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PART 2 – Book Review

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Dear Readers,

Welcome to the fifth volume of the Norwich Economic Papers for the 2011-12 Academic Year. The Norwich Economic Papers is an academic journal that aims to showcase the best work produced by the School of Economics, providing a platform for our students to demonstrate their economic insight and academic aptitude.

Firstly, I would like to thank your continued support of the Norwich Economic Papers. This past year, we saw a significant increase in readership and participation – most notably in the 2011-12 School of Economics Essay Competition – and we have our readers to thank. We anticipate seeing greater student involvement for 2012.

The Norwich Economic Papers is proud to present in our fifth volume, the winning entries of the 2011-12 School of Economics Essay Competition. Competition this year has been intense and our winners were chosen after much deliberation. This year, we have given out a large number of prizes to the best essays – our top essays having awarded a cash prize of £1,000 each. The topics of this year’s competition have been central to contemporary economics, drawing relevance between theoretical economics and the real world. The academic value of our winning entries has most definitely reflected the level of excellence advocated at the University of East Anglia. Additionally, this volume will feature one of our esteemed alumni, James Hutchins, as he shares with us his professional profile beyond academia at UEA.

For the forthcoming editions, the NEP would value your input. If you have had work experience, either in a graduate or professional role, or as an intern, the NEP will gladly remunerate you for sharing your experiences. In addition, the NEP will be launching a book review section, where we invite you all to write reviews of books – the best of which will be awarded a cash prize and will be published in subsequent editions. For the first time, the NEP is also requesting for reviews of CEI lectures. Again, suitable reviews will be remunerated. If you have a suitable article for the Norwich Economic Papers, please e-mail us at s.schmitt@uea.ac.uk.

I hope that you enjoy reading this edition of the NEP as much as we enjoy bringing it to you. I wish you all the best in your upcoming examinations and every success in the year ahead.

Tan Jun Jie. Associate Editor.
Discuss the benefits and detriments of micro finance in emerging markets.
First Prize – 1st Year Undergraduate Category

CAL CORKERY*

Introduction

In recent years microfinance has been heralded as the development Holy Grail, providing a growth path for emerging markets that is both sustainable and progressive. The basic idea is that the provision of financial services to the millions of people in developing countries who are currently without access will empower these people to create jobs and services thus lifting themselves out of poverty and becoming incorporated into the economies of emerging markets. Microfinance can occur in three forms: microcredit, micro-insurance and micro-savings. For the purposes of this essay I will focus solely on microcredit as the other two forms are substantially less prevalent in emerging markets and as such play only minor roles in the debate surrounding microfinance. Three of the main alleged benefits of microfinance in emerging markets will be discussed firstly: poverty reduction, the ability to become self-sustaining and the empowerment of women. The aim of this essay is to argue that none of these supposed benefits stand up to the evidence and in fact microfinance has on aggregate had detrimental effects in emerging markets.

Poverty reduction

The reduction of poverty in emerging markets is an important step towards their continued economic development. Poverty prevents labour being utilised efficiently and therefore the reduction of poverty brings with it a more efficient utilisation of one of the key factors of production, thus leading to long term economic development and growth. Microfinance reduces poverty by allowing the poor to start or expand income-generating microenterprises such as a stall selling fruit or handmade clothing (Johnson and Rogaly, 1997: 11). These income generating microenterprises

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provide the poor with a regular source of income which they would otherwise be without. This income creation effect lifts the poor out of poverty thus producing positive effects in emerging markets. However this is based on the assumption that microfinance is used for the purposes on income-generating activities. This assumption is brought into question by studies such as the one undertaken by Aminur Rahman which found that up to 70 per cent of the microloans sampled were used not for the creation or expansion of microenterprises but for other uses such as consumption (Rahman, 1999: 106). Such findings seriously undermine the argument that microfinance provides a sustainable path out of poverty for the poor in emerging markets.

**A self-sustaining development policy**

Prior to the rise of microfinance there had been a greater emphasis on aid as a development policy. There is rarely, if ever at all, any return on aid spending so more and more funding is continually required to keep aid programmes going. A reliance on foreign aid is often said to have been one of the major barriers to development in emerging markets (Asante, 1985: 265) and therefore if microfinance is able to minimise such reliance then it provides a clear benefit in emerging markets. One of the main reasons microfinance gained popularity in the international development sector was its alleged ability to become self-sustaining. The argument was that once microfinance institutions received their initial start-up capital they could then use the microcredit repayments to fund further loans and running costs. This assumes of course high repayment rates and the ability for microfinance institutions to lend at interest rates which cover their costs. These assumptions have proven to be optimistic at best, leading to the situation where ‘of the 10,000 MFIs currently estimated to be operating in the world, only 3-5 per cent will become financially self-sustaining.’ (Bateman, 2010: 59). With such low proportions of microfinance institutions estimated to become self-sustaining the argument that microfinance is a benefit to emerging markets is again undermined.

**Women’s empowerment**

Women have often been the subject of discrimination and marginalisation in developing countries. This means that potentially up to half the labour force is not being properly utilised which is an inefficient use of valuable factors of production. This will consequently have negative consequences for the prospects of economic growth in emerging markets. Many microfinance institutions prioritise women as clients because they believe them to produce higher repayment rates, spend the loan more efficiently and are more likely to share the benefits with their families and communities. This prioritisation is said to empower women to be liberated from male dominance (Faraizi, Rahman and
McAllister, 2011: 10) through their ability to gain financial independence and increased social standing. This has been regarded as one of the most significant and important benefits of microfinance in emerging markets as evidenced by the press release for the 2006 Nobel Prize won by Muhammad Yunus and Grameen Bank for their work on microfinance which stated that “Microcredit has proved to be an important liberating force in societies where women in particular have to struggle against repressive social and economic conditions. Economic growth and political democracy can not achieve their full potential unless the female half of humanity participates on an equal footing with the male.” (Nobel Prize, 2006).

However it has been proven that women often lose control of the loan to their husbands but nevertheless retain responsibility for its repayment (Goetz and Sen Gupta, 1996: 55) thus their microloans do not become sources of empowerment but rather act so as to further marginalise and disadvantage the recipients. Worse still evidence has emerged that social violence and public humiliation have been used in Bangladesh against women who have been unable to keep up with repayments (Karim, 2008), further calling into question just how much of a benefit microfinance has been for women in emerging markets. This point is well summarised by Linda Mayoux when she states “Unless microfinance is conceived as part of a broader strategy for transformation of gender inequality, it risks becoming yet one more means of shifting the costs and responsibilities for development onto very poor women’ (Mayoux, 2002: 80). Thus in theory microfinance does appear to be able to offer empowerment to women in the developing world, however upon analysis of the evidence it appears that it has not been the case in reality. In fact in some cases microfinance has actually been shown to actively disempower women leading to a less efficient utilisation of a valuable resource (human capital/labour) in emerging markets.

Displacement

Displacement effects occur when jobs and incomes in non-client microenterprises (the individuals and firms not receiving microfinance) are negatively impacted upon as a result of the entrance into the market of client microenterprises (the individuals and firms receiving microfinance). There are two main reasons for this. The first is that market entry or firm expansion may only be achieved through the reduction in market share previously held by the incumbent firm(s). The second is that market entry or firm expansion will lead to downward pressure on prices and wages caused by increased supply.
Figure 1 shows the response to an increase in supply of microenterprises. Here demand is assumed to be relatively price inelastic. The demand for the kind of goods or services produced by microenterprises (e.g. hairdressing) in emerging markets is not likely to fluctuate much in relation to small changes in the price of those goods or services. As a result of the increase in supply from $s_1$ to $s_2$ employment and output have increased slightly from $E_1$ to $E_2$ however that has been more than offset by a much larger decrease in prices and wages from $P_1$ to $P_2$. Here it is obvious that the increase in supply of microenterprises has had no overall positive effect due to the large downward pressure it has caused on wages.

The majority of the supposed benefits of microfinance in emerging markets rest on the assumption that there are no significant displacement effects, however there is evidence to suggest otherwise. In *Planet of Slums* Mike Davis argues that the doubling in supply of microenterprises in Latin America during the 1980s and 1990s was matched with significant increases in poverty and deprivation and that the explanation for this was that ‘space for new entrants is provided only by a diminution (sic) of per capita earning capacities and/or by the intensification of labor despite declining marginal returns.’ (Davis, 2006: 182). Thus microfinance does not increase overall levels of output or employment but rather redistributes existing levels between new entrants and incumbents resulting in lower incomes across the board which is only going to entrench poverty resulting in a detriment to emerging markets. The microfinance industry can be seen to have fallen victim to the ‘fallacy of composition’ flaw in that it ‘is wrongly inferring that something is true of the whole – microfinance must create additional jobs and incomes in the community – based on the fact that it is true for part of the whole – microfinance can create additional jobs and incomes in one client microfinance.’ (Bateman, 2010: 66).
Economies of scale

A crucial factor in sustainable economic development is for firms to realise economies of scale, which is the reduction in unit costs resulting from increased output. This ensures low cost production and vitally the ability to accumulate a surplus which can then be used for the purposes of investment. Microfinance is predominantly used to fund the creation or small scale expansion of microenterprises which inherently are too small to reach minimum efficient scale. An example of this is the agriculture sector which has traditionally been regarded as an important source of development in emerging markets. The types of firm which are best able to reach minimum efficient scale have been said to be small family farms (Pretty, 1999), however microfinance is of no use to these types of firms as the amounts available to borrow are insufficient for their needs and more aimed at smaller scale producers who are less able to realise economies of scale. Thus a focus on microfinance, as opposed to a focus on providing funds to SMEs more capable of realising economies of scale can be seen as a barrier to sustainable development in emerging markets.

Informalisation

The microfinance model channels funding to the informal sector: the part of the economy that is not taxed or monitored by government due to its activities taking place on a small, informal scale. With the massive expansion of microfinance has come the expansion of the informal sector in emerging markets. This process of informalisation allows informal firms, who do not have to pay tax or comply with industry and employment legislation, to gain a cost advantage over formal firms who do have to pay tax and comply with relevant legislation. This allows the informal firms to compete artificially despite operating on a much less efficient scale meaning that the more productive and efficient formal firms are prevented from gaining the market share they would otherwise achieve, resulting in a ‘negative impact on economic growth and job creation.’ (Farrell, 2004: 28).

With the expansion of the informal sector larger firms in emerging markets have been able to move away from a supply chain consisting of SMEs with unionised work forces towards a supply chain consisting of non-unionised microenterprises thus drastically reducing their production costs. They have also been able to minimise any social responsibility they owe towards their supply chains as in the informal sector there is no employment or health and safety legislation to protect the workforce (Rainnie, 1989). Thus the growth of the informal sector associated with microfinance can be seen to cause microenterprises to ‘crowd out’ more efficient and productive larger firms as well as reduce
wages and labour rights all of which is detrimental to the prospects of sustainable growth in emerging markets.

**Industrialisation**

Development economists such as Erik Reinert have argued that one of the most significant factors behind the superior relative economic development of Western economies has been their embrace of industrialisation through the adoption of policies which encouraged industrial firms (Reinert, 2007: 57). Microfinance however in its attempts to maximise profits over short periods tends to encourage microenterprises that are engaged in simple retail operations as opposed to complex industrial firms which may be less profitable in the short term but lay the foundations for long term economic growth. This point is well made by the American economist William Baumol who argues that successful entrepreneurial activity is not necessarily conducive to the long term health of the economy, it depends what form the entrepreneurial activity takes (Baumol, 1990: 918). This again links back to the argument mentioned earlier, made by Bateman, that the concept of microfinance as a development policy in emerging markets falls victim to the ‘fallacy of composition’ flaw whereby the short term success of individual microenterprises are taken to equate to long term sustainable economic growth even though it is clear that this is not the case. In fact as shown here with the example of non-industrial micro enterprises microfinance can be seen to have a detrimental effect in emerging markets through its focus on short terms profits as opposed to long term development.

**Conclusion**

It has been shown how there is strong evidence to reject claims that microfinance has had any significant impact upon: poverty reduction, the levels of economic activity and the empowerment of women in emerging markets. In fact often the complete opposite has proven to be the case. Not only has microfinance failed to produce the benefits it promised but it can be seen to be playing an active part in the prevention of sustainable development in emerging markets. The influx of microenterprises into local markets has acted so as to displace incumbent firms resulting in downward pressure on prices and wages further entrenching poverty. Microenterprises also systematically fail to reach economies of scale and appropriate the limited finance available in emerging markets that would better be aimed at SMEs capable of achieving minimum efficient scale. The rapid expansion of the informal sector associated with the increased provision of microfinance has acted so as to subsidise inefficient firms and reduce worker’s wages and employment rights. Perhaps most significantly the idea of long term sustainable development in emerging markets through the provision of microfinance forgets how Western economies became so powerful and
encourages a situation where the value and benefit of industrialisation is not properly realised. Far from being the development Holy Grail microfinance has brought about a situation where emerging markets are being led away from a path of sustainable growth by microfinance providers and government institutions keen to make short term profits and provide a quick fix respectively, neither of which is good news for developing economies and emerging markets.
Bibliography


Is nationalisation of banks ever justified?
Second Prize – 1st Year Undergraduate Category

LEWIS ROBINSON*

Introduction

The financial crisis of 2008 onwards saw unprecedented pressure on our banking system. The free market model, reliant on liquidity and trade between banks and other financial institutions, broke down and the potential consequences on the ‘real economy’ were painfully obvious. In some ways, it was a perfect storm; as with most big crashes, the years prior were characterised by excessive confidence, overleveraging (both by financials, non-financials and households) and a sense of immunity to the pitfalls of our economic past. Gordon Brown, previously Prime Minister and Chancellor, is perhaps best quoted as an example of this hubris when he famously said, among many other variations, “we will not return to boom and bust”.¹ He was hardly a lone figure in this regard, though; it is a truism in life that things are only obvious in hindsight.

Background

Given the rather exceptional economic circumstances the world is currently experiencing, then, it seems logical to begin any discussion on bank nationalisation with a review of the recent crisis. It is not without some irony that a macroeconomic event of this magnitude generates so much new data relevant to the understanding and development of economic theory; indeed, studying the nationalisation of banks in much of the last 20 years would have been a much less interesting task.

The main thrust of the reasoning for nationalisation of banks, by both the governments² directly responsible and most economic thinkers³ comes from the perspective of financial stability. The interconnectedness of our financial sector, it is argued, means that a weakness in any link in the

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² BBC News, 2008 “B&B Nationalisation is Confirmed” [http://bbc.in/w8tGT2](http://bbc.in/w8tGT2)

³ NY Times (Krugman) 2009, “Banking on the Brink” [http://nyti.ms/wbJ2L](http://nyti.ms/wbJ2L)
chain risks undermining the whole system. This is patently not an outcome desirable for any of the stakeholders in banks; a group which encompasses more or less the whole of society. One easy way of graphically illustrating this interconnectedness is by looking at the equity markets, as in Figure 1 below, which plots the share price of 3 of the largest UK banks.

![Graph of share prices](image)

**Figure 1: Share price of LLOY, RBS, BARC - Jan '05 to Apr '09. Data not adjusted for dilution.**

It should be obvious to any casual observer that, at least in the eyes of the equity markets (largely driven by multinational, institutional investors) the fates of our banks are very closely entwined. As with much of economics, there are a multitude of other explanatory factors for such correlation – perhaps the causality is faulty, and the causal factor is actually a decline in the wider macroeconomy. That is almost certainly true. Perhaps asset markets are simply over correlated, either intra-sectorally or between broad asset classes. This is also an opinion gaining some traction. Even so, such co-ordinated downward runs, to such a low multiple of the previous price level - and earnings or book value, two common investing measures - must indicate some sort of fear for the long-term future of the banks in question, and seems to imply a great deal of interdependence. It is difficult to justify such low valuations using any sort of model without inputting either a significant - certainly non-zero - chance of business failure, large capital raising from the equity markets (signifying financial duress) or many years of losses.

Still, for those not masochistic enough to enjoy deriving any sort of logic from stock markets, they were by no means the only group in a state of fear about the financial system. A more familiar
example of the complete collapse of confidence when banking stability is in question drove the extraordinary measures of early 2008, as Northern Rock found itself needing support from the Government. Mile-long queues of customers trying to withdraw their savings – despite assurances by the FSA that their money was guaranteed – contributed to the liquidity squeeze on the bank that finally led to state ownership. In this sense, the cyclicality of the whole situation is clear – in both bank funding markets (viewed in terms of LIBOR rates) and the more traditional method of customer deposits, weakness begets further weakness. Perceptions of Northern Rock’s instability brought about mass withdrawal of savings and an increase in their borrowing costs. The prophecy of failure was self-fulfilling.

Northern Rock was, by all accounts, just a herald of what was to come. Bradford & Bingley in September 2008 preceded the colossal state intervention a month later, when the Government essentially nationalised RBS and Lloyds/HBOS. It should be noted that Lloyds and HBOS at this point were not the merged entity they are today – that was a deal waved through at the behest of the Government to supposedly shore up their balance sheets and maintain financial stability. The success or otherwise of that is left entirely up to reader, but at least some small regard should be given to the competitiveness of a sector now dominated by a firm with 30% share of the personal current account market.⁴

The UK Story

The situation the UK currently finds itself in, then, is a position of some historical note. The Government still holds significant amounts of the equity of both Lloyds (~40%) and RBS (~82%), as well as parts of the previously held Bradford and Bingley and Northern Rock.

The UK’s banks are, by most measures, now rather safe. The European Banking Authority, who publish yearly stress tests, found all UK banks passing their most recent requirements. Their measure of resilience – the core tier 1 capital ratio – could perhaps best be described as looking at the amount of lending and speculative activity, taking into account the relative risk of those activities (hence generating risk-weighted assets) and comparing it with the equity base - core tier 1 capital - of the bank. A higher ratio is obviously better, and Figure 2 shows that both RBS and Lloyds performed better than the median EU bank in the stress testing results.

Both banks passed the main, forward looking element of the test, too. This imposed a number of negative macroeconomic outcomes on the Eurozone, which naturally filters through to the balance sheets of banks, and sought to determine whether or not they would have sufficient tier one capital to absorb the shocks. The potency (or otherwise) of their ‘adverse’ scenario and the strenuousness of the tests make ample material for a further discussion, but suffice to say 8 banks of the 90 in the sample did not pass as Lloyds and RBS did.

Considerable emphasis is placed by the boards of both banks on derisking the balance sheet, though whether this is directly related to nationalisation or not is debatable. Certainly, it is hardly just Lloyds and RBS whose management make noises in that direction – the market is simply responding to the wishes of shareholders, money managers and ‘the city’ in general.

Having ensured our banks and financial system are safe – or, at least, as safe as can be given a rather shaky currency union as our neighbour and a volatile global environment as the backdrop, the UK Government has received little credit for their actions. Indeed, most of the focus is on whether the ‘investments’ will realise a paper loss. This hardly seems rational.

The Bigger Picture

The simple fact of it is that bank nationalisation falls prey to exactly the same problem as much of mainstream economics – the absence of the counterfactual. What we would love to do, as economists and rational thinkers, is take two identical banks at the onset of the crisis, nationalise one and leave the other to the whims of the free market.
Unfortunately, this idea crumbles at every level. It is practically and politically impossible to conduct such an experiment, a hopelessly naïve concept to hope to find two ‘identical’ banks and obviously morally rather questionable. One thing that any debate absolutely must involve, though, is a proper understanding of the alternatives. Much of the tabloid press, as I have already mentioned, focuses on how the taxpayer has ‘lost out’ on its investment in RBS and Lloyds. They note how the share price has plummeted, reducing the apparent value of the holdings, and grumbling in typical media style about how the taxpayer is somehow swindled by devious market participants.

This engenders a negative feeling towards the nationalisation by many people. But this should not be so. Judging the success or otherwise of a nationalisation by the paper profit the Government earns upon exiting the position is much like making the assertion that building hospitals is not worthwhile, because the market value of the hospitals does not give the Government a decent return on capital. It is patently absurd. The point of building hospitals is not to incur a profit on the buildings, it is to treat sick people. The point of nationalising the banks was not because the Government hankered after the city lifestyle of a fund manager for a few years, and saw the opportunity for a quick buck – it was to shore up financial stability.

Figure 2: EBA 2011 Bank Stress Test; current core tier 1 capital ratio; RBS (left) Lloyds (right) highlighted. Source: EBA
Any discussion on the merits of nationalisation should take things as they were in 2008, then, in the middle of a catastrophic drop in confidence both in the markets and on the street. The simple fact of that analysis is that it is difficult to envisage any scenario whereby a bank should be left to fail. We should be under no illusions about white knights and market heroes – the British Government were the only institution big enough to bail out the failing banks. Furthermore, given the amount of money pumped into them, it should be obvious that the need was very much there. Recall that that particular ‘crisis’ was the hangover of reduced confidence caused by the subprime implosion. The Euro area woes of 2 years later were not just some small aftershock to the system – they were another sledgehammer to the foundations of the European banking system. One should be under no illusions that RBS and Lloyds would’ve managed to limp through without severely damaging the entire UK financial system.

One should also not be under the illusion that a bank failure is ‘not a big thing’. Kupiee and Ramirez⁵, 2009, studied the early 20th Century banking situation in America; their data suggested that:

“… a 0.14 percent (1 standard deviation) increase from the mean value of the liabilities of the failed depository institutions results in a reduction of 17 percentage points in the growth rate of industrial production and a 4 percentage point decline in real GNP growth. The reductions occur within three quarters of the initial bank failure shock and can be interpreted as an important component of the cost of systemic risk in the banking sector.”

Grossman’s study⁶ on the New Banking era starting in the mid-19th Century asserts that:

“Simulations suggest that a relatively small bank failure shock could lead to a 2% decline in real GNP, while the consequences of a large bank failure shock – a one-fifth decline in GNP – could be catastrophic.”

And while the temptation may be to disregard these analyses as out of date and not relevant to the modern economy, there is a convincing case that exactly the opposite is true. Banks today face, paradoxically, both far more competition and far less than they used to. Thinking globally, there are often local monopolies – Lloyds in the UK would be a neat example of this. Even though that may be the case, banking has become a worldwide activity – a UK bank’s competitors are as much J P Morgan and Société Générale as RBS and Barclays. The reasons for this are manifold, but the core of

the issue is that economic efficiency dictates it. Scale efficiencies create monopolies in financial services, and the ever-blurring lines between investment and retail banking hardly help this.

Far from the old analysis being irrelevant, it is even more pertinent today. The chain has far fewer links and each link is more integral to the whole structure. Short-termist thinking – and not just by the demonised bankers – incentivises an arms race, whereby it makes sense for banks to leverage their assets more and more to increase returns for shareholders.

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**A Societal Problem**

It is an attractive and easy option for politicians to pin the blame on city types. They are an easy target – anyone who earns a lot is – and have been rather hindered by a few notable individuals throughout history acting with slightly less decorum or understanding than may otherwise be warranted.

It is a gross oversimplification to say that bankers caused the crisis, though. The Government debt issue, which is as much a problem as financial sector stability, was no fault of the bankers – that was short-termism on the part of politicians and, more fundamentally, ordinary people. It seems unlikely a party would have rode to power in the boom days of the 2000s on a pledge of fiscal prudence and no more expenditure hikes.

Equally, most people understand that markets need regulation, yet bankers managed to increasingly shake off state influence. Blaming the institutions for this is foolish – it is the mechanism of the markets to try and maximise returns for their shareholders. They did entirely as should have been expected of them. That the regulatory regime was not up to scratch is not their fault.

It strikes me, then, as not only wholly justifiable to nationalise the banks but wholly predictable, too. Humans did as they have done for hundreds of years, through the tulip boom of the 1600s to the Great Depression – they became overconfident in the promise of perpetual growth and did not see the risk of failure just around the corner. Markets mirror the human psyche, and that overconfidence fed through to the actions of our banks. They are not the all-seeing, perfectly calculating beasts that the free marketeers see them as – they are (in a rather theological way) created in our image, and fall prey to the same cognitive biases we do.

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**Looking Forward**

If nationalisation is justified, then, one must make some sort of statement about what is to be done with the nationalised banks. Surely, it seems, we should use the market power the Government now
has at its fingertips to improve conditions for the UK as a whole – to repair some of the damage they caused, if you will.

A common demand is for the Government to take a more activist role as shareholder of the nationalised banks\(^7\), and to direct investment spending to bolster the wider economy – a national investment bank, as it is often referred to. This is an approach which represents a startling lack of foresight.

After all, if one were to look for what could best be described as the ‘root cause’ of the 2008 global downturn, most fingers point at the subprime crisis in America. Underpinning that particular mess was an incentive structure entirely of the state variety – two state run lenders being forced by Congress to lend more. In fact, in a twist that should’ve been obvious as deeply damaging in the long run, in 1996 Congress gave a target to Fannie Mae and Freddie Mac that 42% of their mortgage lending went to borrowers with income below the median in their area. In 2000 this became 50%, and in 2005 this became 52%.\(^8\) This is one of many of the incentive structures designed to push lending to those who the market had deemed too risky to lend to.

If bank risk taking is a case of market failure, then, the above is surely just as potent a case of government failure. Government is in no position to direct investment spending. It may appear attractive in the short run, and is probably beneficial to GDP growth – but misdirected capital only serves to stoke the fires of a future bust.

The arms-length model the Government is adopting, then, seems best placed to minimise government interference in the market while ensuring financial stability. UKFI, the holding company responsible for managing the investments, is said to act like a “any value orientated shareholder”\(^9\). In addition, the Government’s decision to ‘partly nationalise’ - crucially leaving a small amount of the share capital as free float on the market to maintain a market price and market direction also seems logical and conducive to the aim of returning these businesses to private hands in the near future.

### Concluding Thoughts

By most measures, then, nationalisation seems to have been successful. The direct question of whether nationalisation is ever ‘justified’, then, follows from this – hopefully I have served to persuade that few cost-benefit analyses a government ever makes offer as potent a benefit (staving off financial catastrophe) with so little cost (investment, most of which will later be paid back).

The best scenario of all, of course, is the situation whereby banks never need to be nationalised, preventing the damaging moral hazard and ‘too big to fail’ mentality from distorting markets and hampering innovation and competition in financial services. This is something which requires rather extensive regulation on a global level. The likelihood of such legislation ever being agreed by all parties seems, sadly, rather low – it is a classic prisoners’ dilemma whereby cooperation benefits all, but the cost of imposing regulation on your own financial sector is enormous if others do not.

Regardless of sad reflections on human incentives, then, the UK Government response to the 08 – present financial crisis was decisive, well thought-out and, crucially, market-orientated. The firms are very much still private, with the efficiency that brings and without the government’s distortionary influence.

That strikes me as making the best of a bad situation – nationalisation is not merely justified, but earns my whole-hearted support.
What are the impacts of an international migration quota?

Third Prize – 1\textsuperscript{st} Year Undergraduate Category

JOSH MCINTYRE*

Abstract

The UK already has strict migration guidelines in place, but with the Conservative Government wanting to reduce net migration in the UK from 250,000 in the year to June 2011 to ‘tens of thousands’ before the end of the current government. What could the economic impacts be of a strict migration quota? And what might happen if that quota was increased or abolished?

Before examining the impact of a migration quota, it is important to first think about why people migrate between countries in the first place. Opportunity differentials between the sending and the receiving countries are a key reason as migrants believe the country they are going to can provide them with something which the country they are leaving cannot. Push and pull factors are used to categorise reasons for migration which may include the offer of a job or education, family, safety or simply happiness. This question is particularly relevant at this moment in time with the UK government’s targets for net migration to be in the ‘tens of thousands’ before the end of the current government in 2015. This would mean a huge fall in the number of immigrants entering the UK.

However, the UK has very little control over much of its migration. Emigration figures are currently falling and the government is powerless in this area as it clearly cannot force or incentivise people to emigrate from the UK. Additionally, the UK cannot control immigration from within the EU. This leaves immigrants from outside the EU as the only variable they can

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control. In this essay it will be discussed whether it is desirable to or not. The current system in the UK splits potential immigrants into different categories; there are workers who are assumed to be split into skilled and non-skilled workers for simplicity, students coming to the UK to study and people for non-economic gains including family members and dependants.

Ideally, the limit for any migration would simply be set at the point where marginal cost is equal to marginal benefit, where the economic and social cost of an additional migrant is equal to the marginal benefit. More simply, the marginal net benefit is zero. However as with many things in economics, it is very difficult to estimate and put a comparable value on the costs and benefits on a migrant and this value would vary with each migrant considered. On the graph, this would mean admitting X number of migrants, with a selection process designed to admit those in area Y. As this is very difficult or impossible, it is important to instead look at the effect on the economy of changing the different areas of migration.

Source: British Immigration Policy and Work Lecture, Slide 11
The most common reason for migration with over 40% of the total number of migrations to the UK was full time education\textsuperscript{10}, mostly university and college courses, and that figure is set to rise even further with applications from international, non EU, students increasing by 13.7% for 2012 intake\textsuperscript{11}. These students are of vital importance to the UK, as education is a hugely lucrative export market in which UK sits second, behind only the US\textsuperscript{12}, in the most popular destinations for foreign students. A migration quota resulting in a fall in students and therefore exports would, ceteris paribus, mean a fall in GDP, as looking at the simplest expenditure method of calculating GDP:

$$\text{GDP} = C + I + G + (X-M)$$

A fall in X would result in a fall in GDP because international students are a huge contributor to the GDP of the UK. Not only do they have much greater fees than home students, on average £11,435 per year in 2010/11 compared to just £3,323 for home students,\textsuperscript{13} but they also consume goods and services during their stay in the country. An important fact to note however, that many of these students, upon completion of their course, will return to their country of origin. Therefore, although the IPS, the Identity and Passport Service, definition of long term migration is that of more than one year, it is clear many will not become permanent residents of the UK. The ones who do however may stay on to fulfil graduate level roles and therefore become skilled workers in the economy, the impact of which will be considered later. These facts have led many people to argue that students should be excluded from migration statistics, however opposition claim that student visas are an easy way into the UK to work and that many apparent ‘students’ in fact go missing.

The reduction in the number of skilled workers into the country could result in increased unemployment, as there would be vacancies for jobs which UK or EU nationals do not possess the skills for, which without a quota would be filled by foreign workers. This structural unemployment would mean that firstly, there would be a fall in output as companies would not be able to recruit people to fulfil their needs and could mean they relocate to somewhere that they are allowed to recruit the right people for their job. Secondly, the government would have to invest heavily in training and education so that in the future people do have the right skills for the jobs available, if it was the case that workers couldn’t be brought in from abroad. It is evident that skilled workers contribute to growth and productivity.

\textsuperscript{10} Migration Statistics Quarterly Report February 2012
\textsuperscript{11} UCAS Release
\textsuperscript{12} Universities feel the squeeze on immigration
\textsuperscript{13} Tuition fees 2010/11: find out how much each university charges
If a quota reduces the number of unskilled workers, this will mean a reduction in the supply of labour. Simple market economics will tell us that if there is a fall in supply, without an equivalent fall in demand, then wage rate will increase and there will be a fall in employment. ‘Lower levels of net migration will, all else equal, reduce the growth rate of the potential labour supply and therefore the rate of growth of overall GDP.’\(^{14}\) It could also result in illegal trafficking of people into the country. If this happens, these people will not be holding citizenship and therefore will not be able to work legally and not paying taxes on their income if they have one. This would result in a fall in GDP and a possible increase in crime.

If there was a stricter limit on the number of dependants such as children and spouses allowed to join people already living in the UK, this could cause massive controversy. In addition, this may impact the UK’s ability to recruit highly skilled workers or academics as they would be unable to bring their loved ones or dependants with them to the UK. Consequently, they may consider relocating to somewhere they would be able to or not immigrating at all. It is unlikely that it would affect GDP if these were decreased as there are already guidelines in place to stop these people becoming a burden to the government as the sponsor of them must be able to show ability to support them by the way of a minimum income threshold. ‘The minimum income threshold for sponsoring spouses/partners and dependants in order to ensure that the sponsor can support his/her spouse or civil or other partner and any dependants independently without them becoming a burden on the State’.\(^{15}\)

However it is also very important to look at the impacts of not having a quota, or having a very high one. The graph below shows the projected population growth based on different levels on migration to the UK.

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\(^{14}\) Migration Advisory Committee (2012) Page 33  
\(^{15}\) Migration Advisory Committee (2012) Page 15
As demonstrated in this graph, even if net migration were to be significantly lower than it currently is at 180,000, then the population would still reach 70 million within around 15 years. There are many social impacts that should be considered with reference to an increasing population. If there are more people in a country, they will clearly put more strain on the services of that country, such as healthcare, education and other public goods. They will also contribute to congestion, especially as studies have shown many migrants will be located in and around large cities which already suffer from congestion problems. There may also be an impact on crime rates and on the housing market as the demand for properties will increase if population increases.

If the quota for students is increased, it is assumed that the entry requirements would be reduced or the visa application may be less strict. This may result in more people claiming to be students to easily obtain a visa, coming into the country to work in unskilled jobs, clearly undesirable. However if there are more students allowed into the country, this will increase GDP through an increase in exports. GDP will further increase through the domestic consumption of goods and services as already mentioned.

Skilled workers raise the GDP of the country by bringing in extra revenue, paying extra taxes and consuming many goods and services. At present, there is a minimum salary in place before a worker is allowed to take up a job within the UK, unless that job is deemed to be an occupation with a shortage of workers. This minimum salary is above the national average salary and set to be increased to £35000 in coming years,\(^\text{16}\) this means they will raise GDP per capita. Looked at very

\(^{16}\) BBC News (2012)
simply, one could conclude that skilled migration should be increased indefinitely so long as the incoming migrant has a salary above a certain threshold, until marginal wage is equal to average wage. However, an increase in GDP is not an indicator of the overall living standards of that country and the total size of an economy is not an index of prosperity. GDP per capita, as already mentioned, will increase because the migrant will have to have a high income, it will not necessarily change the average income for the population already there. Previous studies show that ‘gross domestic product will increase, but this increase will accrue largely to immigrants in the form of wages’.\textsuperscript{17} However as already noted there are social costs to infinitely increasing a population, so this rests on the assumption that the benefits of the increased GDP will more than cover the costs.

It is assumed that if the population increases, this will automatically increase unemployment as these people will have no jobs to fulfil. This is the lump of labour fallacy; the aggregate number of jobs is not fixed, therefore if the population increases this will increase aggregate demand thus increasing the number of jobs in the economy. However, ‘the annual volume of immigration is inversely related to the average wages of unskilled workers’.\textsuperscript{18} The graph below demonstrates this, if the supply of labour increases without an equivalent increase in demand, wage rate will decrease from $W_1$ to $W_2$. This is the market wage rate for anyone in the unskilled jobs market, and not just the wage rate for immigrant workers; which will mean UK workers would be displeased.

\textsuperscript{17} Roodenburg et al Page 7  
\textsuperscript{18} Hix, S. And Noury, A. Page 184-185
To look at the effects of allowing an increase in the number of dependants or family members allowed into the UK would firstly depend on whether they would become a burden on the state. As already discussed, the rules at the moment say that the sponsor must show the ability to look after them. Providing this remains the case, these migrants should not affect the GDP of the country through an increase in transfer payments. However it is the case that, like with any increase in the population, there will be an increased strain on public services. There would also be an increase in aggregate demand as they will consume things. It may also be the case that these dependants could become workers themselves, leading to an increase in the labour supply, and as already seen, that could lower the wage rate.

Due to the length and brevity of this essay, it solely focuses on the impacts of immigration and simply to receiving country, only one aspect of the vast topic of migration. There are also many impacts on sending countries such as brain drains, etc, and many interesting debates on the impact on UK workers and wage rates and displacement of those workers with contrasting conclusions from different studies. However, it is clear to see, that immigration is desirable, however only if controlled in the correct ways. The aging demographics of most European countries means that in the years to come these countries will need more migrants who will raise the GDP of these countries if controlled properly. However they will bring many other benefits besides just increases in revenue; one only has to walk around a university campus or city centre to see many foreign people. They bring different ways of thinking about life and education which are very important.
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Other

How can we stimulate growth in the UK economy?
First Prize – 2nd Year Undergraduate Category

OLLIE LEE† AND TRISTAN JOSE‡

“The Governor of the Bank shows himself perfect happy in the spectacle of a Britain possessing the finest credit in the world simultaneously with a million and a quarter unemployed” – Winston Churchill, January 1925

Abstract
Taking a simple Aggregate Demand (AD) equation, we use public data to plot changes in the identities that comprise AD. We find that government spending has been the most resilient component of AD since 2007, which we interpret as an a posteriori case for fiscal expansion as an effective policy. We organise our fiscal stimulus into three groups, from our most preferred (spend more) to the least contentious (cut later). Our AD analysis also shows that the component that has performed the most poorly since 2007 is investment and it is this that informs our argument for expanding the use of monetary policy and supply side measures.

Introduction
This essay examines proposals for stimulating economic growth in the UK economy. For four years growth in the UK has been negative or weak. There is no shortage of discussion on the causes of recession; our attention is solely on how to increase economic growth.

The case for stimulus is to increase employment, and the path to this is to increase demand. We set out proposals for stimulating demand using fiscal and monetary policy. We briefly examine supply-side measures effective in the short-run.

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The Nature of the Problem: Weak Demand

The financial crisis that began in 2007 led to a recession in 2008-9 that saw economic growth in the UK to fall for four consecutive quarters. Four years after the start of the recession, GDP remains 4% lower than its 2007 peak (ONS, 2012).

The relationship between employment and growth can be said to run in both directions: employment-led growth, and growth-led employment. At the time of writing, (February 2012), the UK unemployment rate is currently at a 17 year high of 8.4% (HM Treasury, 2012). Employment has fallen in the public and private sector as a result of policy in the former and demand deficiency in the latter.

We emphasize the human impact of unemployment and the large negative effect it has on life satisfaction. Economists are well aware of the classical trade-off between inflation and unemployment. However, the Bank of England’s remit to priority to inflation targeting demonstrates how the unemployment issue is (at least formally) a secondary concern. Insights from behavioural economics and studies on life satisfaction demonstrate that the negative impact of unemployment on happiness is more than twice that of inflation, as shown in Figure 1.
Figure 1: Life Satisfaction

<table>
<thead>
<tr>
<th>Variables</th>
<th>Unemployment</th>
<th>Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life Satisfaction</td>
<td>-2.8</td>
<td>-1.2</td>
</tr>
</tbody>
</table>

(Tella, MacCulloch and Oswald, 2001)

With life satisfaction rated on a ten-point scale, Figure 1 shows that a one percentage point increase in unemployment will lead to a fall in life satisfaction of 2.8, whereas a one percentage point increase in inflation will only lead to a fall in life satisfaction of 1.2 (Tella, MacCulloch and Oswald, 2001). Having described the recent recession and unemployment we analyse some of the components of GDP.

Figure 3: AD Identities

\[ GDP = AD = C + I + G + (X - M) \]

Below we plot data that are analogous with the AD identities in the above table.

Figure 4: GDP components since Q1 2007 (Q1 2007 = 100)
Household final consumption expenditure (analogous to Consumption, $C$) fell with the recession and has stagnated since. Growth potential of $C$ is limited by low consumer confidence and by consumers de-leveraging.

Net exports ($X-M$) fell during the recession but favourable currency changes have allowed a rise almost to pre-recessionary levels. Sterling depreciated by 25% against the Dollar and Euro, to which we attribute much of the improvement in net exports (Historical Statistics, 2012).

General Government final consumption expenditure ($G$) has increased quarter-on-quarter since the recession. Up to now this has mostly been traditional, counter-cyclical spending. We will set out the case for an expansion beyond the usual automatic stabilisers to full stimulus.

Gross fixed capital formation (a proxy for Investment, $I$) has fallen more than 16 percentage points with the recession and stagnated since (Bank of England, 2012). Confidence is low, a lot of investment is being deferred, and firms have not yet completed the de-leveraging cycle. Investment is the component of AD that has performed the most poorly relative to GDP; it is this that informs our supply-side suggestions.

**Examining Debt: The Case for a Medium-term Increase in Debt**

We believe that fiscal policy can increase demand, and that increased demand would increase employment. Viewed within our AD/AS model, current fiscal policy is contractionary and left unchanged will not help stimulate growth or employment in the short or medium term. We therefore advocate a fiscal expansion financed by debt. We discuss debt before we outline proposals for fiscal expansion.

There are two popular views that form the prevailing counter argument to a debt increase. The first is that debt is too expensive; the second is that the UK is at its debt limit. The first view is simple to refute. We argue that the current low cost of borrowing makes a debt increase attractive. We strengthen this view by citing recent Government analysis showing that increased bond yields would not significantly alter the UK’s budget position. The second view can be challenged with evidence that the UK has not reached its debt limit, that it possesses adequate “fiscal space” (Ostry, Ghosh, Kim, and Qureshi, 2010).
The Low Cost of UK Government Debt and Implications for Policy

The yield on Gilts is lower than at any time since the 19th Century; in real terms the Government is able to borrow at negative interest rates. We believe that this is a greatly convincing case for debt-financing fiscal expansion. The prevailing counter argument (and the stated view of the chancellor) is that Gilt yields are low because the commitment to austerity has convinced investors that the UK is a safe haven; reversing or slowing austerity plans would alarm the markets and the yield on Gilts would increase. Moreover, it is frequently claimed that the UK would lose its AAA credit-rating.

We believe that the ‘safe haven’ argument holds some weight, but this is also true of most other developed economies with their own non-Euro currency, who have all seen a ‘flight-to-quality’ as the Sovereign Debt crisis has continued. With respect to the UK’s credit rating, there are numerous historical examples of countries being downgraded by ratings agencies and then seeing bond yields fall: Japan in the 1990s, and the US (Wall street Journal, 2011) and France within the last twelve months (Bloomberg, 2012). We believe that the UK’s risk of default is virtually nil, and so low yields are unlikely to be completely dependent on debt reduction. Rather, we believe they reflect the perceived weak growth potential of the UK.

It is possible to circumvent this argument. The Office for Budgetary Responsibility published its ‘Economic and Fiscal Outlook’ in November 2011 (OBR, 2011). The report models the effect of increased yields on the Government’s debt position, and finds that even a 150 basis point increase in yields only has the effect of decreasing the 2016-17 budget balance by 70 basis points. The report states that:

“...Shocks to gilt rates have a relatively small impact on the chances of meeting the mandate and supplementary target. This is because an increase in rates only applies to new debt issuance, and the UK has a relatively long average debt maturity for conventional gilts of 131/2 years, and because new issuance is projected to fall as borrowing declines. Therefore over a short horizon, such as our five-year forecasting period, the impact of a shock to the average nominal rate on gilts is relatively small.”

We interpret this as compelling evidence that a medium term increase in Government debt is not unaffordable, as frequently argued. We now challenge the view that the UK is at its debt limit.
The Scope for Additional Debt: Adequate Fiscal Space

A working paper from the IMF defined fiscal space as “the distance between current debt ratios and the corresponding debt limit”, and the authors provide the data shown in Figure 6 (Vox EU, 2012).

The paper’s authors stress that the values given should not be interpreted too literally. Commenting on the paper, Jonathan Portes, Director of the National Institute of Economic and Social Research, says that while the UK’s fiscal space does not rank highly in comparison to other economies, the UK still belongs in the group of countries that possesses adequate room to expand fiscally in the short and medium term (Portes, 2012); the time-frames in which we have set our stimulus proposals. However, ‘fiscal space’ is somewhat conceptual, so we intend for it to be considered as supplementary to our first-order argument that the low price of debt should allow for more borrowing. Combined, this evidence forms the basis of our case for fiscal expansion.
Stimulating the Economy with Debt-financed Fiscal Expansion

Government spending is the only AD identity we list that is growing at a rate greater than GDP; to the extent that the UK has experienced recovery from recession, the recovery has been led by sustained Government spending (ONS, 2012).  

We begin our discussion on public expenditure by looking at the Government’s calculated fiscal multipliers for different policies: their effectiveness. We then look at different levels of total spending: the direction of overall policy.

The Effectiveness of Policy: Fiscal Multipliers

Figure 6: Fiscal Multipliers

<table>
<thead>
<tr>
<th>Table C8: Estimates of fiscal multipliers</th>
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</thead>
<tbody>
<tr>
<td>Change in VAT rate</td>
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<tr>
<td>Changes in the personal tax allowance and National Insurance Contributions (NICS)</td>
</tr>
<tr>
<td>AME welfare measures</td>
</tr>
<tr>
<td>Implied Resource Departmental Expenditure Limits (RDEL)</td>
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<tr>
<td>Implied Capital Departmental Expenditure Limits (CDEL)</td>
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</tbody>
</table>

Figure 6 lists the OBR estimates for the fiscal multipliers of different policies. The last three require elaboration. “AME [Annually Managed Expenditure] welfare measures” represents benefit payments. “RDEL” is Resource DEL [Departmental Expenditure Limits], while “CDEL” is Capital DEL. RDEL is made up of “current expenditure such as pay, allowances, and running costs”. CDEL is “New investment in equipment and infrastructure that has a life over more than one financial year” (Budget, 2010). In these estimates RDEL and CDEL have the greatest multiplier effects, we interpret this in a broad sense as “efficiency” of policies, and these feature in our proposals for fiscal expansion.

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19 At the time of writing, government spending has reached new highs and the announced austerity program has yet to deliver reductions in total Public expenditure. Whichever position one takes on the effect of austerity, it is not the primary cause of the recessionary pressures that exist right now in the UK economy (Gemmell, 2011).
The Direction of Policy

With regards to expenditure all governments face three choices: spend more, carry on spending at the same level, or reduce spending. We identify the first ('spend more') as our preferred option, and we make a case where this could be achieved with increased infrastructure spending.

In the short-term capital spending offers the chance to increase demand and employment simultaneously, particularly the construction sector has declined precipitously since the recession. In the medium-term capital spending has the strongest impact multiplier, as described above. In the long-term, infrastructure improvements improve the economy’s supply capacity (an inherently good thing).

Our second most preferred option is 'carry on spending'. Our simple AD/AS model would predict that a fall in Government Spending (G), *ceterus paribus*, would cause AD to decrease. We believe this outcome is especially dangerous because G, as stated, has helped mitigate the weak demand in the private sector since 2008. Our logic says that until the other components of GDP return to their pre-recession peak, it is premature to cut G. More concretely: private sector job creation has been unable to offset job losses in the public sector, so reducing public sector employment is to contribute to total unemployment (Peppes, A, Robinson, M and Wei, 2011)
One perennial criticism using capital spending to fight recession is that time lags reduce the effectiveness: too few projects are “shovel ready” and so stimulus arrives too late (Boyer, 2012). Krugman, blogging specifically on the effects of austerity in the US, offers the view that simply resuming previous levels of local and state government spending would significantly reduce unemployment (Krugman, 2012). Applying a similar logic to the UK (unlike Krugman’s example, we make no provision for population growth) we see that total Public Sector employment has fallen by 414,000 since its post-recession peak. The data we use extends to Q3 2011, at which point the Claimant Count was 2.64 million; these Public Sector job losses represent 15% of this (BBC, 2012). As stated above, departmental spending has an impact multiplier of 0.6, which is why we prefer this policy to tax cuts of the same magnitude.

Our least preferred option is ‘cut later’. Though our least preferred, this policy would appear to be the least contentious in the political reality of 2012. Blogging in his capacity as the Chief Economist at the IMF, Olivier Blanchard offered “Ten commandments for fiscal adjustment in advanced economies” (Blanchard 2010). One of these ‘commandments’ is particularly pertinent for our argument to cut later: “you shall not front-load your fiscal adjustment”. If one accepts the UK Government’s case for deficit reduction, but agrees with our case for debt affordability, then our AD/AS model allows the interpretation that the economy would receive some stimulus the cuts were implemented more gradually and evenly.
Stimulus by Monetary Policy: Targeting Growth within a simple Taylor Rule

Monetary policy is typically loosened in a recessionary environment. Interest rates have been at 0.5% since March 2009, and as such policy is at the ‘zero-lower-bound’ (Bank of England, 2012). At the lower-bound it is not possible to lower interest rates to increase the money supply, and so the Bank must use unconventional methods to inject money into the economy (Woodford, 2011).

We believe that the conventional and unconventional policy responses of the Bank have been sensible and have helped growth during and since the recession. Within the ‘rules of the game’ of monetary policy, the Bank has responded correctly. We advocate changing those rules to allow a larger (and still correct) response.

We can assume that, formally or informally the Bank uses some form of Taylor Rule. The two principal features of any standard Taylor Rule are inflation and the output gap. The output gap is a proxy for unemployment of resources (including but not limited to labour). We believe that the best chance for Monetary Policy to stimulate the economy is for the Bank to place less emphasis on inflation and more emphasis on the output gap. We advocate an expansion of QE – expansion in money terms and in the range of assets purchased.

Supply Side Measures: increasing Investment by encouraging lending to SMEs

Supply side improvements are the key to sustaining growth, but growth needs to be stimulated before it can be sustained. GDP is 4% below its 2007 peak. We believe that this is not because the UK’s capacity to supply goods and services has fallen by 4%, but because there is inadequate demand for goods and services. We single out one supply-side policy as critical to stimulating UK growth within our expressed time period: increasing bank lending to small and medium sized enterprises (SMEs). The prima facie case for this is set out in our AD/AS analysis that showed Investment is the weakest component of GDP. We recognise two causes for this: some companies are choosing not to invest, while some others that want to cannot obtain the funds to do so. Both of these are the effect of a balance sheet recession: those companies not investing are repairing their balance sheets; and a lack of funds for other companies is a result of banks repairing their balance sheets. We identify the second cause, ‘cannot obtain funds’ as requiring Government action; and we are supportive of current policy on this issue. Bank lending turns savings into investment, and it is this process that has stalled, as shown in Figure 7.
Net lending in fell quarter on quarter in 2011, prompting the Government to launch 'Project Merlin', with the aim of making banks increase their lending to SMEs (HM Treasury, 2011). The banks made gross new loans (to businesses of all sizes) of £214.9bn against a target that they were set of £190bn. However, they failed to meet the lending target for SMEs (£74.9bn against the £76bn target) and there is to be no repeat of project Merlin this year (BBC News, 2012). Instead the Chancellor is proposing a £20 billion credit easing national loan guarantee, which will cover loans and overdrafts to businesses with a turnover of less than £50 million for the next two years. It is hoped that this will reduce interest rates, making it easier for businesses to borrow. At a general level we support current policy because believe that Government action increases the likelihood of SMEs receiving more lending, increasing Investment and stimulating growth. But at a more specific level we observe shortfalls in Government policy. More needs to be done to instil confidence in the businesses that are choosing not to invest; banks can be made to commit to lending more, but if businesses do not seek funding then the stimulus potential of Project Merlin et cetera is diminished.

Conclusion

We conclude that in order to stimulate growth in the UK economy, a number of different policy options have to be combined as a stimulus package. These policies fall under monetary, fiscal and supply side improvements. We argue that interest rates should be held, Quantitative Easing should be increased and fiscal policy should be expanded with debt-financing. Our monetary policy is aimed
in the same direction as that of the Bank of England, though we believe that relaxing its inflation target would allow an increase in asset purchases that would be sufficiently great to provide stimulus.

We believe that fiscal policy can increase demand, and that increased demand would increase employment. Our AD/AS model shows that current fiscal policy is contradictory and left unchanged will not help stimulate growth or employment in the short or medium term. We advocate a fiscal expansion financed by debt. We conclude that the UK’s debt position does not impede such expansion: the price of debt is low and global demand for low risk assets is high. While the UK’s debt-to-GDP ratio is higher than before the recession (and the case for lowering this in the long term is compelling) it is still lower than in many OECD countries: the UK has adequate fiscal space to debt-finance government spending increases in the medium term.

In our AD/AS model our proxy for investment is the most depressed component. The link between savings and investment is made in the banking sector, and we identify inadequate bank lending to SMEs as harming investment and therefore growth. Our advocated supply-side policy is for the Government to apply more pressure on banks to increase lending.
References


Are we capable of being altruistic?
Second Prize – 2nd Year Undergraduate Category

TOM JORDAN*

Altruism is a social preference defined by unconditional kindness. That is, people benefiting their peers regardless of their own problems, material concerns, and in certain cases incomplete information of the recipient of such charity. Contrary to this uplifting ideal, it has been argued that people abide by more limited and self motivated rules, either in not donating at all, or in the donating for ‘selfish’ payoffs. It is paramount to consider firstly whether people act charitably in the first place, regardless of underlying motive. Following on from this, we also need to consider whether this apparently charitable nature translates into altruism or whether there is some other motivation.

The impact of charitable behaviour alone in modern society is a convincing sign for its prevalence alone, with the massive economic impacts of charity noticeable even without statistical analysis. Numerous acts of goodwill transpire both on a minor scale (e.g. donating to the homeless) and nationwide, such as mass events “Comic Relief” and “Red Nose Day” (the latter of which earned over £74 million in 2011), not to mention government aid also.

Andreoni (2001) in particular comments on the impact that charity has on the American economy.

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He notes that philanthropic action consisted of around 2% of GDP consistently in the period 1970-2000, and individuals managed to donate a staggering $134.8 billion in 1998. The well publicised actions of individuals such as Bill Gates – having given $28 billion of his wealth away in 2007 - and events such as the aforementioned reiterate what seems like a consistently strong sense of goodwill. For the UK, the Charities Aid Foundation show that UK adult contributions are consistently just under 60%, which is a considerable proportion of the population:

These observations clearly indicate that for a certain amount of the public there is worth seen in donating, and furthermore consumption preferences are not simply denoted by personal wealth. It also brings to attention the surprising lack of charitable behaviour within conventional economic theory. Certainly, standard economics would endorse full self-regard, which the above statistics dispute. Partly, this can be attributed to the lack of a two-way physical exchange between
individuals, leading to unclear material costs and payoffs to both parties, as Boulding (1962) elaborates. Due to this, there is limited tangible evidence to soundly analyse altruism without considering the social preference in terms of utility.

This ambiguity means altruism can take many contestable forms, although all with the same ultimate objective. Formally, I shall classify altruism in 3 main ways:

(i) Paternalistic altruism, measuring physically quantifiable wealth (e.g. income, physical wellbeing), therefore being a welfare judgement made under universal standards of taste and preference ordering.

(ii) Non-paternalistic altruism, which considers welfare subject to the beneficiaries’ preference ordering i.e. their utility function of physically quantifiable wealth, is measured. This measurement is therefore more representative of the ‘mental’ or subjective wealth of a person.

(iii) ‘Warm glow’ altruism – a fixed amount of satisfaction is derived from the input of doing a good deed. Proportional wealth is not of significance compared to the deed itself.

The following utility functions sum up these forms of altruistic tendency contrasted to the traditional rational act of increasing one’s own wealth, in a two people economy (person A and B) for simplicity.

(i)  \( U_A = u_1(X_A) + \alpha \times u_2(X_B) \)

(ii)  \( U_A = u_1(X_A) + \alpha \times u_2(U_B) \)

\( U_i \) represents person i’s overall utility, \( X_i \) their wealth, and \( u_\alpha(\ldots) \) utility functions. \( \alpha \) is a positive weighing of altruistic tendency. The higher \( \alpha \) is, the more altruistic individual A is in this case.

(iii)  \( U_A = u_1(X_A) + \Pi \)
Where $\Pi$ represents a fixed “warm glow” as a reward if altruistic behaviour occurs.

These functions show more clearly a trade off between the utility derived from benefiting oneself, or benefiting another. This trade-off is much the same as any normal 'consumer's problem'. A person with a fixed income has the ability to give away earnings in good faith to potentially increase his own utility. In a sense, charity has become a good. There is no reason to deny this, although the question still remains what the nature of the utility derived from charity is, which I shall later address.

These functions can further be analysed in a very simple two person economy through the Edgeworth box as exhibited by Boulding (1962) and Collard (1975). Persons A and B consume two necessities, food and clothes. Self motivated individuals have a utility function strictly convex to the origin with respect to the goods they consume. However altruism creates a satiation point in consumption which is determined by the relative wealth of the other person. Monotonicity (more is better) doesn’t apply, as a rich person A will feel bad for their counterparts’ lack of wealth as he increases his own. The indifference curves form contour-like concentric circles as a result, as an altruist would be indifferent between high wealth for themselves and high wealth for another and all variations in between:
The above diagram is also a clear visualisation for the trade off we may face in real life between high personal wealth and assisting others. As with the initial utility functions, this seems more in tune with real life decisions than pure self regard. We often find situations in which moral judgements stop of us from being fully selfish i.e. a satiation point.

An issue with the above however is the uncertainty and possible sub-optimality of resource allocation. Collard (1975) details “The Shrinking Theorem”. That is, the outer limits of the contract curve in the above Edgeworth box (the function of all Pareto optimal and therefore mutually fair allocations) move closer as the altruism coefficients of person’s A and B, α and β respectively,
converge on 1. At \( \alpha=\beta=1 \) the contract curve becomes a point, the coinciding of identical utility functions. Here, altruistic distribution is both fair and certain. Despite this, real life allocation is anything but certain, let alone fair. This would appear to imply that by the above theory, altruistic coefficients are in fact quite low, at best.

An additionally concerning matter is that utility is not an empirical proof of altruism. Complete knowledge of preference orderings and cardinal utilities is unknown, and so it is hard to predict charitable behaviour in terms of utility functions. Utility and thus altruistic tendencies also vary interpersonally and over time. People may be kind, but not necessarily all the time, or perhaps never. Even for paternalistic utility, it is still difficult to measure the extent to which “warm glow” is experienced by a donor. There will always be a matter of opinion, and it also makes the functions prone to overfitting, giving the fluctuation and lack of precision.

There is also the issue of infinite recursion if non-paternalistic utilities are interdependent. If one person is happy, this may make another person happy; this in turn will make the original person happier and so on until both people have infinite utility in theory. The only real life solution to this is that altruism has diminishing returns based on happiness - the happier a person is, the less you care about them - which an unconditionally charitable person shouldn’t possess. This would imply an element of spite, which I shall shortly examine. Given the above, there is no evidence to say whether altruism is part of the consumer’s choice, or an inconsistent bias added into utility theory arbitrarily.

Besides this, there is still some theoretical ground above for explaining the observational evidence of charitable deeds. There are however other contestable preferences to keep in mind that may negate unconditional kindness and place this kindness elsewhere. These predominantly include self-motivation, reciprocity, competitive preference, as well as the upholding of social norms.
As I stated, economics assumes self-regard. While behavioural economics convincingly denies this assumption, there are still cases of selfishness that need to be considered. Primarily there is the problem of free-riding, which leads to James Buchanan’s “Samaritan’s dilemma” (De Wispelaere, 2004). This states that when somebody attempts to aid another person, the person being aided has no incentive to help themselves since they know they are going to be helped out anyway. This could be seen in any cooperation problem involving moral hazard, from inactive community members, to international aid. The governments of countries being supported financially have little incentive to develop efficiently knowing that altruistic nations wish to bail them out. Hence the political corruption in countries such as the DRC, Sudan etc. In a similar way, a welfare trap develops if money provided by the ‘benevolent’ government is better suited than minimum wage employment.

Reciprocal behaviour is also important to take note of. Reciprocity entails that unkindness is reacted to unkindly and kind behaviour kindly. Therefore ‘altruistic’ actions will in theory lead to more friendly actions, but only because the original person was kind. This is conditional goodwill.

Falk (2007) investigated reciprocity through a study into donations to a charity by 10,000 individuals, where the charity gave a third of people small gifts, and another third large gifts. Altruistic groups would all donate in large numbers to increase their utility regardless of gifts. However, as shown below each group responds differently to the study. The kinder the charity is in the gifts they send out, the more people reciprocate by donating back.

<p>| TABLE 1 |
| DONATION PATTERNS IN ALL TREATMENT CONDITIONS |</p>
<table>
<thead>
<tr>
<th>No Gift</th>
<th>Small Gift</th>
<th>Large Gift</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of solicitation letters</td>
<td>3,262</td>
<td>3,237</td>
</tr>
<tr>
<td>Number of donations</td>
<td>397</td>
<td>465</td>
</tr>
<tr>
<td>Relative frequency of donations</td>
<td>0.12</td>
<td>0.14</td>
</tr>
</tbody>
</table>

Fig 3: Evidence of reciprocal behaviour (Falk, 2007)
This fact would appear to be critical of the notion of unconditional kindness, instead implying that charitable acts are conditional. Obviously we would not expect appearances to make a difference under altruism. People appear to instead be influenced by petty characteristics. It also implies we will reciprocate kind behaviour, which could then be misinterpreted as altruism itself. The example of charity events such as those mentioned earlier could in a sense be successful due to the factor of their entertainment. People ‘pay’ for the entertainment in a similar way to any other good being rewarded, as we feel bad for not rewarding television produced in part for our enjoyment.

What causes this behaviour though? Another study into the behaviour of restaurant consumers by Tidd and Lochard (1978) showed that smiling waitresses tend to get better tips than those who are less friendly, implying a possible psychological aspect to kind activity. Besides this though, such behaviour could be enforced by social norms. People may only be kind for fear of social exclusion, which boils down to self-regard for their own acceptance. If I help a friend at my own expense, it may be so that I am not judged, and additionally my friend will also positively reciprocate towards me in the future when I may need a favour. If not donating to a cause is seen as socially unacceptable, I would be obliged to donate. The same could be said for government aid, if they do not help out other countries, this may damage their status on the international platform. Likewise, strong aid ties will encourage reciprocity in trade agreements. A neighbourhood watch scheme could involve social ties between friendly locals, but beyond this, some of the involved parties may care only for their own safety with a safer neighbourhood being a positive externality. No kind act can reasonably be seen as purely altruistic if there are social rewards and punishments to take into account. That is an inevitability of being integrated within social surroundings.

And to add to the complexity, people are also by nature competitive. That is, there is distaste for those relatively better off. While small donations to the impoverished will not alter your position significantly in terms of wealth, it can be said that a competitive character will not donate to those in need richer than him in most cases; which contravenes the unconditional nature of altruism again.
Interestingly, Andreoni (1990) calculates evidence of a diminishing relationship between one’s own income and altruistic tendency - $\alpha$ (with the anomaly of the incredibly rich). This does little justice for the above utility functions which would suggest altruism increases with the budget constraint, as per an optimisation problem. Instead, it implies that people become more self-regarding with income, and perhaps more competitive. If they want to maintain their relative status more and more, they will disregard the gap between themselves and those worse off more in order to achieve this.

It would appear very possible that these different combinations of preferences write off much of the evidence for charity we have seen up to this point. However convincing utility functions may be, there seems to be a strong likelihood that ‘altruists’ are in fact affected by their society and the people they are trying to help, and that they will rationally be processing future payoffs for themselves for such activity. In particular, social norms and the encouragement to reciprocate are very convincing alternative notions that may cause people to account for the welfare of others.

Finally, taking these preferences to an even deeper level, there is the contestable theory of “psychological egoism” to deal with. Batson and Shaw (1991) openly set up the argument here, stating this idea proposes that the ultimate goal of such ‘selfless’ behaviour is in fact the self satisfaction or reward of being charitable, with the charity in itself being an intermediate step to achieve this. This idea can manifest in different ways.

Firstly there can be some explicit material or social payoff for altruistic behaviour. Material gains such as a prize or reward for donating, or the aforementioned reciprocal behaviour initiated in the person benefited, could easily shift the incentives of an individual if such prizes were expected. Acceptance among society – the aforementioned social norms – is an example of a non-physical, but still essentially highly motivational gain. The fact that good behaviour could be exploited to stimulate
a good outcome doesn’t just prove the existence of a reciprocal society, but also that people are aware of its implications.

One step further, the benefits of altruism may be purely egoistic and not even material in gains. It may be that someone in distress directly causes you discomfort, and therefore while your actions help this someone in need, the primary motive is to remove your own personal discomfort. This could explain the success of advertising campaigns such as those which display causes to end poverty, cancer etc. despite not providing an entertainment value like charity pledges.

Additionally, helping someone boosts one’s own self-regard and allows them to feel good for being kind. This can particularly be seen in the “warm glow” equation which does not even consider the other person’s wealth or utility, but just the personal payoff that an ‘altruist’ receives. It also again shows altruism as a market transaction, making helpful actions a good which provides utility - however this utility is entirely your own satisfaction. Altruism of the above varieties can be formally labelled as “impure” in contrast to altruism that is pure in intention.

In investigating this “impure” altruism Andreoni (1990) found significant empirical evidence for a lack of indifference between donating yourself and a government donating towards a privately funded public good. This firstly implies that government funding and subsidies do not entirely crowd out individual investments in charity – as is often the case in real life, given the prominence of many individual philanthropists. More importantly this finding entails that people care not just about welfare regardless of who stimulates it, but also that they personally set of this mechanism for egoistic purposes. People indulge in donating.

The difficulty as a whole with criticising this theory is that the expected utility functions remain the same whether you are an advocate of altruism or of psychological egoism. The difference is instead in the interpretation of these functions. Altruist advocates would say that people genuinely care for welfare besides their own, as exhibited in the equation, while psychological egoists would argue that
the utility of others is simply included in the equation as it has some psychological or material effect on the individual as part of an intermediary psychological effect. However given the prevalence of other preferences on top of this, it is highly convincing to consider that motivations are impure, one way of another.

What can be concluded from the above is that charitable behaviour is something a large amount of us are capable of. This much cannot be denied given the overwhelming statistical evidence presented at the beginning of this essay. The main question is whether such behaviour is purely altruistic, or has impure biases towards other social preferences - and on top of this is a psychologically selfish stepping stone towards self satisfaction. Given the lack of solid evidence for incorporating altruism into utility functions, and the prevalence of other social biases, it would appear impossible to consider altruism in a pure sense a capable human preference. Even without social pressures, the concept of psychological egoism fully negates any chance of selfless intentions.
Bibliography


How can we simulate growth in the UK economy?
Third Prize – 2nd Year Undergraduate Category

JOE HANSON*

UK unemployment rates are currently at an all time high since the recession in the 1990s\(^{20}\) and interest rates are at 0.5\(^{\circ}\)\(^{21}\); these are common signs of an economy that is stagnating or in a recession. The UK economy shrank 2\(\%\) in the fourth quarter of 2011\(^{22}\), and it is predicted that it will shrink again in the following quarter. Two consecutive quarters of economic contraction will mean that the UK economy has officially re-entered a recession.

Decreasing interest rates, as shown in an ISLM model (Figure 1), will promote economic growth leading to lower unemployment. Central Banks lower the short-term nominal interest rate through open-market purchases of bonds or other securities, which in-turn increase the supply of bank reserves putting downward pressure on the market clearance rate. Once interest rates get close to zero this form of monetary policy is no longer effective because nominal interest rates must not be lowered below zero. If interest rates were less than zero firms would have no incentive to lend money. This is because no firm will lend £100 if they don’t get at least £100 returned; the firm would be losing money by lending. In order to stimulate the economy other policies must be implemented.

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\(^{21}\) [http://www.bankofengland.co.uk/](http://www.bankofengland.co.uk/) (accessed 02/03/2012)

In this essay I shall focus on three alternative non-standard monetary policies the Central Bank can use to stimulate aggregate demand, promoting economic growth and reducing unemployment; quantitative easing, policy expectations and the composition of the Central Bank’s balance sheet. These three policies and their effectiveness have been studied in a lot of literature with some varying and interesting results. I will attempt to analyse a portion of this literature, determining the most effective policy for the Central Bank. I will then move on to discuss the use of fiscal policy and mention other possible policies that could be used to prevent nominal interest-rates reaching the zero bound.

**Quantitative Easing (QE)**

Quantitative Easing pumps liquidity into the economy through the purchase of government and corporate bonds. In recent years QE has become a more common policy for Central Banks, Japan being one of the first. QE takes effect in a multitude of ways, of which I shall now discuss.

We make the assumption that money and financial assets are imperfect substitutes. Therefore when there is an increase in the money supply through quantitative easing firms will attempt to rebalance their portfolios, which in turn raise the price of assets and lowers yields, stimulating the economy. Both Keynesians (Brainard & Tobin 1968\(^{23}\), and Tobin 1969\(^{24}\)) and

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\(^{23}\) Brainard, William & James Tobin (May 1968): “Pitfalls in Financial Model Building”

monetarists (Meltzer 2001\textsuperscript{25}) agree with this view and the process is demonstrated in a paper written by Andres, Lopez-Salido and Nelson (2003)\textsuperscript{26}.

A second possible transition for quantitative easing is the fiscal channel. It assumes that if the Central Bank injects enough money into the economy it will relieve the government’s fiscal strain, enabling them to reduce taxes or increase government expenditure without increasing the public holdings of government debt. Auerbach and Obstfeld (2003)\textsuperscript{27} conclude that fiscal relief can have substantial effects on improving welfare. However, they did note ‘Entrenched price expectations surely are a barrier to policy success in Japan’. The underlying factor determining the effectiveness of the fiscal channel is the credibility of the Central Bank. If firms believe the decrease in taxes is only temporary and will be repaid in future tax increases then the firm policy will become much more inefficient. Both points raised in this paper highlight the importance of public expectations and the credibility of the Central Bank, something I will discuss later in more detail.

The final channel of quantitative easing that I shall discuss is referred to as ‘signal channeling’. If the public sector can see physical evidence of the Central Bank liquidity injections, it complements expectations. I don’t wish to focus on this channel as it is hard to prove any correlations due to the copious amount of external factors that interfere.

Eggertsson, Gauti & Michael Woodford (2003)\textsuperscript{28} doubt the effectiveness of quantitative easing, they believe a frictionless market where fiscal and monetary policies are separated, QE will have no effect. They make two strong and unlikely assumptions, but they demonstrate that the effectiveness of QE depends on frictions within markets. They conclude their analysis stating, if QE proves ineffective through normal channels it still may have positive effects on the economy through expectations management complementing the Central Bank’s policy. This brings me onto the next potential policy Central Banks should consider; policy expectations.

**Shaping Policy Expectations**

The importance of shaping policy expectations has been highlighted in many papers, most notably Eggertsson, Gauti & Michael Woodford (2003). They believe that this is in fact the only tool policymakers have. They focus particularly on advising Central Banks to commit to a policy rule. However, designing policy rules can be difficult, they must function effectively in all cyclical states of

\textsuperscript{25} Meltzer, Allan (2001): “Monetary Transmission at Low Inflation: Some Clues from Japan in the 1990s” \\
\textsuperscript{26} Andres, Javier & J. David Lopez-Salido & Edward Nelson (2004): “Tobin’s Imperfect Asset Substitution in Optimizing General Equilibrium.” \\
\textsuperscript{27} Auerbach, Alan & Maurice Obstfeld (April 2003): “The Case for Open-Market Purchases in a Liquidity Trap” \\
\textsuperscript{28} Eggertsson, Gauti & Michael Woodford (2003): “The Zero Bound on Interest Rates and Optimal Monetary Policy”
the economy and there are often political constraints. Bernanke, Ben & Vincent Reinhart & Brain Sack\textsuperscript{29} (pp. 11) believe lowering interest-rate expectations by making a commitment to policy rules ‘...if credible and not previously expected, should lower longer-term rates, support other asset prices, and boost aggregate demand.’ Kohn, Donald & Brain Sack\textsuperscript{30} (pp. 28) complement Eggertsson & Woodford and both determine Central Bank statements and policy actions shape expectations and ‘should be viewed as a vital component of the monetary policy process.’

One issue that arrives within these papers is the lack of benchmark data, there is no information to show what yields would have been without Japan’s Zero Interest Rate Policy (ZIRP). However Baba et al. (2005)\textsuperscript{31} solve this problem by using a model to determine Japanese yields at each given date under each set of circumstances. Their results showed larger net effects on long-term yields and emphasised the importance of the Japanese Central Bank’s commitment to rules. They also draw attention to the increased effects of policy expectations when nominal interest rates are close to zero. Shaping public expectations through communication is a useful tool for any Central Bank, however it is crucial that the Central Bank maintains its credibility, otherwise any attempts to change long-term rates will be in vain.

**Composition of Central Bank’s Balance Sheet**

The final non-standard monetary policy I shall discuss is changing the composition of the Central Bank’s balance sheet. They are able to buy and sell securities of various maturities, whether it is a few weeks or thirty years, manipulating the supply, and affecting the overall yields. However, there are doubts over the effectiveness of this policy as we assume these assets are substitutes. It is also important to note, as mentioned earlier, that if the market was completely frictionless then this policy would have no effect\textsuperscript{32}.

Bernanke, Reinhart & Sack\textsuperscript{33} note that in reality markets do include a lot of friction and this policy is viable, in theory. Their paper complements classics such as Frankel (1985)\textsuperscript{34} and Friedman (1981)\textsuperscript{35} providing evidence that they are imperfect substitutes. However, another paper by

\textsuperscript{29} Bernanke, Ben & Vincent Reinhart & Brian Sack (2004): “Monetary Policy Alternatives at the Zero Bound – An Empirical Assessment”
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Bernanke & Reinhart (2004) uses a model to determine changes in yields based on changes in the composition of the balance sheet. The paper concludes that even with substantial changes we would only see small effects on the yield.

We have now discussed three of the main non-standard monetary policies the Central Bank may use when the manipulation of nominal short term interest rates is no longer possible. Throughout the analysis of each policy a reoccurring theme has been the emphasis placed on the credibility of the Central Bank, and I believe this to be one of the determinant factors dictating the effectiveness of each of these policies, particularly the shaping of public expectations. I will now discuss the fiscal tools available to the government and comment on the effectiveness and recent implementation in times where nominal rates are close to zero.

**Fiscal Policy**

The liquidity trap occurs when quantitative easing fails to lower interest rates and stimulate economic growth. When firms and individuals have little confidence in the economy they chose not to lend or spend their incomes. This process can be demonstrated in Figure 2; an increase in the money supply has led to no change in economic growth or interest rates, however a shift in the IS curve causes an increase in economic growth whilst interest rates remain the same.

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36 Bernanke, Ben & Vincent Reinhart (January 2004): “Conducting Monetary Policy at Very Low Short-Term Interest Rates”
This demonstrates that fiscal expansion can be a very effective policy where a liquidity trap occurs as long as the cost of government borrowing is not too high that the costs outweigh the benefits. The UK currently has a debt equal to approximately 76% of its GDP\footnote{http://www.ons.gov.uk/ons/rel/psa/eu-government-debt-and-deficit-returns/september-2011/stb---september-2011.html}. As a result its fiscal stance is somewhat compromised by this huge debt, as it cannot continue to borrow, this limits the effectiveness of fiscal policy.

Fiscal policy has inherent time-lags and an emphasis is usually placed on the use of automatic stabilisers, which have little lag. In recent times USA and the UK have used fiscal policy to combat the recession. This is because the recession was believed to last a number of years and the lags associated with fiscal policy would be outweighed by the positive effects it would have on the economy.

Normal fiscal lags include formulating a policy, announcing a new policy, introducing the policy, and waiting for the effects to filter through the economy. An example taken from Blanchard, Dell’Ariccia & Mauro\footnote{Blanchard, Olivier & Giovanni Dell’Ariccia & Paolo Mauro (August 2010): “Rethinking Macroeconomic Policy”} (pp. 206) noted that the USA enacted their fiscal stimulus bill over a year after the recession started and ‘less than half of the authorized spending had been spent by the end of 2009.’ This is why automatic fiscal stabilisers are preferred.

Taylor, John (2000)\footnote{Taylor, John (2000): “Reassessing Discretionary Fiscal Policy”} concludes fiscal policy should be left to automatic stabilisers; otherwise it has the potential to conflict with monetary policy decreasing the efficiency of both policies. He believes fiscal policy should only be used if automatic stabilisers aren’t having the necessary effects and there should be clear systematic rules to prevent it interfering with monetary policy. Something interesting to note from this paper is the further emphasis placed on rules and clear policies aiming to increase the transparency of the government and Central Bank, aiding public expectations.

The Ricardian equivalence assumes that governments investing in the economy now will recoup the funds through increase taxes or decreases in expenditure in the future. Firms and consumers recognise this and decide not to adjust their investment/consumption. This means any changes in government expenditure or taxes will have no effect on the economy. Empirical evidence provided by Bernheim (1987)\footnote{Bernheim, Douglas (1987): “Ricardian Equivalence: An Evaluation of Theory and Evidence”} and Feldstein (1988)\footnote{Feldstein, Martin (1986): “The Effects of Fiscal Policies When Incomes are Uncertain: A Contradiction to Ricardian Equivalence”} shows that government deficits stimulate private consumption and the Ricardian equivalence does not hold in practice. However, debt levels
in most developed countries in recent times are very high and substantial discretionary fiscal policy to promote aggregate demand has been limited.

Blanchard, Dell’Ariccia & Mauro (2010) highlight the lack of knowledge governments have over the effects of fiscal policy. There is a general lack of awareness of the appropriate fiscal package and it was demonstrated in the recent recession where we witnessed many different approaches in countries’ fiscal stances.

Prevent Zero Bound Rates in the Future

Before concluding I shall briefly discuss how governments can prevent zero bound nominal interest-rates and provide some useful analysis on preventing the liquidity trap associated with zero bound rates. In a paper provided by Rudebusch (2009) he predicted, using a simple Taylor rule, that the United States should have lowered their rates another 3%-5% past zero. This severely limited the effectiveness of monetary policy and non-standard policies were used as well as fiscal policies. Williams (2009) determines that if there was a higher inflation target, this would lead to higher nominal interest rates. This would allow Central Banks and governments to reduce rates further in times of recession, minimising the reduction in output. He also notes that there should be further regulation of the financial markets to reduce the probability of large shocks like those we witnessed in 2007-2008. However, there are associated costs with higher inflation and this is a difficult policy decision for governments. It becomes an opportunity cost between higher inflation and balancing the risks of possible zero bound interest rates.

Improving the budget deficit during good times will create more space for fiscal policy in times where the economy slows or where monetary policy is becoming ineffective. Fiscal lags indicate that governments should focus on designing new or improving existing fiscal stabilisers.

Summary and Conclusion

Monetary policy has three main tools to promote economic growth when nominal short term interest rates reach the zero bound. Whilst the effectiveness of these policies is debated amongst literature, a reoccurring theme throughout the literature discussed demonstrates that public expectations and the credibility of the Central Bank is an important determinant of the effects non-standard policies will have on economies. The manipulation of public expectations appears to

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42 Blanchard, Olivier & Giovanni Dell’Ariccia & Paolo Mauro (August 2010): “Rethinking Macroeconomic Policy”
be more effective where nominal rates are close to zero, and some believe it is the only policy Central Banks have available to them in these times.

I believe prevention is the best cure. The Bank of England should seek to maintain an appropriate level of inflation so that short-term nominal interest rates remain high enough to maximise the effectiveness of monetary policy when it is called upon. Tougher regulations on the financial industry should help to prevent future shocks or limit the impact they have on the global economy. Further research into the effects of fiscal policy should be undertaken and specific rules should be created so as not to interfere with monetary policy. A suitable buffer zone/reserve should be built in to government budgetary positions to allow for the substantial fiscal policies needed to promote aggregate demand and escape the liquidity trap.

The key to the success of any of the policies discussed within this essay is the Bank of England’s credibility. They must continue to increase transparency through regular and thorough communications with the public through the use of policy rules, and it is paramount that they do not deviate from their rules.
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Are we capable of being altruistic?
First Prize – 3rd Year Undergraduate Category

ALEX HAINES*

“It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own self-interest.” (Smith. A, 1878)

Since the dawn of modern economics we have always assumed individuals to be self-interested, as Adam Smith points out, self-interest is what motivates individuals to participate and contribute to society. However, we observe behaviour in every day life that contradicts this view, so we ask ourselves is self-interest really the only driving force that allows us to contribute to society? Here is where the concept of altruism fits in, the unconditional act of kindness that an individual implements to better those other than themselves. This essay takes a deep look at the concept of altruism and strives to find out whether it exists by looking at how altruism is typically measured by economists, and by looking at a case study of blood donations: an act perceived by many to be altruistic. By doing so, we will discover the most complete answer as to whether we are capable of being altruistic. In section 2 we will look at the definition of altruism, how it fits in with economics and why it is an important concept to consider. Section 3 will consider altruism in the realm of experimental economics. Section 4 will look at a specific case study of altruism, finally section 5 will conclude.

* BSc Economics
2. Defining altruism

The broad concept of altruism is generally known as an unselfish act to benefit others, however this definition can be explored further. Some economists (Jacobsson, 2007) identify a definition of ‘pure altruism,’ whereby an individual derives no gain or even perhaps a decrease in utility to further the utility of others. Impure altruism is where an individual receives some form of utility (‘warm, glow feeling’) from implementing charitable acts. Other theories of altruism that are worth considering are those from the field of sociobiology. The two main theories are kinsman and reciprocity (Becker, 1976), both of which can be defined using economics. Kinsman theory stipulates that people will only be altruistic to those who are very close to them as the utility of these people are closely integrated to their own. Reciprocity theory stipulates that individuals are only altruistic to those who they expect will reciprocate back, therefore an individual’s expected utility of being altruistic is minus the cost of committing an altruistic act, plus the probability of the act being reciprocated. Here we have defined altruism and have given brief notions as to why people are altruistic, but why is altruism an important concept to study?

Altruism is crucial for the development of markets whereby the market fails to allocate resources efficiently assuming self-interest as a predominant motivator. A good example of this is how a deformed irrigation system in Gal, Oyra in Sri Lanka was transformed into “one of the most efficiently and cooperatively managed systems in Sri Lanka” (Francois, 2003, page 2). The project that brought about this change had farmers co-operatively work together to fix and mend canals. This behaviour counteracts what we should expect from the study of economics, as the situation can be easily modeled as a prisoner’s dilemma game and we all know the Nash equilibrium is to not contribute. The project worked because it exploited the farmer’s intrinsic values of being altruistic. This is just one example of how altruism can help further the development of a community.

Taking this into account, when asked the question: are we capable of being altruistic? The answer must surely be an unequivocal yes. However, with the exception of pure altruism in an economic framework, all the other definitions are counter intuitive. For, if the individual derives utility from an ‘altruistic’ act, then the act is not selfless and therefore not altruistic. This is a formality that economists have been trying to overcome for decades: if we are utility maximisers then why would
an individual sacrifice their own utility to further others? Does altruism even exist? In the next section of this essay we try to answer this by looking at how economists try to measure altruism.

3. Altruism in experimental economics

Experimental economics has become a cornerstone in economic theory and is used to explain the behaviour of individuals. It places individuals in different situations and presents them with a series of choices; the choices made are analysed and quantified using game theory and econometrics. A frequently used game within this field used to measure altruism is the ‘gift exchange’ (dictator) game. The game plays out as follows:

There are two subjects A and B. A monetary lump sum (x) is given to player A. Player A is told that he is to split the surplus (x) between himself and player B. Player A can give any sum (0 < a < x) to player B. Player B has no move and must simply accept the offer a. If player B rejects the offer then the whole surplus will simply remain with player A.

This game is interesting with regards to altruism for two reasons. Firstly, as it is a one shot game and the move by player B has no impact on player 1’s utility, there are no strategic elements that can come into play, no guessing what the other player might do. Therefore, we can infer from the results what player A’s true preference is in what they believe the allocation of money should be. Secondly, this game is incredibly simple making its results easy to interpret.

In this game we assume for the rational individual that money equates to utility and that individuals are utility maximisers. With these assumptions held, the game is very simple to solve: one can see that the individual maximizes their utility by offering a donation of zero. Therefore if we observe any donations at all then that donation must be attributed to altruistic behaviour. So how does the game play out in reality?

The dictator game in practice
The literature on dictator games is vast and one will see that in any dictator game there will always be a significant fraction of people giving zero or close to zero, and an insignificant fraction giving a share greater than 50%. As this game is one shot and the players will never meet we can eliminate the giving of any surplus due to reciprocity. From this, we can infer that the sender either receives some form of utility from the amount he gives (impure altruism) or the act is purely selfless (pure altruism).

An interesting experiment relative to altruism is that of Eckel and Grossman (1996). They employ the same dictator game as we have discussed but with a few enhancements. In one treatment the sender (dictator) is given no information regarding the receiver and the receiver is given no information regarding the sender, this is known as double anonymity. In the second game the sender is informed that the receiver is a well-established charity. In both games the sender’s identity is never revealed. Their results are given below:

<table>
<thead>
<tr>
<th>Amount kept</th>
<th>Treatment 1: Anonymous recipient</th>
<th>Treatment 2: Charity recipient</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>23</td>
<td>13</td>
</tr>
<tr>
<td>9</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>8</td>
<td>2</td>
<td>11</td>
</tr>
<tr>
<td>7</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>6</td>
<td>0</td>
<td>8</td>
</tr>
<tr>
<td>5</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>4</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>0</td>
<td>0</td>
<td>5</td>
</tr>
</tbody>
</table>

Source (Eckel and Grossman, 1996, page 5)
As you can see with anonymity \textit{(pooled)} the average amount donated is 10.6\% however when the subject is made aware that the receiver is a charity then the sender’s amount given approximately triples to 30.1\%. This is evidence to support the notion that we are capable of being altruistic. When the sender is made aware that their donation is going to a worthwhile cause they donate more money. As the sender’s identity remains anonymous then we can rule out the possibility of the sender giving money as they felt socially obliged to. From this we can infer that altruism is induced when the individual is aware their actions are contributing to a worthwhile cause. However it is hard to say whether the increase in donations to charity was a purely selfless act, did the participants donate money because it was the right thing to do or was it because they derived utility from what they felt was a selfless act?

Another interesting and relevant experiment comes from (Burnham 2003). In Burnham’s experiment he plays out the simple dictator game under three conditions. In the first condition double anonymity is imposed just like Grossman (1996). In the second condition the sender is given a photograph of the receiver and finally in the third condition the receiver is given a photograph of the sender. The subjects know which treatment they are participating in. The results are given below:

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>US$ 0</th>
<th>US$ 1</th>
<th>US$ 2</th>
<th>US$ 3</th>
<th>US$ 4</th>
<th>US$ 5+</th>
<th>Average (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No photo</td>
<td>26</td>
<td>14</td>
<td>3</td>
<td>4</td>
<td>1</td>
<td>3</td>
<td>1</td>
<td>1.19</td>
</tr>
<tr>
<td>Recipient photo</td>
<td>24</td>
<td>14</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>6</td>
<td>1.96</td>
</tr>
<tr>
<td>Dictator photo</td>
<td>24</td>
<td>13</td>
<td>3</td>
<td>0</td>
<td>2</td>
<td>6</td>
<td></td>
<td>1.71</td>
</tr>
</tbody>
</table>

Source (Burnham 2003, page 7)

As you can see the amount given is correlated to whether or not there is anonymity in the experiment. When there are no photos the sender donates on average 65\% less meaning that anonymity induces selfish behaviour. When there is anonymity we can assume any donations are purely altruistic however when anonymity is taken away subsequent donations made are not purely altruistic. Perhaps when the dictator receives a photo of the recipient then he will feel more obliged to give because with anonymity it was easy for the dictator to assume there was no \textit{real} person to
give to, the photo makes the act of giving money all that more real. When the dictator is aware the recipient has a photo of them then again they feel socially obliged to give. From this we can deduce that we are capable of being altruistic if our deeds don’t go unchecked, therefore we are not motivated by the increased utility of others but by our own selfish needs, is this really altruism?

**How reliable is the dictator game?**

When measuring altruism many academics turn to the dictator game, but just how reliable are the results we see from the dictator game? Papers by Zizzo (2010, 2011) question the use of dictator games as a means of measuring altruism due to what he describes as ‘*Experimenter demand effects*’. These are where the subject’s decision as to what amount to give is not based on his or hers true preference but what they feel the objective of the experiment is or what they feel the experimenter wants them to do. These are especially apparent in the dictator game as it places the participant in a situation they would have never come across before; the sender’s decision is not one found in day-to-day life. So when we observe a sender donating a fraction of the surplus it is hard to tell whether we can attribute this to altruistic behaviour or irrational behaviour induced by experimenter demand effects. Next we move outside the field of experimental economics and take a close look at an act that many perceive to be altruistic, donating blood.

**4. Are blood donations really altruistic?**

So far we have only looked at the concept of altruism through pecuniary measures. The concept of altruism goes far deeper than just money donations therefore when analysing altruism it is necessary to take into account acts that result in no monetary outcome. An act of altruism that is commonly cited is the process of donating blood. In the UK when an individual donates blood they receive no monetary payment for doing so, the donation does not give the donor priorities when it comes to receiving a blood transfusion. In fact the process is rather painful and discomforting, which would lead us to believe that there is negative utility involved in giving blood yet in the UK in 2011 1.6 million people gave blood (Source: [http://www.blood.co.uk/about-blood/](http://www.blood.co.uk/about-blood/)). However was the act of giving blood purely selfless? One reason as to why an individual gives blood is because they receive intrinsic utility from doing so, yet as we have discussed in section 2, this act of impure
altruism is not selfless and should not be considered as altruistic. To prove this point we turn to an interesting study by Lacetera & Marcis (2009). In their study they surveyed 467 blood donors in a small Italian town and asked them whether they would give blood if paid a small monetary sum. The results are given below:

As you can see around 15% of the donors would actually donate less or stop donating if paid a monetary sum. The altruistic ‘feel good feeling’ is valued higher than the monetary payment to some, this is known as intrinsic crowding out. This goes to show that the act of giving blood was not selfless to some, they were not donating to benefit the utility of others but were doing so because they derived utility from committing what seemed a selfless act. The donors that chose to give the same amount of blood may value the intrinsic feeling at the same rate of €10 so we can no longer infer whether their donation is through selfless means. What this study goes to show is that what is apparently an altruistic act can be motivated by selfish means.
5. Conclusion:

“How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.” Smith, A. (1969) page 47

In this essay we have looked at the ways in which altruism is measured and have analysed a common example of what many people perceive to be an altruistic act. In both areas we have shown that what is considered by many to be a simple concept to understand, is an incredibly difficult concept to explain within the realms of economics. One may think of this as a sad finding as it is depressing to think that every action requires an incentive. However, one could argue that economists are being too logical when it comes to the meaning of altruism. In the blood donation example why should it matter whether the act of giving blood was selfless? The end result is just as fruitful. Therefore when answering the question are we capable of being altruistic? We should infer two things:

1) Are we capable of acting selflessly?
2) Are we capable of committing acts to benefit others?

The evidence to support notion 2 is clear, however, the answer to notion 1 is still a mystery within the boundaries of economics. Yet this is not a negative finding, indeed it is quite the opposite. The fact that individuals are motivated by incentives is good news for policymakers as they can harness this to achieve better results, perhaps this is why the NHS award you with a certificate of gratitude rather than a monetary lump sum for donating forty pints of blood. To conclude, although we may not be able to act selflessly, we are capable of committing acts of kindness and that should be good enough for society.
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What are the impacts of an international migration quota?:
A UK perspective
Second Prize – 3rd Year Undergraduate Category

PATRICK HARDING*

Introduction

Immigration is a divisive topic. The decision about how many and whom we should allow into our country is as much a moral dilemma as it is an economic problem. In the last general election a range of immigration proposals were presented to the voters and amongst the different ideas the policy which prevailed was a cap on migration.

The UK is part of the European Union which considers labour market mobility central to the success of the single market. Member states are prohibited from introducing measures to control EU migration such as quota or any other barrier. Therefore, the cap on immigration will only affect immigrants entering the UK from outside the EU. Typically there are four legal ways in which non-European immigrants can enter the UK:

- work,
- study,
- asylum and
- family reunification.

The quota will reduce immigration through the work and family routes. The cap will directly lower the number of immigrant workers granted access into the UK and thus lower the number of family members accompanying immigrants into the UK.

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* BSc Economics
Assessing the economic impact of the quota is a difficult task. Empirical investigations often contradict one another whilst data collection is often plagued with difficulties. To unravel what the impacts of the quota are, this essay will consider the effects on some of the most hotly debated economic topics of immigration including wages, employment and GDP. Social problems and people’s attitudes to immigration are part of the government’s motivation for the quota, however analysing these in an economics context is somewhat inappropriate and therefore these issues are a notable exception from the analysis.

Firstly a brief explanation of the policy and economic theory is necessary to focus one’s mind on this difficult topic.

Policy

Prior to the immigration quota the UK controlled non EU migration using a points based system. Potential immigrants fell into one of the five tiers shown below:

<table>
<thead>
<tr>
<th>Tier</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td>Highly skilled individuals to contribute to growth and productivity without a job offer</td>
</tr>
<tr>
<td>Tier 2</td>
<td>Skilled workers with a job offer to fill gaps in the UK labour force</td>
</tr>
<tr>
<td>Tier 3*</td>
<td>Low skilled workers to fill specific temporary labour shortages (*Never introduced)</td>
</tr>
<tr>
<td>Tier 4</td>
<td>Students</td>
</tr>
<tr>
<td>Tier 5</td>
<td>Youth and temporary: people coming to the UK to satisfy primarily non-economic objectives.</td>
</tr>
</tbody>
</table>

Each tier required applicants to score a sufficient number of points to gain entry into the UK. In Tiers 1 and 2, the work route, points were awarded for criteria such as age, qualifications and prospective salary with a total of 50,000 work visas being issued in 200945.

The immigration quota was part of the conservative party’s promise to limit net migration at the ‘tens of thousands level.’ Today, the policy involves a cap on Tier 1 migration of 1,000 and Tier 2 migration of 20,700 with further reductions likely. Intra-company transfers in which employees of multinational companies are transferred from an overseas branch to the UK are not included in the

45 Migration Advisory Committee Report: Limits on Migration, 2010
quota; however that may change in the future. The other Tiers have also not been affected by a quota and therefore are not the focus of this essay.

Immigrant workers, especially those from Asia, often bring immediate family members and dependants with them to the UK. Indeed for every 100 immigrant workers that entered the UK in 2010 88 family members accompanied them\(^{46}\). Family members are usually issued visas allowing them to work regardless of their skill level. Therefore the quota will impact the supply of both skilled and unskilled workers. Research published in the ‘Migration Observatory’ (Blinder, 2012) found that the typical family immigrant is a wife from Asia with little human capital.

Analysing the economic impact of the quota is complex. Immigration data is notoriously difficult to collect and different measures produce vastly different results. Even the simplest question of ‘how many immigrants enter the UK in a given year’ is surprisingly difficult to answer. For example the International Passenger Survey estimated that 303,000 immigrants entered the UK in 2009 whereas the visa issuance measure places that figure at 550,000.\(^{47}\)

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\(^{46}\) Blinder, 2012

\(^{47}\) Office For National Statistics, 2011
Theory

Let us consider a static model of immigration. For simplicity we will assume that the UK is always at the full employment level and each worker earns the equilibrium wage. The diagram below shows us that higher levels of immigration cause wages fall and national income to rise:

The area constrained by the labour demand and labour supply curves represents national income. With an immigration quota national income is described by the orange area (A) and wages are at $w_1$. When the quota is relaxed the labour supply curve shifts outwards. This lowers wages to $w_2$ and increases national income to ABC. The blue area, ‘B’ illustrates the welfare gain paid to the immigrant workers therefore the immigration surplus, which benefits the UK as a whole is shown by the red triangle ‘C’. The model predicts that the immigration quota will preserve UK wages and limit national income growth.

Wages and Employment

The theoretical framework predicted that immigration would lead to lower UK wages. Therefore a quota which prevents wages falling will protect the welfare of UK workers. In reality the evidence suggests that the impact on wages and employment depends on what type of worker you are. Immigrants who possess an abundance of skills, experience and expertise are likely to complement UK workers whereas unskilled immigrants are likely to add competition for jobs. Skilled immigrants raise UK workers productivity by improving innovation and filling skills gaps, additionally they are
usually well paid and stimulate aggregate demand through their consumption. On the other hand an increase in the supply of substitutable immigrant labour with no productivity gains may displace UK workers and lower wages.

For firm evidence we turn to a study by Dustmann (2005) who investigated data spanning 1997-2005. Contrary to our model his findings suggest that immigration has a positive effect on UK wages. He estimated that a 1% rise in the ratio of immigrants to UK workers leads to a 0.6% increase in median wages. However delving a little deeper into his study we find that that workers in the lowest decile of earnings experience a 0.5% decrease in wages whilst workers whose earnings lie in the ninth decile enjoy a 0.4% increase in wages. This provides compelling evidence that immigration harms the least well paid who possess little human capital and benefits the well paid skilled workers.

Turning our attention to employment, Dustmann found similar results – the impact of immigration varies across education groups. Workers educated to the GCSE level are adversely affected by immigration, whereas workers at educated to degree level are positively affected.

Building on our static immigration model from earlier we can separate the effects on substitutable and complementary immigration.
An influx of (unskilled) substitute immigrants increases the supply of labour. This leads to a fall in wages to \( w_2 \), some UK workers are not prepared to work at this wage and UK employment falls to UK\(_2\). The immigrant workers are prepared to work at the lower wage and supply their labour from the distance UK\(_2\) to E\(_2\). The overall effect is lower wages and displacement of UK workers.

Complementary (skilled) immigration shifts both the demand and supply of labour curves. Their expertise increases labour productivity which shifts the demand for labour curve. The overall effect is a higher wage of \( w_2 \) and increased UK employment to UK\(_2\).
From the empirical evidence and theory we can conclude that the quota will benefit the unskilled UK labour by suppressing competition for jobs, but harm skilled UK labour through lost productivity gains. This evidence is based upon the short and medium term effects of immigration. In the long run the evidence suggests that the labour market smooths out the short run effects. This is known as the lump of labour fallacy. In the long run there are not a fixed number of jobs and an economy adapts to the labour available. For example after WW2 there was a baby boom which subsequently increased the size of the UK labour force, however the unemployment rate remained constant during that time. *(Walker, 2007)* The time taken to smooth out the short run effects depends somewhat on the business cycle, in a boom where investment and confidence is high the economy is likely to adapt more quickly than when the economy is in a recession.

**Government Finances and GDP**

Measuring the fiscal impact of immigration is especially difficult. Some people claim that immigrants are a burden on the tax payer whilst others argue that they more than pay their way. In 2002 the Home Office commissioned a report with the intention of discovering the net effect immigrants had on the government finances. The study was conducted by Gott and Johnston (2002). They investigated the fiscal year of 1999/2000 and found that the net contribution of the 5million migrants was positive to the tune of £2.5bn, approximately 0.27% of GDP. This figure has been widely used to show that the UK benefits from immigration and tighter controls, such as a quota, will be detrimental to the treasury.

Sadly it is not that simple. Using the exact same data Coleman (2004) made some reasonable adjustments which changed the figure considerably. For example in 1999/2000 the government ran a budget surplus, Coleman found that in a ‘normal’ year of a balanced budget £1.3bn can be wiped off the net contribution. Other adjustments found that the net contribution of immigration could lie anywhere between £-0.4bn and £2.6bn. This is shown:

### TABLE 5 Alternative estimates of the fiscal impact of migrants in the UK 1999/2000

<table>
<thead>
<tr>
<th></th>
<th>Tax £ billion</th>
<th>Expenditure £ billion</th>
<th>Balance £ billion</th>
<th>% GDP</th>
<th>% individual consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original</td>
<td>31.2</td>
<td>28.8</td>
<td>2.5</td>
<td>0.27</td>
<td>0.36</td>
</tr>
<tr>
<td>Adjustment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporation tax</td>
<td>-0.8</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Budget balance</td>
<td>-1.3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>After first adjustment</td>
<td>29.1</td>
<td>28.8</td>
<td>0.4</td>
<td>0.04</td>
<td>0.06</td>
</tr>
<tr>
<td>Adjustment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Immigration and citizenship</td>
<td>0.7</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>After second adjustment</td>
<td>29.1</td>
<td>29.5</td>
<td>-0.4</td>
<td>-0.05</td>
<td>-0.06</td>
</tr>
<tr>
<td>Adjustment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Defense</td>
<td>-1.9</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt interest</td>
<td>-1.1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>After third adjustment</td>
<td>29.1</td>
<td>26.6</td>
<td>2.6</td>
<td>0.28</td>
<td>0.36</td>
</tr>
</tbody>
</table>

*Source: Coleman, 2004*
Slightly more recent research from Rowthorn (2008) looks at the fiscal year 2003-2004 and found the net contribution to be slightly positive and worth £0.6bn.

Whilst the overall fiscal impact of immigration is likely to be small there are significant variations across immigrant groups. In reality it is likely that some immigrants are net contributors and some make a negative contribution. In theory the fiscal impact depends on migrants’ characteristics (skills, age, and length of stay), their impacts on the labour market and public service entitlements. For example highly skilled migrants in well paid jobs pay more tax than low skilled migrants in low paying jobs and young migrants are more likely to be healthy than older migrants who require more health services.

The impact of immigration on growth and government finances are closely linked. Unsurprisingly studies into economic growth have produced varying results. The former immigration MP, Liam Byrne, claimed that immigration is worth £6billion to the UK and was responsible for 15-20% of economic growth since early 2000’s. However the National Institute of Economic and Social Research (2006) found that immigration has a slightly negative impact on GDP per capita.

Since there are so many factors affecting the growth and fiscal contributions it is very difficult to assess the impact of the quota. However in his lecture at the UEA (2011) Professor David Metcalf spoke of the conflict of interest between the Home Office and the Treasury. He remarked that the Treasury have a preference for increased migration whereas the Home Office tries to limit it. His observation was that the fiscal impact of non EU immigration is slightly positive and the immigration quota would have a negative effect on GDP. Ceteris paribus his research found that GDP will lower by approximately 0.04 percentage points (or £559m) in the first year and approximately 0.22 percentage points lower (or £2.8bn) over 5 years.

**Population and Pensions**

Immigration increases population. Half of the increase of the UK population between 1991 and 2010 was due to migration. Today the UK is the most densely populated country in Europe, a fact which has caused concern to many citizens and pressure groups. Recently the home secretary justified the cap on immigration arguing that it is vital to control "the rate of change of population so that our public services and attitudes can cope with a controlled change in population." (Teresa May, 2011)

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48 Home Affairs - Minutes of Evidence 2007
49 Office for National Statistics 2010
50 BBC News 2012
The figure of 70 million has emerged in recent years as the “tipping point” at which campaign groups believe the ever-increasing population will become ‘unsustainable’ (Daily Mail, 2011). Research from the Migration Advisory Committee forecasts the impact different levels of net migration have on population.

Source: Migration Advisory Committee. (2010)

In 2010 net migration was at the 180,000/year level (the highest line). In order to prevent the population exceeding 70 million by the end of the century, net migration would need to fall the 50,000/year mark, (the middle yellow line).

Lobbyists argue that immigration increases the strain on schools, hospitals and housing. However those in favour of immigration claim that it improves the UK’s dependency ratio, the number of dependant people (such as the elderly) to those who are in the labour force. The UK’s ageing population has led to fears of an impending pensions ‘time bomb’. Falling fertility rates and higher life expectancy have increased the number of dependant people to productive people in the UK. In 2050 it is predicted that the dependency ratio will reach 0.48 almost double today’s figure of 0.25. This creates difficulties funding the state pay as you go pension system, in which those in the labour force pay (through taxes) for the pensions of the elderly.

Increasing the number of economically active people through immigration lowers the dependency ratio. Typically immigrants are young and therefore expand the labour force, paying taxes which ease the pressure of funding state pensions. However this is not necessarily a long term diffusion of the pension’s time bomb as the immigrants may eventually settle in the UK and need support themselves. Data on immigration settlement in the UK is lacking, however a study conducted in the

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51 Department for Work and Pensions, 2008
USA found that half of all immigrants returned home within two years (Reyes, 2007). Either way the short term effect of the quota will lower the level of net immigration, with the government targeting a level of the “tens of thousands” by the end of parliament. This will temper both population and labour force growth.

Conclusion

If the government achieves its target of cutting net migration to the ‘tens of thousands’ then undoubtedly there will be some winners and some losers of the quota. The existing evidence would predict that unskilled workers will fare better than skilled workers due to suppressed competition for jobs and the absence of complementary migration. However, in the long run the lump of labour fallacy suggests that the employment effects will smooth out.

The quota was implemented in April 2011, however thus far the labour market, treasury and population impacts have been negligible. The quota appears to have been ineffective with employers utilising the intra-company transfer’s route which were not included in the quota to maintain Tier 1 and 2 migration at around the 50,000 level (Financial Times, 2011). Indeed net immigration is predicted to reach record levels of 250,000 this year suggesting that the cap on immigration has had no impact whatsoever.

It is likely that the quota will be adjusted to achieve what it is supposed to do: cut migration. When this happens the net economic impact will most probably be slightly negative mainly due to the lost productivity gains from skilled migration. That said employers may simply decide to increase recruitment of migrant workers from within the EU undermining the efforts to control population. On the other hand firms may decide to up-skill their current workforce which will benefit UK workers, but cost the firms. Therefore the overall economic impact of the immigration quota depends on how employers and the EU migrants respond to the policy change.

The issues discussed in this essay are the hotly debated economic arguments with both sides presenting strong cases. However this only tells half the story. The UK’s motivation to cap immigration is largely concerned with non economic reasons such as people’s attitudes and social problems. In order to gain a holistic view these issues need to be considered in addition to the economics. A fact which underlines how difficult a topic immigration is.

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52 Institute for Public Policy Research, 2012
References


Are we capable of being altruistic?
Third Prize – 3rd Year Undergraduate Category

BENTON KNIGHT*

1. INTRODUCTION

The concept of homo economicus suggests that people are able to make fully rational decisions to maximise their own utility, and are generally unconcerned with the utility of others. In other words, we are self-interested beings. “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest,” (Smith 1904). This opposes the notion of altruism, which is to behave in a manor that benefits others at a cost to the altruist (Jaffe 2002). Economists are skeptical as to whether humans are capable of altruism, and many experiments have been conducted to prove/disprove its existence. The purpose of this paper is to challenge actions that appear altruistic, and convey reasoning as to why this behaviour may not necessarily be derived from altruism at all.

2. THE DICTATOR GAME

The Dictator Game is one used in experimental economics to provide evidence of altruism. The dictator is endowed with $X$ amount of currency, and has the opportunity to transfer an amount $Y$...
to an anonymous recipient. \( Y \) can be any amount between and including the entire endowment \( X \) and 0 (\( X \geq Y \geq 0 \)). The game ends once the dictator has chosen how much, if any, currency to send to the recipient. The dictator will achieve a payoff equal to \( X - Y \), whilst the recipient receives a payoff equal to \( Y \). Assuming that players are rational and self-interested, it is predicted that \( Y \) will be equal to zero, since the dictator will choose to maximise their own utility by keeping the whole endowment.

A UEA classroom experiment of the dictator game conducted in a lecture proved otherwise. On average, the dictators sent 31% of the initial endowment to the recipients.\(^{53}\) The findings of the small classroom experiment were consistent with much larger studies (Engel 2010). Initially it would seem entirely reasonable to suggest that dictators that send positive amounts are displaying altruism, but further investigation may challenge this thought. People do not derive utility from money alone; there are other factors involved. Guilt has a powerful influence in the dictator game. Although participants may wish to keep the entire endowment for themselves, they feel a sense of guilt if they do not transfer an amount that they believe is fair. Therefore the dictator’s payoff should include ‘\( \alpha \)’ which represents the cost of guilt if the outcome is unfair.\(^{54}\) A revised version of the dictator’s payoff should equal \( X - Y - \alpha \). This demonstrates that people may only be giving to reduce the burden of guilt on themselves, and maximise their own utility by giving what they deem is a fair amount. Although the dictator considers the other player in their decision, they have no interest in maximising the recipient’s utility.

It is also believed that the ‘experimenter effect’ can lead people to giving positive amounts in the dictator game. This is where the participants’ behaviour is influenced by the experimenter knowing their decisions. The existence of the “experimenter effect” was proven by conducting a double-blind version of the dictator game, where the experimenter is unable to match the decisions to specific individuals (Hoffman \textit{et al.} 1996).

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\(^{53}\) Results from the classroom experiment appear in the appendix.

\(^{54}\) An outcome that is deemed fair differs across the population.
3. CHARITY

Charity is an area that seems entirely plausible to be considered as altruistic. Giving money or your time to a complete stranger or a cause whilst receiving nothing in return appears to fit the definition of altruism. The “warm glow” theory may provide another explanation (Andreoni 1990). If people were purely altruistic, they would care only that a charitable organization raised their desired total of money, irrelevant of who donated it. This means that an individual will be indifferent between donating a pound to charity, and someone else donating a pound to the same charity (Hernández-Murillo & Roisman 2005). This is not the case in reality because donors get more satisfaction from giving directly than knowing the same amount of money was still going to the charity, even if this is from the individual’s own tax contributions (Steinberg 1987). In return for giving directly, they receive satisfaction in the form of a “warm glow”. Although the satisfaction is derived from helping someone else, at least part of the reason for giving is to increase one’s own utility.

The public recognition associated with giving may influence people to donate, whilst certain situations make people feel obliged to give. Consider the following example: A neighbour’s child knocks on your door and asks you to sponsor them for a fun-run they are completing in aid of “The British Hedgehog Preservation Society”. Whether or not you feel you would like to support the charity, you may feel obliged to do so with the child smiling up at you clutching a sponsorship form. You may dread the thought of the child going home to their parents and saying, “Mr Smith at no. 44 refused to sponsor me”, branding you the Scrooge of the street. You may be even further persuaded when looking down at the sponsorship form you observe that everyone else in the street seems to have donated, and therefore feel obliged to conform. Without the child knocking on your door, you may never have donated to the cause, even if you were aware of it. If this is the case then the donation is not through altruism, but to prevent the cost of being branded tightfisted by your neighbours. You are willing to incur a monetary cost in order to prevent your reputation in the neighbourhood from being tarnished.

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55 This is a purely fictional example aimed only to suggest an explanation of people’s behaviour when donating, and in no way reflects the worthiness of the British Hedgehog Preservation Society.
4. BLOOD & ORGAN DONATION

Blood and organ donations appear to be entirely altruistic actions. Donors usually have no contact with the recipient of their blood or organ(s), in fact it is almost always the case that the donor and recipient’s anonymity is kept. Therefore it is impossible for a donor to receive anything in return. This is the case in the UK; the US has a system in place in which donors are able to give blood for a monetary payment in return. Richard Titmuss (1970) studied the effect to the supply of blood of offering monetary incentives to donors. He suggested that introducing monetary incentives caused a ‘crowding out’ effect, in which the altruistic motivations to give blood were diminished, causing supply to fall. Other negative effects are associated with offering payment to blood donors, such as adverse selection. The monetary incentive attracts people whose primary motivation to donate is the cash payment. These can often be donors who are more desperate for money such as drug addicts and alcoholics; but can also include carriers of diseases including hepatitis or malaria. Since there is imperfect information in this transaction, high-risk donors can often conceal their addiction or disease and may also donate too frequently. This leads to a decline in the quality of blood collected.

In the UK, small incentives are used to nudge donors towards giving blood. Although it is not a legislative requirement, many businesses allow their workers to take a few hours of paid leave in order to donate. The NHS Blood and Transplant service runs a ‘Donor Award Scheme’ in which donors receive token awards upon giving a significant number of donations (25, 50, 100 etc.) These awards include cards, key fobs and certificates that act as small trophies. This enables donors to advertise the fact that they give blood simply by attaching a key fob to their keys. It could therefore be argued that donors give blood not only through altruism, but also to gain respect amongst their peers. If the Donor Award Scheme had no influence on the supply of blood, it would not be economically viable to distribute these awards. The influence of non-monetary incentives is further explored by Neckermann & Frey (2008).

A method to increase organ donation recommended by the Nuffield Council on Bioethics is for the NHS to offer free funerals to those who sign the organ donor register. This policy has been met with some opposition by people who believe organ donations should be purely altruistic and

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56 Donor and recipient are only aware of each other’s identity if the donor has specified a friend or family member who is in need of a transplant or transfusion.

57 In 2009, 16% of all blood donated came from workplace donations and included 1553 employers. (Source: Smithers, R. (2010) If you only do one thing this week ... donate blood – at work if you can, The Guardian, 17th May, Date accessed: 25/02/12, http://www.guardian.co.uk/money/2010/may/17/donate-blood-work)
not influenced by other factors that could exploit those in poverty.\textsuperscript{58} The fact that 29\%\textsuperscript{59} of UK citizens are registered organ donors under the current system suggests that many people are altruistic, and do not require some form of incentive to become donors.

5. GOOD DEEDS

Every day many of us will do good deeds for one another. By good deeds I mean actions such as helping an elderly person to cross the road, giving up your seat on public transport or holding the door open for the person behind you. These actions appear altruistic, but in some cases this may be an illusion. Many good deeds are also part of social etiquette, and are consequently expected by society. Whilst on public transport, whether or not you wish to give up your seat for someone less abled, you may feel obliged to do so by the other passengers. Therefore you may give up your seat to prevent other passengers from looking at you unfavourably. Consider also the case of holding the door open for the person behind you; a true altruist should expect nothing in return. However, I would suggest that the majority of people expect a ‘thank you’ or some appreciative gesture, and would hope that the individual would return the favour should the situation be reversed. Although these expectations are small, this behaviour can be acknowledged as reciprocal altruism (Trivers 1971). This is because the individual is expecting something in return, even if it is just a thank you. If the same situation is repeated and no gratitude was shown in the first instance, the reciprocal altruist will not hold the door open again.

Similar behaviour can be observed in nature. Wild vampire bats are known to share food with unrelated bats by regurgitating blood. Help is given to those bats that return without food. It has been discovered that vampire bats are reciprocal altruists, in that they will offer blood to other bats in need, but will recognise non-reciprocal altruists and punish them by not offering aid (Wilkinson 1984).

\textsuperscript{59} Organ Donation, “One in four of those waiting for a kidney transplant are Black or Asian”, 10/03/11, Date accessed: 25/02/12, http://www.organdonation.nhs.uk/ukt/newsroom/news_releases/article.jsp?releaseld=264
6. WAR

War is one of the most destructive acts that humans can partake in. Since recorded history began, humans have been engaged in warfare. The Battle of Kadesh, C.1275 B.C.\textsuperscript{60} was one of the first formally documented battles, however we know that tribes and cities were battling long before this time. Amid this death and destruction may seem the most unlikely place to find an act of altruism, however the act of ‘falling on a grenade’ is one of the most selfless acts known. It is to use one’s own body to absorb the blast of a live time-fused grenade in an attempt to save the lives of nearby comrades. With little chance of survival, an individual can experience no benefits, and faces the ultimate cost – the loss of their life. This act surely fits the definition of pure altruism.

Some regards Japanese Kamikaze pilots as altruistic. In World War II, Japanese pilots embarked on suicide missions to fly planes loaded with fuel and explosives into warships in an effort to destroy them. These missions were the ultimate sacrifice. These pilots were dying for their country and could not receive anything in return. This example of altruism is obviously controversial, since dying for one’s country means killing many other enemy soldiers, but seems to fit the definition of altruism.

7. CONCLUSION

The examples considered suggest that we are capable of being altruistic, however there are often other factors that drive behaviour that appears altruistic. Truly altruistic examples appear to be rare, but tend to occur in relation to life or death situations, when our unconscious instincts step in. In some situations, self-interested or reciprocal motivations may be disguised as altruism. In other cases, altruism may form only part of the explanation for particular behaviour. Deriving utility from altruistic actions, such as giving blood, is not necessarily a bad thing. As economists we can use this to our advantage when developing strategies to encourage certain behaviour or actions.\textsuperscript{61} This is incredibly important when attempting to influence people to make decisions that lead to more optimal outcomes for society. If as economics, we can understand the truthful motivations behind particular behaviour, we will be able to successfully nudge society towards a more efficient state.


\textsuperscript{61} The UK NHS use the tagline “Do something amazing...”, and offer the Donor Award Scheme.
References


APPENDIX: CLASSROOM EXPERIMENT RESULTS

<table>
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<tr>
<th>Pair No.</th>
<th>Amount the dictator kept</th>
<th>Amount sent to recipient</th>
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<tr>
<td>1</td>
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<td>50</td>
</tr>
<tr>
<td>2</td>
<td>70</td>
<td>30</td>
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<tr>
<td>3</td>
<td>75</td>
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</table>

Average: 69.04  30.96
Are we capable of being altruistic?
First Prize – Postgraduate Category

PANAYIOTIS AGISILAOU†
AND FREDERICK WANDSCHNEIDER‡

“Man is neither angel nor brute, and the unfortunate thing is that he who would act
the angel acts the brute.” Blaise Pascal (1670), Pensées #358

1. Altruism and Society

Understanding human behaviour has been the oldest concern and tradition of economic thinking, though its focus has shifted over the centuries and its explanations have been subject to the fashionable methodology of its time. Starting at the beginning of the last century and still being predominant in contemporary studies, neoclassical economics aimed to explain how human beings should behave, using the analytical fiction of a *Homo Economicus*. Models based on this heuristic device perform well most of the time and are tractable too; yet observed phenomena sometimes contradict the conventional wisdom that human beings are intrinsically selfish, rational and exhibit stable preferences. In the second half of the last century, the new methodology of experimental economics created a range of evidence regarding choices made in the interest of other-regarding preferences.

In an experimental study of the prisoners’ dilemma game Kreps et al. [1982] show that a small probability of playing against an altruistic subject can trigger subjects to cooperate rather than playing the dominant strategy of defection. It is challenging to directly test for non-selfish motivation, hence economists strived to eliminate all other possible sources, such as reputation, for the observed behaviour. Nonetheless, Andreoni and Miller [1993] show that 20% of the subjects need to be altruistic to support the equilibrium finding of cooperation in prisoners’ dilemma games.

†PhD Economics
‡PhD Economics

62 ‘*Homo Economicus*’ is a term originally coined by John Stuart Mill to describe a narrowly self-interested individual. See Mill [1836, 1844].

63 For a comprehensive survey of altruism in experimental studies see Andreoni et al. [2007].
Another line of research by Andreoni [1995] and others examines the role of altruism in the willingness of people to contribute to charities or public goods. Despite the fact that kindness and confusion play a significant role, experimental subjects choose to donate or contribute albeit they were aware of the opportunity to free-ride. Prominent in the experimental literature is the finding that proposers in dictator games give away on average 25% of their endowments (e.g. Forsythe et al. [1994]), while unfair offers in the extended ultimatum game are rejected (e.g. Güth [1982]).

Evidence from a field experiment by Uptorn [1973] suggests that money banishes non-selfish behaviour, as the number of blood donors’ drop when they are being paid.

The range of apparent contradictions leads to a renaissance in economic thinking, with scholars re-examining the premises of economic theory. At the heart of this development is the question why human beings behave like they do. Several theories have been developed to elucidate the observed phenomena within the realm of rational choice theory and utility maximisation. A starting point of this progression is the assumption that human beings have a genuine concern about the welfare of others, and, ceteris paribus, prefer outcomes whereby another person enjoys greater welfare. The “willingness to act in the consideration of the interests of other persons, without the need of ulterior motives” is the core of human altruism.

Much of the ongoing debate on whether altruism or selfishness, or a mixture of the two, predominates as a driver of human behaviour has been the topic of economic discord since the early work of Adam Smith. The praise of both altruistic and selfish motives in Smith’s work come to a contradiction. While in The Wealth of Nations Smith maintains that human beings are pursuing their own interest without any intention to promote that of the society, and therefore all benefits come as a result of ‘unintended consequences’, in his later work on the Theory of Moral Sentiments he states: “How selfish soever man be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.” (Smith [1976, p. 9]).

Khalil [2001] claims that the theories which contemporary economists have developed over the last decades to explicate altruistic giving resemble the three theories of altruism which had already existed during Smith’s time. A first explanation for altruism is that it ensures cooperative giving. A second explanation is that altruism increases one’s own utility if ones utility includes the utility of

64 Zizzo [2012] questions whether giving rates in Dictator games really reflect social preferences and are not confounded by experimenter demand effects.
65 Nagel [1978, p. 79].
66 The idea that human beings act strategically and reciprocate has most famously been expressed by Sugden [1984] and Axelrod [1984].
the potential recipient. A third explanation maintains that altruism arises from a canon of morality. So while individuals can act selfishly to take advantage of efficient mutual exchange in the tradition of Smith’s invisible hand, there seem to exist several other reasons why human beings can act altruistically (including Smith’s own interpretation, that Altruism is grounded on the natural tendency of people to feel sympathy).

The linkage between efficient selfish exchange and benevolent altruistic behaviour is well established in economic thinking. According to Kolm [2006] the main advocates of altruism are those classical economic thinkers who contrive our understanding of the efficiency of selfish exchange (i.e. Smith, Mill, Edgeworth, Walras, Pareto). Kolm argues that a population of altruists could jeopardize the efficient functioning of a market (prices could not send the correct signal to market participants if you would frequently pay more for an exchange than required, and in return receive an additional gift from your partner!), while on the other hand an exchange with a population of purely selfish agents could collapse (imagine your trading partner constantly tries to fool you!).

It seems reasonable to postulate that both altruism and selfishness coexists and both play their role in economic exchange systems. As Wicksteed [1933, p. 174] puts it: “What makes it an economic transaction is that I am not considering you except as a link in the chain, or considering your desires except as the means by which I may gratify those of someone else-not necessarily myself. The economic relation does not exclude from my mind every one but me, it potentially includes every one but you”. Hence, altruism and selfishness do not contradict or exclude each other, but are rather voluntary choices in a state of smooth symbiosis. However, if we establish that both types of preferences exist, we need to ask why (sometimes case dependent) some people choose to act selfishly, some to act altruistically. In what follows, we explore in a framework of a parametric centipede game whether human beings are capable of being altruistic, that is, whether the choice to adopt altruistic preferences is evolutionary stable. Only if altruism does not lead to a reduced fitness, some human beings will be capable of acting altruistically.

2. Is altruism evolutionary stable?

The centipede game is a finite sequential move game with perfect information, wherein two players alternatively get a chance to take the larger proportion of a continuously growing pile of

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67 Becker’s [1974] theory of social interactions understands altruism as an enhancement of others to increase one’s own utility, in a utility-based setting where \( U_i = U_i(U_{-i}, x_i) \).
68 Etzioni [1986] among others argues that morals and norms dictate altruistic giving.
69 The idea that altruism can enhance efficiency has been present in the economic literature since the seminal contributions by Barro [1974] and Becker [1974]. The original idea of cooperation is due to Axelrod and Hamilton [1981] and Axelrod [1984].
money or pass the pile to the other player. Passing decreases a player’s payoff if the opponent player takes the larger proportion on the next move. If the opponent also passes, the players are presented with the same choice situation, however with increased payoffs.

Backward induction reasoning implies that the unique subgame perfect equilibrium of the game is for both players to take at every time they have to make a move in the game. Despite the very lucrative opportunity the game offers to players, the equilibrium prediction is that the player who makes the very first move takes the pile.

However, various experimental studies evidence systematic departures from the equilibrium prediction, inferring among others that subjects may have other-regarding preferences. One of the suggested explanations for the pronounced discrepancy between the theoretical prediction and the experimental behavior upholds that the pool of subjects contains two types of players: altruistic and egoistic.

Based on the idea that a specific preference is more likely to be maintained and to flourish if it proves to be economically successful, we study, in the framework of the centipede game, a dynamic process in which preferences for those types can change over time, building on the indirect evolutionary approach developed by Güth and Yaari [1992]. The key question is whether individuals of the altruistic type are evolutionarily successful in the sense that their population share increases over time. To provide continuous dynamics of the evolution process we look at an explicit model of evolutionary dynamics, the replicator dynamics, which is due to Taylor and Jonker [1978].

2.1. Description of the game

We consider a parametric class of centipede games with \( K + 1 \) nodes, numbered by \( k \), where \( k \in \Lambda = [0, K] \). The player deciding at the last node (node \( K \)) is labeled \( L \). The other player is labeled \( O \). At each node players can either pass or take. As soon as one player take the game is over. If a player pass, then it is the other player’s turn to decide. The payoff structure is as follows. Take at node \( k = 0 \) gives \((0,0)\) payoffs. From then on, any pass adds to both players’ accounts a payoff of \( 2 \). The player who eventually take gets whatever is in his account plus \( 1 \); the other player gets whatever is in his account minus \( 3 \). If player \( L \) passes at the last node, both players get exactly what has been accumulated in their account so far, i.e. \( 2K \). Let \( \pi_i: \Lambda \to R \) be the material payoff function of each player \( i, i = \{L, O\} \). We consider two types of players, egoists, denoted by \( E \), who maximize their own payoff and altruistic types, denoted by \( A \), who maximize the aggregate payoffs (i.e. the payoffs of both players). Let \( m_i \in \{A, E\} \) denote player \( i \)'s preference type. The (subjective) utility

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70 See for instance, McKelvey and Palfrey [1992], Fey et al. [1996] and Nagel and Tang [1998].
function of an altruistic player is \( u_{(A)} = \pi_i + \pi_j, \ i \neq j \) and for an egoistic player is \( u_{E} = \pi_i, \ i = \{L, O\} \). Given that players are randomly matched the expected (subjective) utility of each player is

\[
V(m_i, m_j) = \left(\frac{1}{2}\right) \pi_L(m_i, m_j) + \left(\frac{1}{2}\right) \pi_O(m_i, m_j),
\]

where \( \pi_L(m_i, m_j) \) is the material payoff of a type \( m_i \) player when a player \( L \) meets a player of type \( m_j \) and \( \pi_O(m_i, m_j) \) is the material payoff to a player of type \( m_i \) when a player \( O \) meets a player of type \( m_j \).

To begin with, if all players are egoists (subjective and material payoffs are identical), the unique subgame perfect Nash equilibrium (henceforth “SPE”) prescribes for both players to take at every node they have to make a move. Therefore, the equilibrium predicts that the game ends at \( k = 1 \). At the SPE both players receive a (material) payoff of 0 (see Figure 1).

![Figure 1: two egoists.](image)

Now suppose that two altruists meet. In this case, given that decisions are based on subjective utility maximization players pass every time they have to make a move in the game. Thus, at the SPE each player receives a material payoff of \( 2K \). Remarkably, this outcome is (first best) efficient as both players obtain the maximum feasible material payoff (see Figure 2).

![Figure 2: two altruists.](image)
Consider now the more interesting scenario where the game is played by an altruist and an egoist. If player $L$ is altruist, and thus pass at all nodes, player $O$ also pass at all nodes. Therefore, at the unique SPE each player receives a material payoff equal to $2K$. The outcome is (first best) efficient (see Figure 3).

![Figure 3](image)

Figure 3: $L$ is altruist and $O$ is egoist. The left (right) graph depicts the subjective (material) payoffs.

The outcome is second best efficient if player $L$ is an egoist. Given that player $O$ always pass player $L$ mimics the behaviour of player $O$ at all nodes but the terminal one where he takes. At the SPE player $L$ receives a material payoff equal to $2K + 1$, while player $O$ receives $2K - 3$ (see Figure 4).

![Figure 4](image)

Figure 4: $L$ is egoist and $O$ is altruist. The left (right) graph depicts the subjective (material) payoffs.
The material payoff (fitness) matrix for the emerging evolutionary game where preferences are endogenous and compete with each other for survival is:

<table>
<thead>
<tr>
<th>L/O</th>
<th>Altruist</th>
<th>Egoist</th>
</tr>
</thead>
<tbody>
<tr>
<td>( \sigma_A ) Altruist</td>
<td>(2K, 2K)</td>
<td>(2K - \frac{3}{2}, 2K + \frac{1}{2})</td>
</tr>
<tr>
<td>(1 - \sigma_A) Egoist</td>
<td>(2K + \frac{1}{2}, 2K - \frac{3}{2})</td>
<td>0,0</td>
</tr>
</tbody>
</table>

The evolutionary game has three Nash equilibria: two are in (asymmetric) pure strategies and one is in mixed strategies: i) \((\sigma_A = 1, \sigma_A = 0)\), ii) \((\sigma_A = 0, \sigma_A = 1)\) and iii) \((\sigma_A = \frac{4K-3}{4K-2}, 1 - \sigma_A = \frac{1}{4K-2})\). It is straightforward to show that the symmetric Nash equilibrium in mixed strategies where players randomize between their pure strategies (here preferences) is the unique evolutionary stable equilibrium\(^{71}\). This strategy is robust to evolutionary pressure and can resist the onslaught of mutants with different preferences.

The evolutionary stable population distribution is mixed and in such proportion that just balances the advantages and disadvantages of being of either type. The evolutionary stable state is determined by the following trade off. On the one hand, an altruist reduces his success by choosing an action that reflects some concern for the other player’s success. On the other hand, his preference type restricts him to pass at every node he has to make a move, which triggers a favorable (strategic) reaction by the other player.

To explore the properties of the evolutionary process we look at the replicator dynamics, which for our game is governed by \(\frac{\dot{x}}{x} = \left(\frac{1}{2}\right)(x - 1)[2x(2K - 1) - 4K + 3]\). In words, the population share of individuals programmed to a certain pure strategy (altruists or egoists) grows in the replicator dynamics if and only if the strategy earns a material payoff above the average material payoff of the current population state, which is represented by the mixed strategy. Note that only the material performance matters for the growth of players of a given preference. However, preferences matter indirectly, since they (together with the population’s preference configuration) determine players’ material performance.

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\(^{71}\) The concept of evolutionary stable strategies was initially introduced by Smith and Price [1973].
It is straightforward to see that the exact composition of preferences in the population that emerges crucially depends on the length of the game as represented by parameter $K$. In particular, as $K$ increases the frequency of altruists in the population increases, however at a diminishing rate

$\frac{dx}{dk} = \frac{1}{(2K-1)^2} > 0$ and $\frac{d^2x}{dk^2} = \frac{-2}{(2K-1)^3} < 0$. Intuitively, the longer the length of the game, the greater
the efficiency gains ensuing to the population from cooperative behavior. In the limit where $K$ tends to infinity $x$ tends to 1, i.e. unmixed population consisting only of altruists.

![Graph showing frequency of altruists in the stable equilibrium as a function of $K$.]

Figure 7: Frequency of altruists in the stable equilibrium as a function of $K$.

3. Conclusions

A glimpse to the inquiries of the classical economic thinkers unequivocally reveals that the idea of apprehending altruism and selfishness as being complementary, rather than mutually exclusive, has been a long-standing convention in economics. With the promise of behavioural economics, scholars have recently reviewed the premises of rational selfish behaviour. This development has enriched our understanding of various phenomena previously thought to contradict the conventional wisdom of the narrow minded Homo Economicus.

In this essay we explore, in the framework of a centipede game, whether altruistic types can survive over the evolutionary process. By committing to altruistic preferences an individual constrains his behaviour, thus altruism has a commitment value for the society. By linking opponent's success with his own success the altruistically motivated individual discourages his egoist opponent from actions that would lower his material payoff because egoists' economic success would also decline. These beneficial indirect effects on the behavior of others may dominate the direct disadvantages of being altruistic. Without departing from the realm of rational choice theory our analysis concludes that individuals are indeed capable of being altruists. Altruism is perceived as a mechanism to improve the welfare of a population/society.
References


Are we capable of being altruistic? Assessing the evidence from experimental economics.
Second Prize – Postgraduate Category

BAZIL A. SANSOM*

1. Introduction

Altruism, defined as motive, is intrinsically private and subjective and thus eludes direct observation. For this reason experimental research into other-regarding motives has focused on the elimination of confounds, culminating in the double-blind dictator game. This type of experimental work has produced results widely interpreted as strong evidence for altruism. I critically assess this received interpretation of dictator game giving in the light of recent challenges to the established literature. I find grand claims made both to proof and rejection of evidence for altruism may be overstated, but that recent work does demand a re-evaluation of current theoretical models, and suggest possible directions for a more sophisticated understanding of the psychology of giving and other-regarding behaviour.

* MSc Economics
2. Dictator games as evidence for altruism

The possibility of altruistic motives for giving in the ultimatum game\textsuperscript{72} (Güth et al., 1982) is clearly confounded by the possibility that positive offers reflect a strategic self-interested response to fear of rejection (e.g. fear of envy etc.). The dictator game, in which one player - the “dictator” - decides a division, but the other player - unlike the ultimatum game responder - lacks the power to reject, emerged as an apparently elegant solution to this ambiguity (Forsythe, et al., 1994). With strategic considerations eliminated, positive giving in dictator games has been widely interpreted as evidence for an altruistic element in positive ultimatum game offers (Camerer, 2003; Adreoni et. Al., 2007; Fehr and Schmidt, 1999; Bolton and Ockefels, 2000; Ruffle, 1998 etc.). The game became and remains extremely popular among experimental economists. Engel (2011) reports a literature of 129 published contributions testing 616 different treatments with 30 new papers published in 2008 alone. What is more, non-trivial positive giving has been widely replicated. Engel reports a “grand mean” for dictator giving of 28.35% of the endowment pie from his recent meta-study of over 100 experiments - this is significantly more pie than no pie at all - the clear prediction under simple assumptions of rational-self-interest\textsuperscript{73}. Is however, elimination of fear-of-rejection, really sufficient to justify claims to proof of altruism by elimination?

\textsuperscript{72} In the standard ultimatum game, two players are allocated a sum of money $X$. One player is assigned the role of first mover or “proposer”, and must propose a division of the allocated sum $X$ between themselves and the other player by choosing an amount $Y$ in the interval $[0,X]$ to offer to the other player. The other player, the second mover, or “responder”, may either accept or reject this proposal ($Y$) (and implied ratio $Y/X$). If the responder chooses to reject, neither player receives anything. If the responder accepts, the first mover receives ($X-Y$) and the second mover receives $Y$. In the standard version this is a one shot interaction (No bargaining). This simple strategic game has a clear game-theoretic Nash-Equilibrium under assumptions of rational self-interest, according to which the responder should accept any $Y>0$ and the proposer, anticipating this, should offer the smallest possible positive $Y$. The responder should be indifferent to an offer of zero. Experimental results for the game however, demonstrate systematic divergence from this theoretical benchmark, with a significant proportion of participants consistently offering positive amounts (see e.g. Camerer 2003 for survey).

\textsuperscript{73} This meta study includes it should be noted, some studies which explicitly investigate the impact of social pressure.
It is of course clear that the simple elimination of second mover power to reject does not, of itself, eliminate perhaps the most intractable confound for any motive based definition of altruism: fake altruism. The power of our desire for social approval as motive is well recognised. Attempts to achieve a rigorous test for genuinely other-regarding behaviour have therefore sought to minimize social pressure within the game through the employment of devices such as “double-blind” - guaranteeing dictator-experimenter anonymity as well as between-subject anonymity (introduced by Hoffman et al. 1994, 1996; subsequently Bolton et al., 1998 etc.).

3. Challenging received interpretation of dictator game giving

Some recent work however casts doubt on the meaningfulness of dictator game results, suggesting an insidious distortionary effect from the presence of an experimenter, not satisfactorily mitigated by double-blind type devices (e.g. Bardsley 2008, List 2007, Zizzo & Flemming 2011). These studies question the external validity of dictator games, pointing in particular to a purported inconsistency between dictator game and real world giving, as well as to a high sensitivity to parameters not, it is claimed, to be observed in more natural economic settings. If dictator game results are meaningful, it is asked, why do we not see more anonymous giving outside of the laboratory. The hypothesis that dictator game giving may be an experimental artifact is proposed as an explanation, and new experimental work presented as direct evidence in support of this hypothesis.

3.1 Internal validity of dictator game results?

Bardsley (2008) starts from the theoretical assumption that, given a well-behaved indifference map for other regarding preferences, the introduction of a taking option without any alteration to available giving options, aught not - other things equal - to impact subjects willingness to give. In a two-treatment between-subject modified dictator game with a 1/1 transfer rate and unequal endowments, he finds the introduction of an asymmetrical taking option (with no alteration to the giving domain), is associated with reduced giving. In another two-treatment between-subjects experiment he ran a similar control treatment\textsuperscript{74} and a symmetrical taking game (where the option to

\textsuperscript{74} A standard dictator game with 1/1 transfer rate and unequal endowments.
give is removed). While generous subjects might be predicted to choose the status quo as the most generous option available, Bardsley finds that only 17% of subjects choose the status-quo in the taking game where 55% of subjects chose to give a positive amount in the standard dictator game - perhaps his most striking result.

Bardsley claims that this “reversing of generosity between treatments is inconsistent with any theory of dictator game giving which regards underlying other-regarding motivation as causing a desire to share the endowment” (Bardsley 2008, p.128) and himself clearly favours the experimental-demand hypothesis he set out to test. He goes on however, in the same paper, to present the bones of a highly plausible alternative explanation for his results, itself not incompatible with an updated theory of other-regarding motives: the “perceived kindness of an action may depend on its location in the range available” (Bardsley 2008, p. 129). That is, our perceptions of kindness, or fairness, may be relative/contextual, meaning it may not in fact be the “reversal” of generosity observed, so much as a subjectivity or referent dependence. This would be consistent with reference dependence in preferences observed elsewhere (e.g. Easterlin, 1995; Clark & Oswald, 1996; Layard, 2003; Kahneman et al., 2000).

In both of Bardsley’s above described experiments, a majority of participants did not choose the most selfish option in either control or taking treatments. What is more, it is interesting to note that in both experiments, the results of both treatments describe a remarkably similar bimodal distribution, with the most selfish option the global mode, and a second local maximum around a “fair” division. I have transposed the results from the taking treatment onto those for the control (Fig.1) to illustrate this point. These results are consistent with the possibility of reference dependence in the psychology of other-regarding motives - all be it perhaps equally consistent with a cognitive-experimenter-demand-effect (Zizzo 2010) - thus arguably posing a greater challenge to rationality (challenging e.g. Andreoni & Miller, 2002; less directly Zizzo & Oswald, 2001) than to other-regarding motives per-se. Bardsley concedes the need for further empirical work (Bardsley 2008, p.130).

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75 Experiment 2 and 3 in Bardsley 2008.
Further empirical work is carried out by List (2007). List largely replicates Bardley’s asymmetric taking option experiment, but also introduces a game with a symmetrical taking option; and experiments with varying the origin of (still unequal) endowments, running one treatment in which endowments are “earned”, rather than random allocations as made by Bardsley and in List’s own other treatments.

In the game with asymmetric taking option, List, like Bardsley, finds giving reduced in the treatment with an asymmetric taking-option - 35% of subjects making a positive offer in the taking treatment compared to 71% in the control. Interestingly, where List introduces a symmetric taking option, positive giving is almost eliminated, with the most selfish option the modal result at c.40% while a substantial c.30% spike sits right on zero - neither giving nor taking. Thus List’s work seems to confirm the main features of Bardley’s results: the most selfish option is the modal choice across treatments, yet a majority of participants fail to choose the most selfish option. Changes to the available choice set seem however, to be associated with dramatically different average giving and distributional outcomes, consistent with a referent dependence in the psychology of other-regarding preferences.

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76 Note that the work for Bardsley 2008 was known to List as presented Bardsley 2005.

77 Control treatment and variation on control which includes the option to take a single dollar; unequal endowments; 1/1 transfer rate.
Varying the origin of unequal endowments also yields interesting results: List finds that introducing a “pre-play” session in which participants “earn” their endowments, almost eliminates all giving and taking - 66% of subjects choose the status-quo compared to 30% in the control treatment as a result of much reduced “selfish” taking. This result seems highly suggestive of the possible relevance of “just deserts” - and perceptions of normative entitlement - in distribution related decision-making (that is to say, concern for distributional justice). Especially interesting, is that this result implies the possibility that a majority, even of those taking maximally under the taking option treatment in this experiment, are in fact concerned with distributional justice. This raises the possibility that those taking maximally within the game, may consider this behaviour, by some definition, “fair”. This would be consistent with the context dependence observed elsewhere for the moral significance of behaviour: often in life, “fair”, is defined by the rules of the game - what is “fair play” in one institutional context, often is not in another. Unfortunately, in the absence of any factorial analysis of these two parameters, we can learn lit- ittle from List’s experiments, about how “just deserts” interact with the apparent sensitivity displayed in distribution related decisions to the range of positive entitlements as defined and enforced by the experimental design.

Overall, List’s results seem to help us develop our referent-dependent social-preference hypothesis, without disentangling it much from the alternative experimenter-demand explanation. A common feature of both Bardsley and List’s work, is that by employing an incentive structure by which the most selfish choice is to take maximally, it allows space for interpretation of reduced average nominal giving as referent dependence in the resolution of tension between selfish and other-regarding motives, making evidence for the high level of experimenter-demand suggested, inconclusive.

Zizzo & Flemming (2011) make a provocative contribution to this conundrum, running back-to-back giving and money-burning dictator games with unequal endowments and augmented transfer rates. Under this incentive structure the neutral point of neither giving nor taking is the clear rational self-interested solution - since not only can a player not steal by burning, but actually incurs a cost. Altruists meanwhile, are free to give; while a sufficiently “spiteful” individual may be ready to actually pay to reduce the relative value of the other player’s endowment. Zizzo & Flemming (2011) expect moreover, that altruistic individuals should burn less, and spiteful individuals give less, while individuals susceptible to experimenter-demand-effects, it is hypothesized, may both give and burn. The authors find a statistically significant positive relationship between session level average giving and average burning in their results (spearman $\rho=0.3472$ $p=0.038$) - where each “session” consists
of two back-to-back giving/burning games, each game having the inverse direction of inequality in endowments from the other. This is presented as unequivocal evidence for experimenter-demand-effect: social-preferences, we are told “…are not... able to explain how a subject may both give and burn under these circumstances.” (Zizzo & Flemming 2007, p.3; see also Zizzo 2011, p.5).

These results certainly seem to challenge received interpretation of dictator game behaviour, but are social-preferences really unable to explain how a subject may both give and burn? Zizzo in an earlier burning experiment, finds that not only are subjects prepared to pay to burn other player’s endowments, but also, interestingly, that 75% of players are “rank egalitarian” - that is, they burn richer players as much or more than poorer ones, providing support, according to the author, for theories of interdependent preferences that predict agents care about how money is divided among other agents and not only about their own relative shares (Zizzo 2002; 2003; Zizzo & Oswald 2001). I propose that given the reversal of unequal endowments Zizzo & Flemming (2011) employ within sessions, and the relative size of the two players’ endowments, it seems that individuals with any sort of equity based preference for fairness, may be expected both to give and burn - consistent with a session level positive relationship between giving and burning. In fact, given that subjects would have to burn double what they gave in order to achieve a perfectly equal distribution, there would appear if anything, to be a structural incentive for any individuals with a preference for fairness, to burn more than they give. Thus it may not be possible to entirely rule out social-preference explanations for the observed positive relationship between giving and burning.

While there seems to be something intuitively wrong with the idea that burning could be other-regarding, if a preference for “fairness” operates irrespective of the direction of advantage, this is not consistent with simple self-interest but rather appears pro-social/other-regarding. The positive correlation between giving and burning identified by Zizzo & Flemming (2011) therefore, may, unexpectedly, provide support for an other-regarding motives hypothesis. An examination of the relationship between the direction of inequality in endowments and giving and burning behaviour in

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78 Note that given the 45/145 and 145/45 starting distribution for endowments, in the two treatments where players have the power to improve the equality of the split, they would have to give 25 and burn 50 (more than their entire endowment) to achieve a perfectly equal distribution.

79 Although it might be interesting to compare the relationship between giving and burning with those individuals who scored higher on the social-desirability scale stripped out. However the social desirability scale may not provide robust evidence given that a positive relationship between actual pro-social behaviour and participants scores (reported) should be expected, especially for non-extreme scores.
the study might help to clear up ambiguity on this point. As would running the same experiment with equal endowments and/or 1/1 transfers - there seems no reason to suppose that unequal endowments are intrinsic to the experimenter-demand hypothesis, thus why use augmented-transfers if you are not interested to explore preferences over relative endowments?

3.2 External validity of dictator game results?

These new contributions to the dictator game literature clearly seem to demand we reconsider received interpretation of dictator game giving. It is not clear however that any of the work discussed succeeds in establishing any convincing internally valid distinction between experimenter-demand and other-regarding motives. The appeal then, of an experimenter-demand hypothesis over an updated model of other-regarding motives, is that experimenter-demand apparently better accounts for the purported inconsistency between experimental results and “real-world” behaviour. What then, of this question of external validity? Why do we not see more anonymous giving in real-life? I propose that claims to inconsistency between dictator game and real-world behaviour stem from a naïve reading of the external relevance of dictator game results.

Bardsley complains “A common concern is that people could always make anonymous donations to random strangers in everyday life, for example by mailing cash to persons sampled from the telephone directory, but few if any choose to do so.” (Bardsley 2005, p.1). The personal satisfaction people obtain from being seen to be pro-social altruistic beings is hardly in question. The un-natural anonymous design of dictator games is precisely to control for these types of motives. Hardly surprising then, if in real-life, given the choice people generally take credit for giving. What is more, these sort of complaints miss the fundamental significance of the underlying tension between selfish needs and desires on the one hand; and other-regarding motives on the other, in the context of unlimited opportunity for giving. This tricky situation is resolved through personal and social regulating constraints on giving that define essential agent-centric limits to moral responsibility/culpability. Where unlimited responsibility would demand either discardal of other-regarding considerations, or complete effacement of self (as per e.g. Nitzsche’s view of un-reciprocal altruism as an unacceptable martyrdom (Nitzsche 1887[2007])), these regulating constraints

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80 This data not to my knowledge publicly available nor yet requested of the authors.
facilitate a managed compromise. Not only that a dictator game is a clearly limited one shot interaction making finite moral demands; but also critically the transparency of moral responsibility within the procedural relations established by the institutional structure and context of the game, constitute critically defining and meaningful features ignored by this type of skepticism regarding external validity.

The work of Dana et al., (2007) on “moral-wiggle-room” showing substantially reduced fairness when the connection between choices and outcomes is obfuscated in dictator games, at once challenges conventional interpretation of giving in dictator games, and highlights the importance of moral accountability through a direct investigation of its mechanics, addressing the question of how agents “manage” moral responsibility. Their conclusion however - that their results suggest fair behavior may be driven by a desire to appear fair without actually wanting a fair outcome - rests both upon the assumption that other-regarding preferences extend only to other players financial pay-offs not to their feelings; and moreover upon a particularly simplistic conceptualization of the ego, as unified and coherent. If we allow (1) that participants may be concerned for the social as well as material impact of their choices and (2) that we may not exploit uncertainty or lack of clarity only in the deception of others, but also in self-deception (see Cohen, 2000, for discussion of “denial”); it is not clear that Dana et. al.’s conclusions follow from their results.

Perhaps most importantly though, comments like Bardsley’s apparently assume an equivalence between game endowments and “real-world” personal-wealth. However while in dictator games, subjects generally receive arbitrary sums of money, in real-life there is little manna-from-heaven. Mostly we have to work for whatever we get; what is more, wherever unearned privilege does exist, more often than not this is perceived or constructed in terms of “just deserts” (the objectively-disadvantaged often coming to believe they deserve their lesser outcomes, while the objectively-privileged often come to believe, or persuade themselves, that they are entitled to/deserve their position of advantage (see e.g. Major 1994)). In this context, the suggestion in List’s results of the power of perceived “just deserts” in the psychology of normative entitlement to eliminate most giving and taking behaviour irrespective of positive entitlement to take as defined and enforced by the game, or inequality of distribution, clearly suggests another possibly important explanation for why we do not see more “real life” giving. After all, the idea of “just-deserts” as entitlement is enshrined at the ideological heart of “free-market” societies in which everything earns what it is
worth and is worth what it earns, and some psychology of entitlement must surely fundamentally underpin the persistence of the unequal outcomes these systems generate.

4. Final remarks

The experiments discussed provide interesting challenges to received interpretation of dictator game giving, but dramatic claims to proof of levels of experimenter-demand effect of a degree that invalidates social-preference interpretations, may be as exaggerated as some of the claims made for proof of altruism. Whilst highlighting the potential significance of cognitive and social demands placed on the subject by dictator games\textsuperscript{81}; the results of these studies may also, unexpectedly, suggest ways in which we might formulate a more sophisticated understanding of other-regarding motives, raising issues - e.g. referent dependence of other regarding preferences; the psychology of “just deserts” in unequal distributional outcomes etc. - of clear relevance to a wide variety of economic settings and problems.

While the sensitivity of dictator games to parameters is referred to critically by some (Bardsley, 2008; Zizzo, 2011); it must be recognised that dictator games are not the only games to display this sensitivity - as Levitt et al., (2007) note, in a wide range of experimental settings, subtle manipulations have been shown to have drastic effects on actions. Where these relationships are systematic, we can learn from them. A single word in an experiment, may be sufficient to entirely alter the game participants are playing - hence defection rates in prisoner dilemma games shift dramatically between “Community” and “Wall Street” games (Ross and Ward, 1996). This highlights a subtle conceptual concern associated with the problem of experimenter-demand: Levitt et al., (2007) note that “…an aspect of the lab over which experimenters have incomplete control is that subjects may not be playing the game that the experimenter intends.” (p.163). I suggest that in this sense, a healthy level of experimenter cues may be essential for interpretability, just as an experiment must be properly incentivized. But how do we distinguish between experimenter-demand inducing cues, and essential information, and thus how between experimental artifact, and genuine other-regarding motives? This may be a question that naïve realism and objectivist inquiry can only approach asymptotically.

\textsuperscript{81} See Zizzo, 2010 for discussion.
References


Are we capable of being altruistic?
Third Prize – Postgraduate Category

JACK WHYBROW AND JIWEI ZHENG*

Abstract

This short essay will seek to address whether we are capable of being altruistic. The essay will start with a discussion of the definition of altruism both from a modern language and theoretical perspective. Before moving on to discuss the ways in which economists have attempted to capture altruism and concluding with a general discussion. The results suggest behavioural economists have as yet been unable to explain acts of kindness purely in altruistic terms and instead have elements of other motivations. That does not however suggest that we are not capable which incidentally may or may not be true, but given current experimental methods we are yet to be successful in isolating strong altruism.

Altruism

The Oxford English Dictionary (Paperback) defines altruism as "unselfish concern for other people" (Oxford English Dictionary, 2006, pp.20). It originates from the Italian 'alttrui' meaning somebody else. To the authors of this work it appears that the definition of selfish and how this is defined is key to answering this question. The same source defines selfish as "concerned mainly with your own needs and wishes" (OED, 2006, pp.683). Needs and wishes are likewise defined as "want something because it is essential or important" (OED, 2006, pp.501) and "to feel a need or desire to have or do" (OED, 2006, pp.863). Similarly the body of literature on altruism defines this as: "Not abject self-sacrifice, but merely a willingness to act in the consideration of the interests of other persons, without the need of ulterior motives" (Thomas Nagel, 1970, p.79).

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Traditionally economists like to model the psychological processes of agents in terms of expected utility, where utility (or utils) is a quantified measure of gain/satisfaction from consumption of material goods. Doing a good deed therefore does not involve any material consumption and in this sense satisfies the definition of altruism. All-in utility (Zizzo, 2000) however is not constrained by the same materiality condition therefore if an individual gains some utils from the act (referred to as warm glow (Andreoni, 1990)) then this is not pure altruism. Conversely the same solution is arrived at if there is a penalty (dis-utils) in their utility function such as guilt associated with turning a blind eye to a fellow human in need -- inequity aversion, (Fehr and Schmidt, 1999). Therefore if an individual were to rationally stop help (assuming the cost of doing so is less than the disutility associated with doing nothing) then the individual is motivated by self-interest and therefore cannot be altruistic.

**Experimental Economics – Measuring Altruism**

Behavioural economists have attempted to use a variety of games to capture altruism, the most widely-used of which are the Ultimatum, Dictator and Trust Game. Each of these and their variations are conducted in experimental labs with test subjects. The Ultimatum Game (Guth et al., 1982) involves two participants who are randomly paired without complete information of who the other is paired with in a group of experimental subjects. The dictator (proposer) is given an endowment of experimental credits and then decides how much (if any) to allocate to the recipient (responder). These are subsequently exchanged at the end of the experiment into real monetary values. With knowledge of the dictator’s proposal the recipient now decides whether or not accept or reject. If the recipient chooses to accept then both parties receive what was proposed by the dictator. If however the recipient chooses to reject the dictator’s allocation both participants receive 0. Assuming both players are rational and are only interested in their associated payoffs the dictator will reason that as long as his offer is strictly greater than 0 then the recipient should agree, maximizing their respective earnings. The dictator should therefore offer the smallest denomination of experimental credits and the recipient should accept.

What we find is that although this result is observed in some instances the majority offer between 40-60% of their endowment. Offers below 40% are often accompanied with a high rate of rejection. (e.g. Cameron, 1999; Croson 1996; Eckel and Grossman, 2001;) Fairness and inequity aversion are

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82 There is a substantial literature on Expected Utility, its alternatives and rationality although this has been omitted for the purposes of clarity.

83 A deterministic way of expressing the happiness an individual feels for a certain event.
often used to justify why recipients reject as the negative utility from accepting offers below 40% are greater than the utility associated with the monetary payoff to the recipient, leading to the recipients to reject the allocation. It is however curious as to why dictators propose offers of more than 40%. One reason may be due to inequity aversion (Fehr and Schmidt, 1999) in that individuals are adverse to offers that are less than ‘fair’. Other academics have also attempted to explain this by extending the number of periods in which participants are paired. The results suggest that through learning effects we observe some convergence to 40% although some dictators still offer consistently more than this.

Several reasons in addition to altruism have been proposed to explain this effect these are namely: inequity aversion, warm glow and experimenter demand effects (Zizzo, 2010). Considering inequity aversion, the dictator may have only shared the material payoff to her co-player because an unfair proposal would generate substantial negative utilities above those associated with a greater material payoff. Alternatively if we consider warm glow, in sharing the allocation more equally the individual may gain positive utilities above that which would have been generated from receiving a higher material payoff. Finally, experimenter demand effects may influence individual decisions and result in a higher incidence of sharing either because of experimenter scrutiny or because the participants act in a way the experimenters would hope to see.

The Dictator Game (Kahneman et al., 1986) is a variant of the Ultimatum Game but with no avenue of recourse for the recipient when faced with the dictators’ proposal. The dictator is given an endowment of experimental credits and then decides how much (if any) to allocate to the recipient. Rational self-interested individuals would deduce that the recipient has no recourse to object to the dictator’s decision and therefore should allocate 0 to the recipient. Although this result is witnessed in test conditions not all agents allocate 0. Of those that do not allocate 0 the dictator gives on average 40% of their endowment to the recipient. Some have tried to verify this result by turning the game from a one-shot game to multiple periods, keeping the allotted dictators and recipients constant throughout. Regardless of adding additional periods the mean does not converge (fully) to 0. This result suggests something systematic in the way dictators are choosing to allocate their endowment. As we saw in the ultimatum game similarly inequity aversion, warm glow and experimenter demand effects have also been proposed to explain this result in addition to altruism.

\[ \psi = -\alpha (v-u) \text{ if } v \geq u \text{ and } \psi = -\beta (u-v) \text{ if } v \leq u, \quad 0 < \alpha < \beta, \text{ or the difference between the dictator and his/her co-player’s material payoffs will decrease the dictators all-in utilities, the dictator will choose to share some material payoffs to his/her co-player to avoid this decrease.} \]
The trust game proposed by Berg, Dickhunt and McCabe (1995) like the previous two involves two participants who are randomly paired in a group of participants without knowledge of who the other is paired with. One participant is then allocated as the investor (truster) and the other the recipient (trustee). The investor is then given an endowment of experimental credits and then decides how much (if any) to invest. Usually the amount invested is then multiplied by some factor and transferred to the recipient. The recipient then decides how much if any to return to the investor. Fully rational investors would deduce that self-interested recipients will return 0 maximizing their payoff over a one period game, although both could do jointly better if they invested. Extending the game to multiple periods rational agents should reason the same by backwards induction. Suppose the trust game runs for 10 periods then the most rational thing for a self-interested profit-maximizing recipient to do is to return 0. An investor will reason this and therefore invest 0 on the ultimate round. The recipient reasoning this would therefore return 0 on the penultimate round and so forth.

What we find is that although this result is observed, many participants establish trust in the initial rounds only defaulting in the penultimate rounds. In some cases trust and fulfilling is also maintained throughout the whole experiment. Jacobsen and Sadrieh (1996) found participants invested 60% and were repaid 110%. Koford (1998) found the participants invested 70% and got 150% back. As with the previous two cases the results found in these experiments cannot be explained purely with altruism. Aside from inequity aversion, warm glow and experimenter demand effects there are at least two other explanations. The first is ‘kindness reciprocity’ and the second is ‘trust responsiveness’. Kindness reciprocity (Rabin, 1993; Falk and Fischbacher, 2001) occurs when a recipient reciprocates the trust of the trustee in returning some of the investment. ‘Trust responsiveness’ (Bacharach and Zizzo, 2007) occurs when the recipient fulfils this trust because they believe the investor trusts them. The more she believes so, the more she is going to fulfil the investor.

In summary we cannot explain the results purely with altruism instead we must use this in conjunction with other reasons. This may be because we do not yet possess the methodology to isolate pure altruism from individual players or simply it does not exist. It is however likely that some form of altruism may exist as in any experiment as in real life there will be differences between individuals and their underlying motivations.
Philosophical Incites and General Discussion

Experimental results aside it can however be argued that it is unreasonable to expect an individual to commit a purely altruistic act/action without some form of gain whether this be material or otherwise. Even if the individual commits an act that appears purely altruistic due to human, computational or forecasting errors (and it is inconceivable that an individual can gain from it), they are likely to have taken this action due to self-interested reasoning. Critiques of this would likely bring forth notable examples such as Nelson Mandela to name one but a few as an example of altruism. Or can it? It would be hard to refute that his fame has not allowed him a much more extravagant lifestyle than that which can be obtained through work. Notable examples aside it is important to remember altruism may come in many different forms such as someone who holds down three jobs and does his/her best for their family and still has the time to help a stranger in need. Although even here it may be argued that this individual has a vested interest in their children (sunk costs) and may help a stranger due to inequity aversion.

In the Wealth of Nations Adam Smith (attributed as the father of economics and by some of behavioural economics) commented about the idea that an individual may sympathize with another individual/being when they are experiencing a bad turn of events, due partly to we imagining ourselves in their shoes. Again this can be explained at least in part through inequity aversion. There may also even be something biological in why we respond this way which may have allowed us to feel compassion for our own (as long as the risks to the individual are not too great) and in that way bolstered the species survival as a whole.

This essay has been primarily focused on interpreting the question as whether or not we are capable of committing an act without some form of gain. If the question is purely concerned with whether or not we are ‘physically’ capable of committing an altruistic act by error or otherwise then we must surely believe this is possible. Key to the argument presented above is whether or not we can indeed separate the ‘act of altruism’ from the ‘belief system’. In essence separating the act from whether an individual believes they are doing a good deed\textsuperscript{85}.

Conclusion

This short essay aimed to address whether or not we are capable of being altruistic. The question itself was broad and could be interpreted in a number of different ways. For example if we are to

\textsuperscript{85} One would be justified in looking at relativism and determinism here, although these were omitted as the authors felt this was steering too far into the realm of philosophy in which neither author is well equipped to navigate.
purely consider whether we are ‘physically’ capable of committing an altruistic act then we firmly agree with this view. If we are to consider the deeper issue of whether an individual would purposely commit an altruistic act we find no justification. The evidence presented within the main body of this essay suggests we cannot dispute altruism as possible justification for what we observe but the results can also be explained by other motivations. We do not yet have the methodology to isolate altruism. Indeed this may even be unattainable. In the meantime we must look to other disciplines for insights into this problem.
Bibliography

UEA Graduate Career Profile: Pricing Consultant

What did you do after leaving university?

After completing my masters I secured a role at Aviva as a Pricing Analyst which started straight after the completion of my course. I joined the company at a trainee level and after six months was promoted to Consultant level, I am still in that role.

Why did you choose your first/current graduate employer?

I applied for a role at Aviva because I liked the area, the job sounded interesting and fitted my degree well, and the pay was good!

What does your job entail?

My job varies quite a bit from day to day, as a high level summary the role involves maintaining and developing insurance pricing methods whilst focussing on Sales, Claims, and Overall Profitability. The key skills required for the role are: Collecting and Analysing large data sets, producing analysis, working with other business areas to agree aims and assumptions, presenting analysis and results to gain sign off from the exec, working as a team on large projects and managing your time effectively etc.

I like my job a lot. I work in a small team and get on well with everyone, the work is interesting and makes a big impact on the overall strategy and direction of the company, the pay is good and the role allows for flexible working hours which is good.

What opportunities for progression are there in your role?

There are many opportunities for development in my role including undertaking professional qualifications though these require meeting entry requirements. The company also provides training courses to help develop technical and personal skills required for the role.

James’ tips for gaining graduate employment

- Apply for jobs as early as possible
- Try to stand out from other applicants
- Show employers that you are keen to learn and are committed to a career with the company
- Practice numerical, and verbal reasoning tests these will be required for most graduate roles
- Make sure your CV is clear, looks professional, and has no spelling or formatting mistakes
- Prepare well for interviews
- Practice presentation and excel skills as some companies may also test you on these
Terminology

QTS (Qualified Teacher Status): The accreditation that enables you to teach in state-maintained and special schools in England and Wales. Achieving QTS means that you are fully qualified to teach.

NQT (Newly Qualified Teacher): A teacher who has completed a PGCE and is in their first year of teaching.

PGCE (Postgraduate Certificate in Education): A postgraduate qualification in England and Wales which is one route to becoming a school teacher.

SCITT (School-centred initial teacher training): Training which leads to QTS but is more school based than the PGCE.

GTP (Graduate Teaching Programme): A programme that leads to QTS while training and working in a paid teaching role.

GTTR (Graduate Teacher Training Registry): The organisation responsible for graduate students applying for initial teaching training.


Thinking about Teacher Training?

By Zoe Bett

Teaching can be a rewarding occupation of the right person both financially and personally. It can be a career that will allow you to use your skills, qualifications and personal qualities. There are great opportunities for development and career progression. Training grants of up to £20,000 are also available for some subjects. However, teaching is not for everyone and the decision as to whether to consider it as a career option should be carefully thought through.

Routes into teaching

- **PGCE**
  
  In order to complete a PGCE you must first complete an undergraduate degree. You can also complete a PGCE after completing a postgraduate qualification such as a Masters or PhD. You will also be required to hold GCSEs with a Grade C or above in English and Mathematics and, if you are applying to the Primary PGCE, also in Science (or equivalent).

- **Other Options**
  
  Another option is to do a SCITT course which are much more school based than the standard PGCE. SCITT courses normally require you to have more teaching experience than PGCE and are normally run by schools rather than universities. Click here for more details for providers.

  You can also do the Graduate Teaching Programme (GTP). Like SCITT this is a school based programme. Click here for further details.

  It is most likely that most people who want to become a teacher straight after completing an undergraduate degree will do a PGCE since the SCITT and GTP generally require more extensive classroom experience.

  Passing QTS involves fulfilling a number of criteria. You will be assigned a mentor when you start your first job after the PGCE who will decide if you have fulfilled all the criteria.

“...some universities will allow you to enrol on their PGCE in a subject other than your degree subject if a significant proportion of your degree was related to that subject such as business or maths”
Work experience and ways to get it.

It is essential to gain work experience before doing teacher training. It will not only aid your application but will also help you decide which level or subject you want to teach at. You will probably be asked about your work experience at interview.

Contact Schools directly – Many schools will be willing to let you observe classes or shadow teachers. Use this website to find school close to you and contact details.

Volunteer – There are a wealth of opportunities that you can fit around your studies (link). UEA also run a Volunteers in Primary School Scheme

Become a Teaching Assistant/Classroom Assistant – You would normally do this after completing your degree as posts tend to be between 20 and 35 hours a week. However posts with less hours a week are available) in this post you would never be solely responsible for class but would instead either assist the teachers with the class or individual pupils (for example those with special educational needs)

Become a Cover Supervisor - in these positions you will be required to be available to cover classes if for example a teacher becomes sick. These positions are generally full time.

Click here for school vacancies in Norfolk

Top Tips:

- Never apply for both the primary and secondary course. The people accessing your application may see this as you being indecisive or not certain about a career in teaching
- Get experience! This will help convince people assessing your application that you are serious about wanting to be a teacher.
- If you are applying for high school PGCE choose a subject and stick to it! (Economics, Maths)
- Prepare for the interview! Click here for some advice.

Most SCITT courses and GTPs will give you Qualified Teacher Status (QTS) after one year (in essence you are able to skip being an NQT after the course in over because of the amount of classroom time within the course) but may not give you a PGCE (some councils may have agreements with a local university to award you the academic qualification). It's a little complicated but the only real difference that you will notice in the course is that the SCITT course and GTPs are a lot more classroom based. It's really a decision about how you learn best and how much experience you have had in the classroom prior to training to be a teacher.

Pay scales

Pay scales for teachers are shown here (link) and you will increase one scale point a year. In your NQT year you will be on scale point 1. Starting salaries for teachers outside London are just over £21,000 increasing in increments of about £2000 a year.

Entry Requirements

For secondary PGCE you will need an undergraduate degree in the subject you want to teach. However some universities will allow you to enrol on their PGCE in a subject other than your degree subject if you can show that a significant proportion of your degree was related to that subject such as business or maths.

Some universities will also require that you do a subject enhancement course if they feel that your knowledge of the subject should be improved before starting the course. These can normally be taken 6 months before the course starts and their completion may be a condition of entry to the course.

The subject area you studied is largely irrelevant if you want to study for a primary PGCE. However courses in subjects that feature in the primary curriculum are preferred. There are also Primary years PGCEs which specialise in languages, art, English, English as an additional language, humanities, maths, music and science for which you may need specific qualifications.

Application Process

You apply for all university based PGCE course through the GTTR website. You apply for some SCITT courses through the GTTR website too but some ask you apply directly to them. You always apply for the GTP directly through the provider. Please look at individual websites to find out more. It costs £19 to apply through the GTTR website for courses starting in 2012. However if you apply for a secondary maths, physics, chemistry or modern foreign languages course through the GTTR you can claim the money back. You will need to register on the website, fill out the application form (together with a personal statement) and provide two referees (link) Deadlines can be found here but remember that some courses may be filled before the deadline. If you are successful at this stage you will be asked for an interview.
Who to contact

For more information on the UEA PGCE please contact edu.pgce.admiss@uea.ac.uk Tel: 01603 592855 (link)

For information of SCITT courses in Norfolk and Suffolk please contact edward.hill@suffolk.gov.uk Tel: 01473 265080 (link)

For information on GTP in Norfolk and Suffolk please contact beverley.gregory@norfolk.gov.uk or debbie.barr@norfolk.gov.uk Tel: 01603 307703 or 307706 (link)

For information on a career in teaching call the teaching information line on 0800 389 2500 or visit the TDA Facebook page

For information on the application please call the GTTR on 0871 468 0469 or visit their website.

Tuition fees and Bursaries

You will have to pay tuition fees to complete a PGCE and SCITT and tuition fees will vary by course, university and SCITT provider. With GTP providers some programmes are funded and some aren’t. Contact each directly to find out exact tuition or training fees. However Home and EU students on PGCE and SCITT courses could be eligible for a tuition fee loan through Student Finance England

The bursaries are the same for SCITT and PGCE. In order to get a training bursary from the government (you don’t have to pay these back) you will need at least at 2:2 degree although many universities require that you have a 2:1 degree to get onto their PGCE. Bursaries are given out according to subject taught, level taught and degree classification and the level of payment increases for subjects where there is a shortage of teachers.

For example for an Economics PGCE and Primary PGCE you would receive a £9000 bursary if you got a first, £5000 if you got a 2:1 and nothing if you got a 2:2. For a Mathematics PGCE you would receive a £20,000 bursary if you got a first £15, 000 if you got a 2:1 and £12,000 if you got a 2:2. Click here for further details. Bursaries are subject to UK residency requirement so please check the TDA website to check you are eligible.

On the GTP you will be paid as an unqualified teacher (http://www.tes.co.uk/article.aspx?storycode=6000189).

“Training grants of up to £20,000 are also available for some subjects.”

UEA offers the following courses

- **Lower Primary** (Specialising in the Foundation Stage - Nursery and Reception - and Key Stage 1 - Years 1 and 2)
- **Primary** (Specialising in Key Stage 1 - Years 1 and 2 - and Lower Key Stage 2 - Years 3 and 4)
- **Upper Primary** (Specialising in Key Stage 2 - Years 3, 4, 5 and 6)
- **Primary Specialising in French/ German/ Spanish** (Specialising in Key Stage 2 - Years 3, 4, 5 and 6 - including language teaching)
- **High school (age 11+) Biology/ English/ Chemistry/ French/ Geography/ German/ History/ Maths/ Modern Languages (French, German, Spanish) / Physical Education/ Physics/ Religious Education**

Many thanks to Rebecca Lewis (History Teacher at Wymondham College) and Leigh Osborne (Admin Assistant – PGCE Admissions) for their input and advice!
Curriculum Vitae Advice

By Stephan Schmitt

Increase your employability

Amongst other things, students come to University to improve their job prospects, or their employability, a term widely used to describe the combination of skills and personal attributes that make people more likely to gain employment and be successful in their chosen occupations. Employability combines three main attributes:

Employment related skills: including oral and written communication, numeracy, team working, IT, problem solving, planning & organisation, adaptability & flexibility and leadership.

Career management skills: including self-awareness, decision making, ability to exploit opportunities, presentation skills on paper and in person and commercial awareness.

Experience of a work environment: this can be gained through paid work, voluntary work, work placements or projects.

Some employability skills will be developed throughout your course of academic study, whilst others can be developed through your social and leisure interests and part time employment. The Careers Centre can help you develop your Career management skills, including how to write an effective CV.

What is a CV and when to use it?

A CV is your marketing document and opportunity to market yourself to an employer who may know nothing else about you. A CV is a summary of your experience and skills to-date that highlights your strengths and suitability for a particular job or employer. You can use it to respond to job adverts or to write speculatively to an employer you are interested in working for. It should be sent in conjunction with a covering letter, which is usually the first document the employer reads when they receive your application. Its purpose is to make a positive first impression by highlighting the most relevant parts of your experience and capabilities as included on your CV.

CV Builder

A good place to start is by looking at CV Builder on the Careers Service website http://www.uea.ac.uk/careers/applications or from the Academic Tab of your Portal pages. All current undergraduate and taught postgraduate students should be enrolled and you can use it throughout your time at UEA.

CV Builder provides space to chronicle your activities and skills developed from academic work, employment and leisure time. It can act as a personal inventory of your progress at UEA and helps to translate it into the language used in CVs and applications. There are also examples of CVs and covering letters.

We recommend that you use CV Builder and then get feedback from Careers & Employability staff before you apply for a job or opportunity. You will then be giving yourself the best chance of success.
CV Essentials

Here are some points to remember when writing your CV:

- **Your unique document** A CV is your personal document and will reflect your unique combination of experience, interests and abilities. It is best to avoid CV templates for this reason, but they can be a useful starting point.

- **Targeting** Target your CV to the opportunity or organisation you are applying to – a simple list of your qualifications and work experience is not enough. Illustrate your relevant skills, experience and achievements that will interest the employer, based on the job description and your research into the organisation.

- **Prioritise** Ensure that the most relevant information is given priority. Think about what to include on the front page that will make the employer want to read on. Arrange all sections in reverse chronological order.

- **Accessibility** Recruiters rarely have sufficient time to review applications. As a rule, assume that the person reading your covering letter and CV will have no more than one minute to make decisions about the quality of your application. Keep it to 2 pages in length for a graduate CV.

- **Be positive** Avoid drawing attention to your negative points (low grades for example) or lack of experience but be prepared to talk about these at a later stage.

- **Attention to detail** Avoid spelling mistakes. Get someone to check it over before sending and do not rely on computer spellcheckers alone.

- **It takes time** Allow plenty of time to put your CV together. Writing an effective CV is rarely accomplished first time; it is likely to evolve as you make more applications.

Careers Advisers are available at the Careers Service to give CV feedback during 15 minute Quick Query appointments which are available daily from 11am until 4pm during term time (closed for lunch 1-2pm during vacation.) Appointments can be made on the day by phone or in person. The Careers Service can advise graduates too.

**Thank you to the Careers Service who provided much of the information contained in this article.**

Careers & Employability, Telephone: 01603 593452. Fax: 01603 593453, Email: careerscentre@uea.ac.uk
Advice on Personal Statements
By Stephan Schmitt

Many job application forms include a large space for candidates to write something about themselves that will convince the employers to take them on. This can be quite daunting: what should you include in your personal statement and, more importantly, what should you NOT include?

It is very important that you tailor each personal statement for the specific job you are applying for. Do not simply copy and paste an old personal statement into your new application.

Don’t be lazy and simple write ‘see my attached CV/cover letter’. While you may find yourself repeating much of the information contained within those documents, it is important to make an effort to craft something new here.

It is important not to make a personal statement into a dense, unreadable block of text. You need to write good prose in full sentences and break it up into small paragraphs. Use headings to help guide the reader’s eye to the most important information.

Try to write in a style that makes your statement fresh and slightly different to the formal prose of most of your application materials. You are trying to sell yourself as an attractive personality as well as a professional employee.

As with all parts of your application, make sure as many people as possible proofread your personal statement. Nothing says ‘unprofessional’ like a personal statement full of typos or grammar mistakes. Also, while you may think you have expressed yourself very clearly, other readers may be able to highlight sentences or words that are incorrect, irrelevant or could be more clearly expressed. A good personal statement passes through many drafts, so make sure you give enough time to the writing and re-drafting process.

Thank you to the Careers Service who provided much of the information contained in this article.
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What to include

- Events from your education/career to date that make you especially suited to the job (including volunteer work/work experience): it is important to be able to write about these events enthusiastically

- What it is about the job that especially attracts you to it

- The skills/knowledge base you have that is relevant to the job

- What is the unique contribution you can make to the university/company? Check online for their mission statement and refer to that when describing how you can contribute

- Refer directly to the job description using the same language and then relate that to your own experiences

- What are your career aims? You might have to be creative here! Tailor your answer to the job you’re applying for and make it seem as though you are desperate to pursue a career in that area! However, try to make your statement as honest as possible; you want to come across as a real person and not simply parroting what you think the employers want to hear. It is a difficult balance to achieve
Book Review: ‘Micro Trends – Surprising tales of the way we live today’
by Jack Whybrow (PhD– Applied Econometrics & Policy)

Penn is a renowned advisor and pollster and is widely praised for his ability to identify and motivate niche groups in society. He has also held advisory roles in several blue-chip companies (Microsoft and BP) in addition to heads of state (Bill Clinton, Tony Blair and others in Asia and Latin America). This book reports on how small groups and their behaviour can and do cause big changes in society and the ways in which we live today.

The book itself is made up of 15 chapters and numerous sub-topics ranging from ‘Love, Sex, and Relationships’ to ‘Race and Religion’. It reveals many intriguing incites from the world in which we live. Penn’s ‘out of the box’ thinking is prevalent throughout. My only criticism is that Penn consistently uses data from two to three years, deriving his trends from that. These incites are however often supported with external data but this does give the book an amateurish feel in places.

This book would appeal to those who take an active interest in American politics or those of us who are trying to identify the next big thing. The book would also be of some interest to the general reader as it reveals just how different we are from each other and challenges prior held beliefs and expectations.

Feeling inspired?

The Norwich Economic Papers are looking for book reviews for volume 6 to be published in June. A list of books which you can review can be found on the NEP website at www.uea.ac.uk/eco/essays. We also welcome reviews of any of the Contemporary Economic Issues lectures.

If your review is published you will receive £25!

Please send reviews to s.schmitt@uea.ac.uk