorating social conditions. However, the opportunities for broad-based income growth differ quite radically between countries and so the focus of research differs, country by country. It seeks to encourage the adoption of effective policies by governments of developing and emerging economies, and to enable both people and governments to better understand the economic choices that they face. →*Cont. Pg 2*

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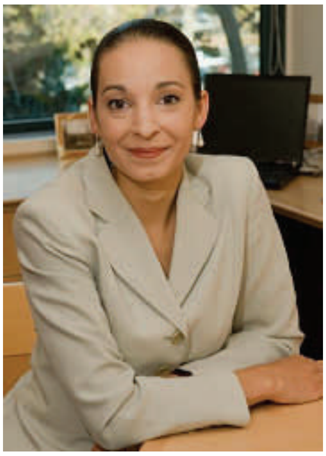
→Engagement is a common factor across many of the Centre's activities - networking in collaborative research projects, making available primary data, organising conferences, policy-briefings and workshops. The CSAE Annual Conference held each March, has evolved into the world's largest forum for academic research on African economies. This year nearly 400 papers were presented on development themes relevant to Africa, and the conference hosted debates on the role of one high profile intervention in Africa – the Millennium Villages Project – and on the role of randomised control trials in evaluating policies in poor countries. The Central Bank Governors' Roundtables were set-up to enable governors of the African central banks to meet and discuss pertinent issues following the Bank of International Settlements meetings in Basle. Informal and organised around a central theme, it is designed to encourage frank discussion. The theme of the 2011 roundtable held in Oxford in June was "Beyond aid: new financing options for Africa". Speakers included John Kay, FT columnist and author; Andres Velasco, former Chilean Minister of Finance and Fellow of the Centre for International Development, Harvard University, and Sir John Vickers, Warden of All Souls and Chairman of the UK Independent Banking Commission.

For more information on the CSAE and its research programmes, visit the Centre website: www.csae.ox.ac.uk

The 2010-2011 Clarendon Lectures in Economics

The 2010-11 Clarendon Lectures in Economics sponsored by Oxford University Press, were given by Caroline Hoxby, the Scott and Donya Bommer Professor in Economics at Stanford University and Senior Fellow at the Hoover Institution. She is also director of the Economics of Education Program for the National Bureau of Economic Research.

The series of three lectures was entitled, "The Role of Markets in Education". In the first lecture Professor Hoxby spoke about the constructive role that markets, properly designed, can play in primary and secondary education. Drawing on her research on charter schools in the US, Professor Hoxby argued that school choice and the greater competition among state schools was of benefit to students and taxpayers. The second lecture explored the complex and increasingly global market for elite higher education. Professor Hoxby drew attention to the high returns but also the very high risks associated with investment in education at the doctoral level. She likened the role of the top US universities to that of venture capitalists with their doctoral students as entrepreneurs, each with their own human capital project. Universities take equity-like positions in the entrepreneur projects, they use their expertise and resources to intervene actively in the projects, and they manage a portfolio of such projects over which they spread the risk. Finally elite US universities reap substantial returns from their investments in the form of donations from successful alumni.



Professor Caroline Hoxby

US Universities are like venture capitalists investing in 'human capital projects'

In the third and final lecture Professor Hoxby focused on competition and autonomy in higher education. Drawing on data from European and US universities, Professor Hoxby argued that a greater degree of autonomy and competition among public universities is associated with a higher level of output as measured by patents, high-cited publications and other measures.

Professor Hoxby is a *Summa Cum Laude* and *Phi Beta Kappa* graduate of Harvard College, where she won a Hoopes Prize. She studied for the MPhil in Economics at Nuffield College, Oxford on a Rhodes Scholarship, graduating in 1990. In 1994, she received her PhD from MIT. Her research covers all aspects of education. Through her research, progress has been made in understanding how the financing and provision of education influences the quality of equality of access to it and leads Hoxby to argue that increased school choice improves educational outcomes for all students.

OxCarre 5th Annual Conference

by Radek Stefanski (Postdoctoral Research Fellow, OxCarre)

The Oxford Centre for the Analysis of Resource Rich Economies (OxCarre) held its 5th Annual Conference at the Department of Economics between the 27th and 29th of June. The conference brought together leading researchers and practitioners in field of natural resource economics, international trade and growth.

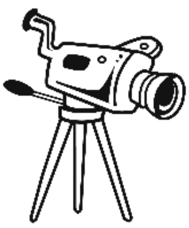
The focus of the conference was on three key features of countries endowed with natural resource wealth. First, the important issue of structural change associated with natural resource discoveries was addressed. Four papers on the subject were presented, two on cross-country experience, and two with a focus on Africa. In a paper entitled "*African Cities and the Structural Transformation: Evidence from Ghana and Ivory Coast*", Remi Jedwab (Paris School of Economics) examined the puzzling fact of Africa's relatively high urbanization rate for its low level of income. The paper found that the phenomenon may be a consequence of specialization in the export of primary commodities, which acts as a spur to urbanization but produces only short-lived economic growth.

Second, participants examined the impact of natural resource endowments on economic volatility. A paper by Kenneth Rogoff (Harvard) and Eyal Dvir (Boston College), "*The Three Epochs of Oil*", showed evidence that the real price of oil has historically tended to be highly persistent and volatile whenever rapid industrialization has coincided with uncertainty regarding access to supply.

Andres Velasco

The third focus of the conference was public spending decisions in resource rich economies. Fiscal rules were discussed, and a paper by Daron Acemoglu (MIT), James Robinson (Harvard) and Ragnar Torvik (Norwegian University of Science and Technology), "*Equilibrium Checks and Balances*", examined why voters often chose to dismantle constitutional checks and balances. The authors argue that checks and balances make it more profitable for politicians to take bribes. In countries with weaker institutions, where the political process can be swayed by bribery, voters may prefer a system without checks and balances as a way of insulating decision makers from the temptation of corruption.

The conference was followed by working meetings of the **Natural Resource Charter**, a policy initiative designed to improve policy making in resource rich countries. The meetings brought together academics and policy makers from some 30 countries and international institutions. A joint session of the Oxcarre conference and Resource Charter featured a talk by Andres Velasco (Harvard; Former Minister of Finance, Chile) on Chile's experience with resource revenue management. www.naturalresourcecharter.org/



Link to the video:
www.youtube.com/watch?v=rFJq3mRIyjY

Mthuli Ncube (Chief Economist and Vice-President of the African Development Bank), Paul Collier (Director, CSAE), Clare Short (Chair of the Board of the Extractive Industries Transparency Initiative), Waheedullah Sharani, (Afghan Minister of Mines).

Behavioural reforms for financial services?

By Nicholas Morris and David Vines

Until three years ago we lived in the `Great Moderation'. Macroeconomic outcomes were unusually good. Light-touch regulation of the financial sector seemed to be just what was needed.

But then things fell apart....

..."these people are continuing to frustrate efforts at reform"

There are now many stories about why the Global Financial Crisis (GFC) caused the largest downturn in economic activity since the Great Depression – low interest rates, subsidisation of mortgages for poor people, high leverage, securitisation, international imbalances. Many of the things which were done involved financial institutions, and individuals within those institutions, acting in a way which was clearly not in the interests of their clients, or their shareholders, or of society as a whole.

Although some reforms to regulatory systems are being proposed, these are being strenuously resisted by those who work in the financial services industry (FSI), who seem to have a limited sense of responsibility for the health of the economy in which they operate, or for the welfare of their clients. If this behaviour persists, advanced economies may well be vulnerable to a repeat of the GFC in – say - the next five to ten years. There is a pressing need to understand how the financial services industry could become more professionalized. How might those who work within the industry become more strongly bound by professional standards of behaviour - as is true of lawyers, and of doctors (who sign a Hippocratic Oath)? There seem to be too few constraints preventing those who work in the FSI from acting in their own interests, rather than in the interests of their clients, or of society. And these people are continuing to frustrate efforts at reform.

Over the last six months, a group of philosophers, lawyers, historians, economists, former civil servants and financial services practitioners have been meeting in Oxford to consider the extent to which the attitudes and behaviour of managers and employees in the financial services industry actually contributed to the financial crisis, and how changes in such attitudes and behaviour might be achieved, in parallel to any regulatory changes. Our work included a series of nine seminars during Trinity Term 2011, which were held in both the Economics Department and at Balliol College, at which the participants examined philosophical, legal, historical, economic and regulatory aspects of the problem.

In particular we have been studying the inadequacy of the selfish-behaviour assumption which underlies most economic analysis, and comparing this with a more general view of human motivations coming from Adam Smith's 'Theory of Moral Sentiments' (TMS). In the TMS, Smith analyses the interconnectedness, and reciprocal obligation, which underpins almost all social relationships. The framework which has come from the TMS provides an important counterweight to Smith's 'Wealth of Nations' - with its emphasis on the workings of the 'invisible hand' of the market. In this alternative tradition, individuals are seen as having not just selfish, but also 'other-regarding', motivations, arising out of a wish to be held in high regard, or from a wish to be well-esteemed. →

→ *Behavioural reforms for financial services continued:* We are seeking to understand how this different view of human nature might be used to underpin a professional code of conduct for the FSI. Such a code might include a Banker's Oath of the kind which has been recently adopted in the Netherlands. But the code would almost certainly be more onerous than this, as is the case, for example, in the code of conduct to which all solicitors within the United Kingdom must subscribe. There is also likely to be a need to strengthen the measurement of adverse behaviour, and to publicise it when it happens, especially behaviour which passes risk on to the vulnerable or uninformed, or onto society as a whole. We also need to understand how the legal system can better impose the fiduciary duties, and the duties of care, which are already present within the legal system. Our group intends to publish a book on this subject in the next twelve months. We also hope to keep alive the lively spirit of interdisciplinary cooperation which has arisen from this project.

About Nicholas Morris

Nicholas Morris has over 35 years' experience as an economic consultant and researcher, advising governments, companies and international institutions in the UK, Europe, Australia and emerging markets. In the last ten years he has worked extensively in China and SE Asia, including advising the Chinese government on banking reform and capital market regulation, and teaching at the China Executive Leadership Academy, Pudong (CELAP).

He is a Trustee of Oxford Policy Institute and was previously Deputy Director of the Institute for Fiscal Studies (IFS), a Fellow of Melbourne University, a Governor of the charity 'Research into Ageing' and a Visiting Professor at City University Business School, London.

About David Vines

David Vines is a Professor of Economics and Fellow of Balliol College. He is also Adjunct Professor of Economics in the Centre for Applied Macroeconomic Analysis at the Australian National University, and a Research Fellow of the Centre for Economic Policy Research. Recently he has worked on the macroeconomics of the global financial crisis, on the reform of the IMF, and on the macroeconomic and financial crisis in Europe. Since June 2008 he has been the Research Director of the European Union's Framework Seven PEGGED Research Program, which is analysing the Politics and Economics of Global Governance: the European Dimension.


Professor David Vines

British Academy Postdoctoral Fellowship

Daniel Marszalec (DPhil, 2011) has been awarded a British Academy Postdoctoral fellowship to undertake research on the optimal design of auctions.

Auctions have gained much prominence in recent years as mechanisms for selling, buying or allocating goods. The structure of auctions becomes more intricate as they are used in ever more complex settings and analytical solutions to problems of auction design are not always available. Daniel's research employs a range of methods – theoretical, empirical and experimental – to provide policymakers and practitioners with practical insights into multi-unit and multi-dimensional auctions.


Daniel Marszalec

Discriminatory auctions with 'top-up rules' are frequently used for selling government bonds. In some countries, such as Poland and France, for example, a top-up auction takes place after the main bond auction is over, during which additional bills are sold at the average price of the main auction. Daniel intends to develop a theoretical model of discriminatory auctions which explicitly incorporates top-up rules, and describes optimal bidding in the base-auction. By comparing results from his model with those from existing models that ignore top-up rules, Daniel is able to evaluate the theoretical and empirical bias from such an omission, and implications for optimal auction design.

In his experimental work, Daniel will compare combinatorial auctions with complementarities to see which generates efficient and revenue-maximizing allocations under a variety of conditions. The results from this study will provide valuable guidance on auction design for scarce licences e.g. mobile spectrum or airport landing slots. Of particular interest is how each auction is influenced by greater complexity of the bidding environment and the extent to which collusion plays a significant role. The second strand of his experimental research evaluates a multi-dimensional 'product-mix' auction, which are used to endogenously price risk-premiums in government-run liquidity auctions. While the auction has already been used by the Bank of England, the data is insufficient to provide a general and reliable guide on the performance of this type of auction more broadly. The aim of the experiments is to assess in what other contexts the auction could be used successfully.

Banking reform roundtable

By Marloes Nicholls (MPhil Economics 2011)

The Independent Commission on Banking, chaired by Oxford University Professor Sir John Vickers, is currently working to recommend reform and regulation of the financial system to the UK Government. There are many similar efforts across the globe, and the aim of the roundtable was to bring the debate to Oxford.

On Friday 4th March the Gulbenkian lecture theatre was filled with students, academics and members of the public attending a roundtable discussion on The Future of Banking. The event was organised by two students at Nuffield College studying the M.Phil in Economics, Marloes Nicholls and Gabriel Kreindler.

Angela Knight

Sir John Vickers

The five distinguished speakers represented a broad range of views and expertise. Representing academia on the panel were Professor David Miles (Bank of England), and Professors Peyton Young and David Vines, both from Oxford University. From a more practical background were Angela Knight, chief executive of the British Bankers' Association ("the voice of banking and financial services") and Ben Dyson from Positive Money, a banking reform campaign group. Professor Alan Morrison (Saïd Business School) chaired the discussion.

Professor David Vines began by painting the macroeconomic landscape against which the financial crisis of 2008 occurred. He highlighted low interest rates that created a search for yield, US politics which encouraged borrowing and securitisation, and problems with BASEL I and II, as important causal factors. He also questioned the ethics of the financial sector and pressed the need to create a 'duty of care' to customers.

From left to right: Ben Dyson, Prof. Alan Morrison, Prof. Peyton Young and Prof. David Vines

Professor Peyton Young, known for his work in Game Theory, focused on the microeconomic issue of incentives. Contrary to the common view that the financial crisis exposed irrational exuberance, Peyton suggested that, given how risk-taking incentives were structured in the financial sector, it is in fact perfectly possible that investors acted rationally. Specifically, compensation schemes reward high returns, which provide incentives to take high levels of risk. He provided an example in which an agent can continue to produce "fake" high returns by taking on hidden tail risk for, on average, more than 10 years. This has implications for "new" compensation schemes such as bonus deferral and paying bonus in stock, since these do not necessarily remove the incentive to take large risks.

Many other issues challenging the future of a more robust banking system were addressed. The Chatham House rule restricts the details that can be divulged. Broadly, however, ideas for structural reform included raising capital ratios, separating speculative activities from retail banking, removing the guarantee of government bailouts, breaking up monopoly power, and the more 'radical' idea of full reserve banking. With regards to regulation, speakers explored ideas such as the need to create a powerful and independent regulatory body, designing prompt pre-planned corrective action for future crises, keeping regulation simple, banning certain products, increasing transparency and the need for global coordination.

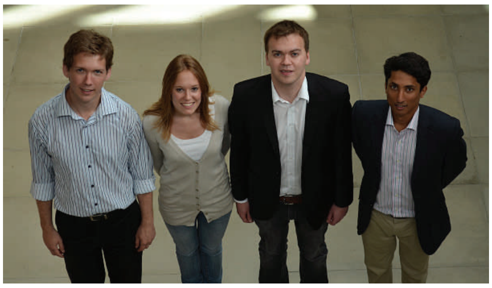
David Walton Distinguished Doctoral Scholar

Kasper Lund Jensen

The David Walton Distinguished Doctoral Scholarship for 2011 has been awarded to Kasper Lund-Jensen. Kasper is completing a doctoral thesis in the area of empirical finance with a focus on equity premium predictability. The finance literature has identified several financial variables that appear to predict the aggregate equity premium. However, it has been questioned whether an investor, with constant risk aversion, can benefit from this predictability out-of-sample. Kasper show that combination forecast methods, which exploit information from several weak predictors, delivers statistically significant out-of-sample gains relative to standard benchmark forecasts. In addition, by defining a loss function that has an explicit connection to a representative investor's utility function he shows that this predictability is economically meaningful.

Prior to starting his DPhil at Oxford in October 2009, Kasper graduated with distinction from the MSc in Finance and Economics at the London School of Economics. In addition, he holds a BSc in Economics from the University of Copenhagen from 2007 where he ranked first of his year's graduating students. Kasper has previously held positions at the IMF, Merrill Lynch, and the Danish ministry of Finance.

As part of the scholarship, Kasper will undertake an internship at Goldman Sachs during the summer of 2011 where he will be working at the Global Markets Research Group. Global markets economists specialise in Global Macro and Markets issues and are a group with representatives in London, New York and Asia. They forecast foreign exchange and interest rates based on the globally coordinated views of Goldman Sachs's global and regional economists.



Supporting Graduate Study at Oxford

The Department's graduate programmes are internationally recognized for the excellence of the training and scholarship provided. Our graduates have progressed to positions of leadership in academia and in the private and public sector and can be found making a contribution in many different parts of the world. However, Government cuts and economic contraction in many countries are threatening the opportunities for highly qualified students to study at Oxford. If Oxford is to maintain its position as one of the world's leading research departments in Economics then it is essential that it continue to attract outstanding students for its graduate programmes.

As a university department, our financial resources are limited, and we are not well-placed to offer the levels of financial support available in many of the leading North American and European institutions. Lack of funding is the main reason why well-qualified applicants reject offers of a place on our graduate programmes. We are seeking to rectify this situation by raising funds to provide all outstanding young scholars accepted by the University with the financial support necessary for them to complete their graduate studies. Postgraduate study is expensive - a postgraduate student requires £29,000 per year for fees and maintenance - but the investment yields substantial returns to the individual, the institution and to society as a whole.

If you would like to support brilliant scholarship, life-changing research and expand the circle of educational opportunity to the most talented scholars by funding postgraduate students in the Department of Economics then please see: http://www.giving.ox.ac.uk/academic_departments/social_sciences/economics.html

Arrivals and Departures

In September 2011, Mark Armstrong will be joining the economics department as Professor of Economics and Fellow of All Soul's College. Between 1997 and 2003, Mark was Official Fellow in Economics at Nuffield College, Oxford. Since 2003 he has been professor at University College London. Mark is well known for his research on the economics of industry, and his work on competition and regulation policy. He is a Fellow of the British Academy and a Fellow of the Econometrics Society.

Johannes Abeler and David Gill are also joining the department in the autumn as university lecturers. Johannes is currently a university lecturer at the University of Nottingham and his main research interests are in the areas of behavioural and experimental economics, labour economics, and public economics. David Gill is joining us from the University of Southampton, and he also works in the fields of behavioural and experimental economics, and in the area of industrial organisation.

Prof Mark Armstrong

Dr Johannes Abeler

Dr David Gill

We are also pleased to welcome the following post doctoral research fellows:

- Ines Moreno de Barreda (LSE). Microeconomic theory; political economy; mechanism design.
- Vanessa Berenguer Rico (UC3, Madrid). Econometric theory; macroeconometrics; co-integration
- Charles Gottlieb (EUI). Macroeconomic theory; monetary economics; computational methods.
- Yuval Heller (Tel Aviv). Microeconomic theory; game theory; decision theory.
- Mike Mariathasan (EUI). Macroeconomic theory; monetary policy; financial economics.
- Diaa Noureldin (Nuffield). Econometric theory; financial econometrics; volatility models.
- Vitaliy Oryshchenko (Cambridge). Econometric theory; non-parametric econometrics; applied econometrics.

2011 sees the departure of a number of long-standing members of the department. Antoni Chawluk is retiring; Albert Park is leaving to take-up a Chair at the University of Science and Technology, Hong Kong; Victoria Prowse is moving to an assistant professorship at Cornell University, Chris Wallace is moving to a Chair at the University of Leicester; and it is with great sadness that we report the death in July 2011 after a long illness of Mark Rogers, Economics Fellow of Harris Manchester College. We are grateful to all of them for their many contributions to Economics at Oxford over the years and offer those moving on to new challenges our very best wishes for the future.