

CONTENTS

page

DIRECTOR'S REPORT

2

Our events programme 2006

4

RESEARCH IN 2006

The citizen's pension – a costly mistake? <i>by Justin van de Ven and Martin Weale</i>	6
The reliability of individuals' expectations <i>by James Mitchell</i>	7
Employment relations in small firms <i>by John Forth</i>	8
Employment equality (age) regulations <i>by Hilary Metcalf and Pamela Meadows</i>	9
Opening up opportunities through advice and guidance <i>by Heather Rolfe and Sadia Nadeem</i>	10
Low-wage employment in the UK <i>by Geoff Mason</i>	11
Spillover effects from education <i>by Rebecca Riley and Simon Kirby</i>	12
Productivity and business churn – is there an optimal rate? <i>by Catherine Robinson</i>	13
Financial integration and the transmission of shocks <i>by Dawn Holland</i>	14
Extending working lives <i>by Ray Barrell</i>	15
Modelling the economy <i>by Ray Barrell</i>	16
Aggregate mortality risk and the annuity market <i>by Martin Weale</i>	18

PUBLICISING INSTITUTE RESEARCH

<i>National Institute Economic Review</i>	19
National Institute Discussion Papers and Monthly GDP	20
Other published reports and articles	21
Papers presented	23
NIESR in the news	26

SUPPORTERS OF THE INSTITUTE

28

FINANCIAL SUMMARY

29

PEOPLE AT THE INSTITUTE

Institute governors	30
Institute staff and visitors	31

DIRECTOR'S REPORT

It is fair to say that the National Institute's quarterly economic forecasts and the debate surrounding them are the contribution to the economic scene for which the Institute is best known and probably most widely recognised. However I would like to take this opportunity to draw attention to the way in which the forecast is produced. Obviously there are, nowadays, many econometric models, but the National Institute Global Econometric Model is, to our knowledge, the only model of the world economy which is used to produce consistent projections for the major countries and regions of the world. The forecasts are consistent in the sense that trade flows are fully accounted for. Our model ensures that the same figures for trade flows between, for example, the United Kingdom and the United States, are used in forecasting the economies of both countries. In maintaining and developing our model we need to strike a balance between the structural requirements of economic theory and the equally essential need to produce a model which is coherent with the data. The skill with which my colleagues carry out this task must be the main factor which leads outsiders to describe the model as a benchmark.

A benchmark economic model does not, of course, guarantee good economic forecasts, and an attempt to compare the performance of our forecasts with those of the Treasury serves to demonstrate the difficulties in such a comparison. Forecasts produced later in the year are likely to be more accurate than those produced earlier. How should one rate forecasts which seemed right immediately after the event but which are then devalued by data revisions perhaps a couple of years later? A reasonable conclusion from the exercise is that the two sets of forecasts are of similar quality, with the obvious inference that it is a mistake for any one forecaster to claim superiority. For example, in recent years the Treasury budget forecasts have been worse than ours but in the late 1990s they were better. It is very difficult to argue that anything except luck accounts for this change.

But in reporting on the Institute as a whole it is important to stress that only a minority of our staff are involved in work on the model and the related forecasts. The areas of our research and the work that we carry out are on the interface between the specific interests and skills of our research staff and set of topics for which we are able to obtain funding.

The broad topic of employment is an important area of our research, with work during the year looking at topics ranging from the link between basic skills, training and employment to studying the evolution of low pay in the country. Our involvement in the Workplace Employment Relations Survey and, this year, analysis of its findings, is a key component of our work in this area.

Moving to other topics, our productivity group is working on a substantial study of the contribution of different types of labour and capital to economic growth in the European Union countries; the substantial effort in data collection in this work is close to completion and next year I expect to be able to report the key findings. We have completed a substantial amount of work on pensions and our efforts in this area are progressing into the study of the interaction between household formation, fertility decisions and female labour supply. Our time-series work on economic statistics has been strengthened by new arrangements with EUROSTAT; in the coming year we also expect to do further work on qualitative surveys.

The subsequent pages give a more detailed indication of some of the research that we have done in the past year and this is followed by details of publication and other dissemination activities. However, as well as carrying out high-quality research, we also contribute to the policy debate. There are a number of ways in which we do this.

First of all, our regular forecasts are as important for the policy commentary associated with them as for the numbers that they contain. On pages 26 and 27 you can see some of the press comment that these, and the related material, have attracted.

Secondly, we find ourselves approached regularly by government departments for work on the key policy issues of the day. Recent examples of this type of work include a study for the Department of Work and Pensions of the effect of later retirement on savings behaviour (see page 15). If life-cycle behaviour is believed to motivate savings, it is not surprising that a policy of encouraging later retirement conflicts with a policy of encouraging saving.

Still other involvement with policy issues can come some time after relevant work has been completed. For example, in 2004–5 we worked on the measurement of health service output. This meant that we had considered in some depth the way in which public sector output should be shown in the national accounts. As a consequence we were able to contribute substantially to the consultation carried out by the Office for National Statistics on this topic as part of the implementation of the Atkinson Review.

However, NIESR's policy influence is not confined to research funded by government departments. As in previous years, during 2006 a number of staff have contributed to policy issues by giving evidence to parliamentary committees and sitting on advisory boards of various government departments and organisations. It is gratifying to report that our international standing continues to be recognised by the appointment of Ray Barrell to the advisory board of the Paris-based *Centre d'Etudes Prospectives et d'Informations Internationales* (CEPII).

This report provides the opportunity to comment on the financial position of the Institute. The accounts on page 29 show a substantial surplus in

2002/3 followed by losses for the past three years; in this context it is worth pointing out that the National Institute is a charity and a non-profit-making company, with the implication that there are likely to be surpluses in some years and deficits in other years. The level of research spending itself can be substantially affected by our participation in European Community projects. In some of these, one partner collects income for the others and then distributes it. This appears in our accounts as both income and expenditure and the fluctuations in the past four years are largely due to movements in this item rather than fluctuations in the amount of research undertaken at the Institute.

From what follows, I am sure you will agree that 2006 has been a productive year for NIESR. We hope to continue in the same vein for many years to come and to maintain the organisation's reputation for combining academic research of the highest standing with policy relevance.

I should like to thank the organisations and individuals with whom NIESR has cooperated over the past year. We have benefited greatly from this collaboration in carrying out both our research and dissemination activities. We should also pass on our gratitude to our corporate members who make a valuable contribution to the generic funding of NIESR and in particular the time spent producing our economic forecasts of both the UK and world economies. Finally, I should congratulate Professor Sig Prais, whose immense contribution to research over the years has been recognised by the University of Birmingham with the award of an honorary doctorate in July.

OUR EVENTS PROGRAMME 2006

NIESR continued to expand its events programme in 2006, organising and hosting more conferences, lectures and seminars than in previous years. We have several events already lined up for 2007.

In January the fourth Public Sector Performance Conference was held at the British Academy, organised by Philip Stevens and Mary O'Mahony. Recent increases in public sector spending have highlighted the need to evaluate the performance of the provision of public services. This conference considered what it is we are trying to assess – the measurement of performance and to what use these measures are put. An introduction was given by Christopher Hood, Programme Director of the ESRC Public Services Programme, and was followed by papers from Rowena Jacobs, Centre for Health Economics, University of York, Iain McLean and Dirk Haubrich from the Department of Politics and International Relations at the University of Oxford, and Gwyn Bevan, Department of Operational Research, London School of Economics, amongst other eminent speakers. Concluding remarks were made by Lord Turnbull, former Secretary of the Cabinet and Head of the Home Civil Service.

February saw the first in the annual Westminster Economics Forum series of lunchtime seminars. 'The State of Small Business in the UK' was presented by Professor Sara Carter from the University of Stirling. Her talk outlined how the encouragement of enterprise has been central to the economic strategies of successive British governments. Drawing on data from one of the largest business surveys, the seminar addressed some of the key questions surrounding the small business sector. The seminar heralded the beginning of the series, entitled 'The Effects of Policy on Business'.

The second in this series followed in February. NIESR Senior Research Fellow, Geoff Mason, presented 'Encouraging Firms to Move up the

Value Added Chain: What Policies are Likely to be Effective?' at NIESR. He asserted that as competitive pressures mount in the world economy, British enterprises are increasingly urged to specialise in high value added goods and services. His findings have important implications for policymakers wanting to encourage firms to move up the value added chain.

In March NIESR was joint host with the Société Universitaire Européenne de Recherches Financières (SUERF) at the De-Regulation and Integration in European Banking seminar. Discussion centred on how powerful pressures of structural change are operating on banking systems both in Europe and worldwide. Ray Barrell, Senior Research Fellow, NIESR, and David T. Llewellyn, SUERF President and Professor of Finance and Banking at the University of Loughborough gave a welcome address. This was followed by presentations from representatives from the Kiel Institute for World Economics, Tilburg University, the University of Ghent, and University of Loughborough, amongst others.

April saw the third and final lunchtime seminar in the Westminster Economics Forum series of 2006. 'The Impact of Competition and Globalisation on Work-Life Balance and Management Practices' was a paper presented by Dr Nick Bloom of the LSE. In his presentation, he asked, Does good management and higher productivity come at the expense of work-life balance? This is the view of critics of Anglo-Saxon liberalism who argue that increased competition from globalisation is damaging employees' quality of life. Held at the DTI conference centre, it proved to be a highly popular event.

In May NIESR hosted a one-day event to promote a discussion on the consequences of Economic Churn in the UK, sponsored by the DTI Small Business Service. It was entitled: 'Business Entry and Exit – Is There an 'Optimal'



Catherine Robinson, NIESR, and David Storey, Warwick University.

Rate of Churn?’ and discussed how the continual entry and exit of firms underpins the dynamic market. This churn may be seen as a positive form of ‘creative destruction’ when it represents a reallocation of

resources to more efficient uses and raises domestic productivity levels. Participants included Jonathan Haskel (QMUL), Rafaella Sadun and David Storey (University of Warwick), Richard Harris (Glasgow) and Paul Temple (Surrey University), as well as senior DTI economists.

In July the Westminster Economics Forum final seminar and dinner was held at The Athenaeum Club, Pall Mall. A talk on the subject of Regulation was led by



Sir David Arculus

Sir David Arculus, former Chairman of the Better Regulation Task Force and a Non-Executive Director of O₂ Communications plc. The event was followed by question time and a dinner.

In September NIESR held a one-day conference at The British Academy. ‘Tackling age discrimination in Britain – the Employment Equality (Age) Regulations (EEAR) and beyond’



(left to right) Pamela Meadows, Heather Rolfe and Hilary Metcalf, NIESR at the conference on ‘Tackling age discrimination in Britain’.

was concerned with the Employment Equality (Age) Regulations that came into effect on 1 October. For the first time this will outlaw age discrimination in employment

(whether against older or younger people). This conference asked what difference this would make to current employment practices. It examined how the EEAR will affect employment practice and how policy may be taken forward to reduce other forms of discrimination. The emphasis was on practical challenges grounded in research evidence. Speakers included Professor Dominic Abrams, University of Kent and Age Concern England, Professor John McNicol, LSE, Hilary Metcalf, NIESR, Richard Baker, Chair of the EU AGE Group on Ageism, and Caroline Waters, Director, People & Policy for BT Group, amongst other eminent academics in the field.

The final event of the year took place at NIESR in December, marking the beginning of the following year’s Westminster Economics Forum series, this time entitled

‘Measurement and Data Performance’. Professor Carol Jagger from the University of Leicester spoke on ‘Measuring Healthy Life Expectancy’. She found little evidence that increases in life expectancy are slowing down.



Professor Carol Jagger, University of Leicester.

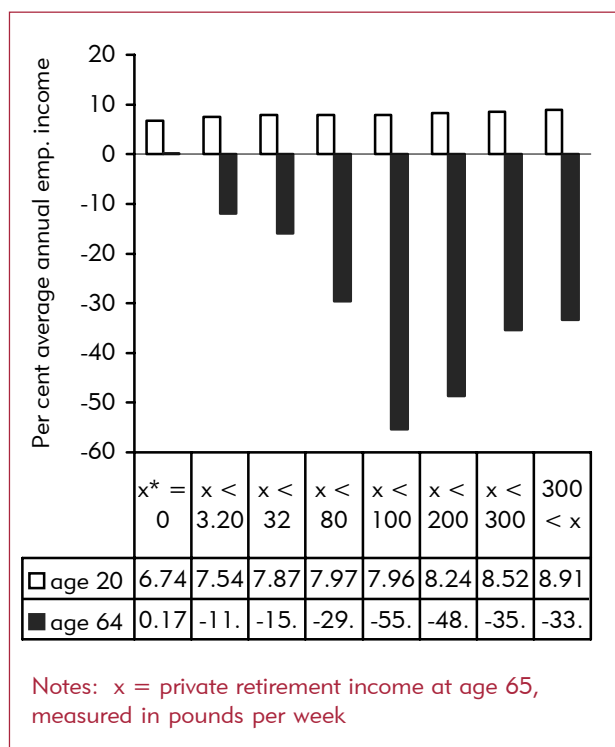
The question is not therefore whether we are living longer, but whether these extra years are healthy years. Measuring and monitoring life expectancy is relatively easy, measuring healthy life expectancy is not. The issues were addressed using examples from the MRC Cognitive Function and Ageing Study (MRC CFAS), ONS and the new European Union structural indicator Healthy Life Years. Martin Weale, NIESR Director, acted as discussant and NIESR Council of Management member Bronwyn Curtis chaired the proceedings, which were followed by a luncheon.

THE CITIZEN'S PENSION – A COSTLY MISTAKE?

Following the publication of the Pensions Commission's final report and the subsequent responses from the Government, the pensions debate in the UK is now beginning to bear tangible results. One of the key aspects of the pension system that is emerging from the debate is the adoption of a means tested benefit, with rates and thresholds frozen (in real terms) around values that are currently applicable under the Pension Credit. This implies that a 40 per cent withdrawal rate is likely to continue to apply to personal income in retirement, up to the point where means-tested retirement benefits are exhausted. Means-testing was, however, an important focus of contention, with many influential parties instead advocating the adoption of a Citizen's Pension. Have we got it right in settling on a means-tested pension, or could we do better by doing away with means-testing entirely?

To consider this question, we modelled the life-course decisions of households in the context of two policy counterfactuals. Both counterfactuals were based upon the existing tax and benefits

Compensated variations of reducing the taper rate on means tested pensions from 40% (Pension Credit) to 0% (Citizen's Pension)



system, and were distinguished principally by the withdrawal rates applied to the difference between the Pension Guarantee and the Basic State Pension in retirement (worth £24.65 per week for a single pensioner, and £32 per week for a pensioner couple in 2003/4). Tax adjustments were also applied during the working lifetime to ensure budget neutrality. Households were considered to make their decisions to maximise expected lifetime utility, subject to rational expectations regarding their economic environment. We then calculated the compensating variations (CVs) implied by a shift from a 40 per cent withdrawal rate to a Citizen's Pension with no means testing. The results of this analysis are shown in the figure.

The statistics reported in the figure reveal an interesting story. Reducing the withdrawal rates applied to means tested pensions improves the welfare of households over retirement age, a result that is clearly consistent with the increased generosity implied for state pensions. In contrast, the statistics reported for age 20 indicate that reducing pension withdrawal rates from 40 to 0 per cent reduces welfare measured from the perspective of the entire life-course. Our analysis suggests that these observations are primarily attributable to the tax adjustments that are required to obtain budget neutrality between the alternative policy counterfactuals. Specifically, a 40 per cent withdrawal rate is less costly to the exchequer than a Citizen's Pension because of the heterogeneous behavioural responses of households strung out along the income/wealth distribution.

As we approach James Meade's centenary, it is interesting to note that Meade speculated that a withdrawal rate of "one pound for every two pounds earned" might be adopted in an ideal system – which is very close to what we appear to be settling on now. Our results provide some calibrated measurements in support for this view.

This research was undertaken by James Sefton, Justin van de Ven and Martin Weale. Enquiries to j.vandeven@niesr.ac.uk.

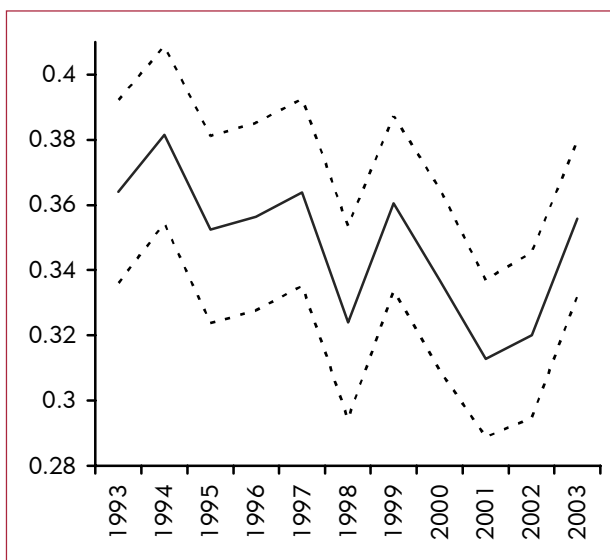
THE RELIABILITY OF INDIVIDUALS' EXPECTATIONS

Consumer confidence data are collected in many countries and are widely reported as they are perceived by many to lead movements in consumption and income. However, often these data are collected by cross-sectional surveys and it is therefore impossible to monitor either how the views of particular respondents are changing over time or how they relate to actual economic experience. In addition, often the results of the surveys are published only as aggregated variables. This has made it difficult to study the data in detail and to come to an informed view about their value.

This project, funded by the ESRC, seeks to understand expectation formation using direct data on expectations. This involves assessing the accuracy of individuals' expectations of their financial circumstances, as reported in the British Household Panel Survey, as predictors of outcomes, and identifies what factors influence their reliability.

The figure below indicates the accuracy of individuals' qualitative forecasts of their financial situation by computing the polychoric correlation, along with the associated 95 per cent

Financial circumstances in the BHPS: polychoric correlation between realisations and expectations and the associated 95% confidence interval



confidence interval, between their expectations and the subsequent realisation which they report. Realisations and expectations are seen to be positively correlated and in a statistically significant manner. However, there is some volatility across time in the strength of their relationship, with a tendency towards decreased correlation. It is also clear that individuals make non-trivial forecasting errors.

To draw out further the differential effect of information on expectations and realisations and to seek to explain individuals' forecasting errors we estimate bivariate ordered probit models. We find that, while statistically significant, macroeconomic shocks occurring after the forecast was made do not explain all of the forecasting error. This suggests individuals' expectations are not rational *ex ante*.

This research was conducted by James Mitchell,
j.mitchell@niesr.ac.uk

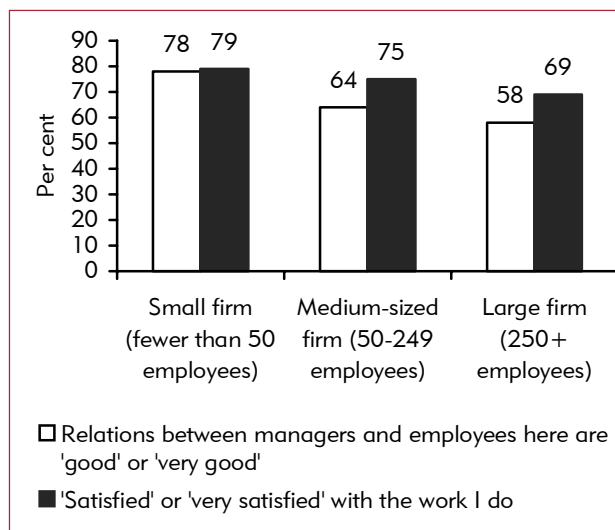
EMPLOYMENT RELATIONS IN SMALL FIRMS

Small and Medium-sized Enterprises (SMEs) are considered by many to be a vital part of a healthy economy, but there is little quantitative evidence on the nature of employment relations in these firms. Analysis of linked data from over 1,700 private sector workplaces and over 15,000 of their employees has produced some novel findings on the formality of employment practice and levels of job satisfaction in small firms in Britain.

The analysis indicated that formal practices were generally less extensive in smaller firms, as one would expect. As firms grow, the tendency to introduce practices that ensure rational and consistent behaviour is likely to increase in response to the decentralisation of managerial control and the greater distance between owner and employee. Thus, larger firms were more likely to use formal recruitment channels, have arrangements for employee communication and consultation, have procedures for resolving disputes, have formal equal opportunities policies, and offer specific arrangements to facilitate flexible working and support employees with caring responsibilities.

Nonetheless, the degree of formality inevitably depends upon other factors, and this was indicated

Climate of employment relations and levels of job satisfaction in small, medium-sized and large firms



in the analysis by the extent to which the degree of formality varied between firms in the same size category. For example, among workplaces belonging to small firms, two-thirds provided formal off-the-job training to core employees and half had a fixed procedural approach to issuing disciplinary sanctions. The analysis also suggested some of the factors, besides firm size, that affect the degree of formality. Workplace size was shown to be important in determining the nature of arrangements for communication and consultation since, even in the largest firms, structured arrangements will be required to a lesser degree at small sites. In addition, the degree of specialised knowledge held by managers was a factor in determining the extent to which certain formal recruitment channels were used in smaller firms. Context is also fundamentally important, as illustrated by the extent to which workplaces used procedures available for resolving individual disputes only in particular situations.

Turning to consider employees' experience of work, there was not a straightforward relationship between employees' experiences and the degree of formality in the practice of employment relations. Although the existence of formal practices may influence employee experience in some situations, the general pattern was of better ratings among employees in small firms. On almost all of the aspects covered in the analysis, employees in small firms rated their experiences of work and management higher, on average, than did employees in medium-sized and large firms. This is apparent from the figure, which indicates the proportions of employees reporting good relations between managers and employees at their workplace, and the proportions that were satisfied with their work.

The research was undertaken in collaboration with Alex Bryson and Helen Bewley (Policy Studies Institute) and funded jointly by the Department of Trade and Industry, Acas, the ESRC and PSI. Enquiries to j.forth@niesr.ac.uk.

EMPLOYMENT EQUALITY (AGE) REGULATIONS

On 1 October 2006 the Employment Equality (Age) Regulations came into effect, making much discrimination in employment on the grounds of age illegal. NIESR (together with BMRB) conducted a study of employers' policies and practices with an age dimension. The study, based on a representative survey of employers, found age and age-related criteria used in a wide range of employment policies and practices.

Directly discriminatory policies and practices were most common in respect of recruitment and retirement; 43 per cent of employers had a maximum recruitment age, whilst 39 per cent had a compulsory retirement age. Much of the direct recruitment and retirement discrimination was related to a retirement age of 65 and will remain legal under the Employment Equality (Age) Regulations. Other directly discriminatory policies and practices were less common but included age as a criterion for setting pay (14 per cent), for selection for redundancy (12 per cent) and for setting redundancy pay (10 per cent).

Indirectly discriminatory policies and practices could not be identified exactly in the survey.

Age as a factor in employment policies and practices

% establishments

<i>Recruitment</i>	
maximum recruitment age	43
selection criteria include potential length of service, judged by period to retirement	18
selection criteria include age	9
selection criteria include potential length of service, judged by age	7
<i>Pay and other benefits</i>	
pay affected by age	14
length of service increments	21
annual leave based on length of service	44
long service award	33
<i>Retirement</i>	
compulsory retirement age	37
<i>Compulsory redundancy</i>	
selection criteria include age	12
selection criteria include length of service	40
level of redundancy pay affected by age	10
level of redundancy pay affected by length of service	27

However, it was clear that there was extensive use of criteria which were highly likely to be indirectly discriminatory. Clearly discriminatory was the use of length of service in holiday entitlement (44 per cent), in long service awards (33 per cent), in redundancy selection criteria (40 per cent) and in setting redundancy pay (27 per cent). The use of potential length of service as a selection criterion in recruitment (18 per cent judged by period to retirement; 7 per cent judged by age) and as a selection criterion in selection for training (8 per cent) was clearly discriminatory. Length of service increments, risky if length of service is not closely related to performance, were used by 21 per cent of employers. Some of these policies and practices will be illegal under the new legislation. However, it seems likely that many will not.

Some of these discriminatory policies and practices are innocuous (e.g. long service awards). However, some have serious effects on the utilisation of older workers and on their economic activity, earnings and employment rates. Others, particularly those disadvantaging young people, tend to reduce pay and benefits (youth pay rates, length of service increments and holiday entitlement based on length of service). The insidious effects of continuing to allow employers to fix a compulsory retirement age were clear: not only did this enable employers to dismiss employees, but it served as a constraint on the recruitment, training and promotion (and, perhaps, pay) of those approaching this retirement age.

This work was carried out by Hilary Metcalf and Pamela Meadows and funded by the Department of Work and Pensions and the Department of Trade and Industry. The full report is given at <http://www.dwp.gov.uk/asd/asd5/rports2005-2006/rrep325.pdf>. Enquiries to h.metcalf@niesr.ac.uk

OPENING UP OPPORTUNITIES THROUGH ADVICE AND GUIDANCE

Career decisions continue to be strongly affected by gender, with variation found in choices at GCSE and 'A' level and continuing into higher education and labour market entry. These choices are influenced by information, advice and guidance (IAG) given in schools and through agencies such as Connexions, for young people. As part of its formal investigation into Transforming Work, the Equal Opportunities Commission (EOC) asked NIESR to research the work of public agencies delivering IAG. The aims of the research were to:

- Identify the key agencies delivering IAG on jobs, learning and careers to young people and adults.
- Assess the extent to which these agencies enable individuals to consider and pursue non-traditional choices and ways of working and encourage women to overcome the barriers they may face in participating in work and learning.
- Assess the extent to which agencies recognise and relate to the changing nature of work, including flexible and non-traditional working patterns.

A range of qualitative research methods were used, including analysis of documents, email surveys, telephone and face-to-face interviews. The research covered the work of Connexions, the service for 14–19 year olds, Nextstep for adults and embedded provision in Jobcentres, Higher Education Institutions, schools and through ESF funded projects.

Findings

Although there was some evidence of good practice, particularly in Connexions and in HE careers services, the research found that much IAG provision does not address gender stereotyping and new working patterns. The research identified a problem where priorities of organisations delivering IAG conflict, leading to lack of consistency and coordination of services. In particular, the scope for partnership working

between adult IAG and HE careers services is limited by the focus of adult IAG on meeting the needs of individuals with few or no qualifications.

The research found resistance in some agencies to the idea that IAG services should seek to open up opportunities by challenging gender stereotypes. There was little evidence that individuals who take non-traditional routes, including young people, are given the additional support they may need. Similarly, there appears to be little work within advice and guidance agencies addressing different working patterns and working lives, including flexible working, which is aimed either at individuals or at groups in particular need of help, such as women returners.

The report makes a number of recommendations, including measures to enable closer working between IAG agencies and between agencies and employers, improving adviser skills and resources in challenging gender stereotyping and improvements in careers education in schools.

Some recommendations from the research

- Extend free access to IAG beyond young people and the under-qualified.
- Increase partnership working between IAG agencies.
- Improve the quality and consistency of careers education in schools.
- Address gender stereotyping in career choice through one-to-one guidance.
- Provide support to individuals choosing non-traditional careers.
- Improve provision of labour market information within IAG to link employer requirements with jobseekers' needs.

'Opening up opportunities through advice and guidance', by Heather Rolfe and Sadia Nadeem, will be published by the EOC in its Working Paper series. Enquiries to h.rolfe@niesr.ac.uk. EOC research reports can be downloaded from www.eoc.org.uk and are also available as hard copy from research@eoc.org.uk.

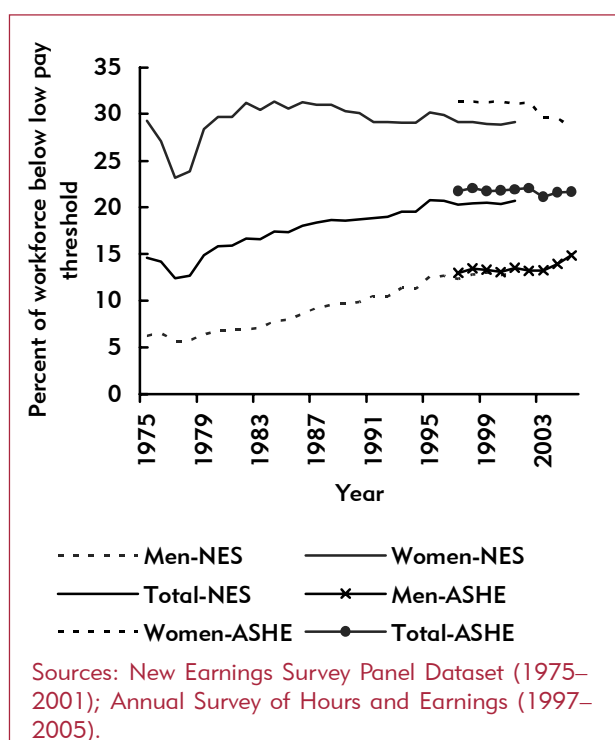
LOW-WAGE EMPLOYMENT IN THE UK

How does the UK compare with other advanced industrial nations in the incidence and persistence of low-wage employment? New information on this topic has emerged from the NIESR's involvement in a multi-country project funded by the Russell Sage Foundation which has examined the impact of different national institutional and competitive environments on low-wage work through detailed analysis of national labour market data and case study investigations in a number of industries where low-wage employees are concentrated (such as retail trade, hotels and hospitals).

If we take a standard definition of 'low pay' – that is, gross hourly earnings below two thirds of the median hourly wage – then the incidence of low pay in the UK turns out to be one of the highest in Europe. In 2002 an estimated 22% of UK employees fell below the low-pay threshold, much the same as in Germany, but well above the Netherlands (17%), France (12%) and Denmark (9%).

Furthermore, it is striking that, in spite of recent government policies designed to shore up pay rates

Proportion of UK workforce falling below low pay threshold, 1975–2005



(through the National Minimum Wage) and reduce household poverty, this relatively high incidence of low pay has remained stable for much of the past ten years. The proportion of low-paid persons in the UK workforce rose sharply between the late 1970s and the mid-1990s, since when it has levelled off at a level far above the prevailing incidence of low pay 25 years ago. The proportion of low-paid women remains significantly above that of men but, nonetheless, much of the increase in the incidence of low pay before 1995 and subsequent levelling-off reflects the changing fortunes of male workers rather than of women.

The growth in low-paid employment in the 1980s and early 1990s occurred at a time when there was a general increase in earnings inequality. Some of the factors contributing to this growth in inequality were common to many countries, such as the impact of skill-biased technical change, but what seems to have been distinctive about the UK during this period was the reduction in bargaining power and organising capability of trade unions and the removal of legislation and institutions (such as Wages Councils) which had previously provided some protection for low earners.

Since 1997, government policies have tended to reinforce the growth of low-paid employment by promoting higher rates of labour force participation and encouraging a 'paid work' route out of poverty (e.g., through in-work benefits). Cross-country comparisons suggest that the UK now tends to resemble the US rather than Continental Europe in terms of the rate of unemployment, average duration of unemployment and the economic incentives for individuals to take up paid work at the bottom end of the labour market. These developments go a long way to explaining why the rise in the incidence of low pay in the UK economy has been halted since the mid-1990s but not forced into reverse.

This work has been undertaken by Geoff Mason and Matthew Osborne. Enquiries to g.mason@niesr.ac.uk

SILLOVER EFFECTS FROM EDUCATION

How important are the social versus private returns to schooling and education? The answer to this question is likely to be relevant to our understanding of the drivers of longer-term economic growth and to the debate on appropriate funding structures that can be adopted to achieve the desired level of skills in the economy. A study underway at NIESR, funded by the ESRC, addresses this type of issue in an analysis of the relationship between individual wages and industry-level human capital.

This study examines the importance and magnitude of spillovers from education in the production process. Externalities in the production process can occur directly through the knowledge spillover from one worker to another, or indirectly through research and development and technology adoption. These occur when the decision to invest in more education by one individual, which consequently raises productivity, also increases the productivity and hence the earnings of other individuals.

The majority of empirical analysis of externalities from education in the production process has relied on cross-country growth regressions and macroeconomic time series data. More recently, a body of literature has emerged which investigates these kinds of externalities at a more disaggregated level. The approach taken in this strand of the literature augments traditional models of individuals' earnings, which typically include

Mean and standard deviation of the number of years of schooling by industry, 1994–2005

	Mean	Standard Deviation
Agriculture and non-manufacturing production	12.09	2.48
Manufacturing	11.81	2.29
Construction	11.59	2.05
Wholesale and retail	11.74	2.02
Hotels and Catering	11.90	2.16
Transport	11.69	2.05
Communications	12.01	2.24
Financial intermediation	12.96	2.39
Business services	13.31	2.95
Personal services	12.40	2.60
Non-market services	13.09	2.90

measures of individuals' human capital, with measures of human capital at a more aggregate level, such as the industry or geographical area. The study here adopts this latter approach and uses a panel of UK employee and industry level data covering the past decade as the basis for the analysis. The main data source is the UK Labour Force Survey.

As found elsewhere, the study finds a significant private return to schooling and to educational qualifications. All else being equal, workers with higher levels of education earn more than workers who have lower levels of education. In addition to this private return to education, preliminary results from this project suggest that there are significant spillover effects from schooling at the industry level. Workers in industries that employ relatively highly educated employees earn more than workers in industries that employ relatively less educated employees. However, the magnitude and significance of this spillover effect from education is very sensitive to the inclusion in the analysis of industry ICT (information and communication technology) capital. This may suggest that the external effect of education in the production process arises through the complementarity between human capital and high-tech capital.

Furthermore, tentative evidence from this project indicates that there may be significant learning effects at the industry level from high to less educated workers. At the industry level, workers receive a premium from working with co-workers who are more highly educated than themselves. All else being equal, the greater the share of an individual's co-workers that are more highly educated than the individual him-/herself, the greater the earnings from employment that accrue to the individual.

This work is supported by the Economic and Social Research Council. Enquiries to r.riley@niesr.ac.uk or s.kirby@niesr.ac.uk.

PRODUCTIVITY AND BUSINESS CHURN – IS THERE AN OPTIMAL RATE?

The role of the dynamic market in reallocating resources is thought to be a mainstay of productivity growth. Entry and exit, or churn, should in theory result in the least productive firms or plants leaving the economy, replaced by innovative and/or more efficient entry. This Schumpeterian view of business churn ignores the costs associated with entry and exit. NIESR has conducted a literature review to explore whether churn, taking account of its costs and benefits, has an optimal level, where the socioeconomic costs of inefficient churn (from unemployment, broken supply chains and reallocation costs) are weighed up against the positive productivity improvements. It also explores the relationship between churn and productivity as it is presented in existing research.

Key findings from the literature

In our review we identify a number of key considerations in existing empirical research on churn, entry and exit:

- Definitions matter – in terms of the unit of analysis, the level of industrial disaggregation and the mode of entry (be it merger, diversification or start-up) – both to the level of churn and the extent to which it impacts on productivity.
- Reliable cross-country comparisons of rates of churn, entry and exit, collected on a consistent basis, are hard to find. Where they do exist we find that rates of churn vary considerably between countries, but are similar across industries suggesting the underlying determinants of churn hold across countries.
- Ultimately we are concerned with understanding the aggregate impact of churn and existing evidence suggests a positive productivity effect, particularly in the longer run. Demanding microeconomic data requirements have limited the number of studies that have been carried out. We propose

to use a top-down approach in future analyses, by generating churn rates that may be used within a sectoral framework where efforts have been taken to harmonise definitions.

- Whilst the notion of an ‘optimal rate of churn’ is appealing, we find little empirical evidence to support its existence in the literature. In reality, this may be due to an ‘optimal’ rate being so time-, industry- and structure-specific as to be uninformative.
- From a policy perspective, churn is just one feature of the wider competitive environment in which geographical, life-cycle and institutional factors also play a part. Thus, analysis of churn needs to be conducted in a broader context.

Future steps

This is part of a longer-term research agenda to explore the underlying determinants of productivity differences by considering competitive conditions.

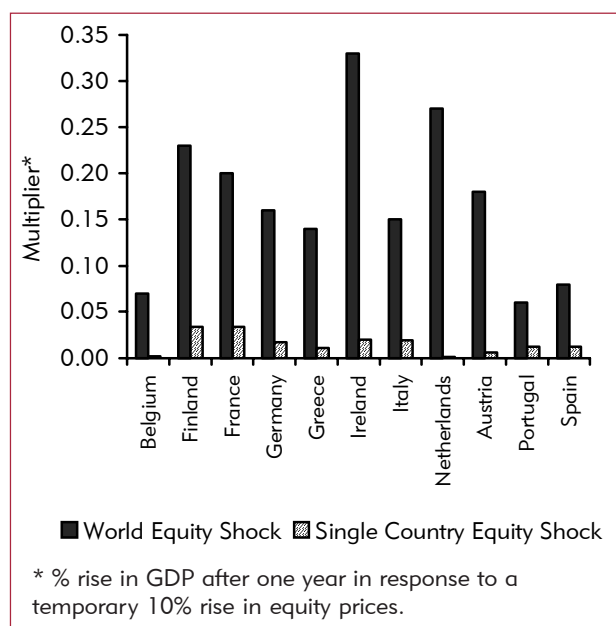
This work was undertaken by Catherine Robinson, Brigid O’Leary and Ana Rincon Aznar, and was funded by the Small Business Service of the Department of Trade and Industry. Enquiries to kate.robinson@niesr.ac.uk.

FINANCIAL INTEGRATION AND THE TRANSMISSION OF SHOCKS

The European Union is one of the most financially integrated regions of the world, and various EU-level policy initiatives have been launched to promote further integration of Europe's financial markets. Enhancing financial integration may contribute to economic growth, by creating larger and more efficient financial markets, and is also likely to facilitate the transmission of shocks across borders. In a recent study carried out for the European Commission, we analyse the relationship between real economic variables, such as consumption and investment, and equity markets. We then look at the impact that increased financial integration, which has strengthened the correlation among equity markets, has had on the transmission of shocks in Europe.

We find that equity markets play an important role in the determination of output, especially through the consumption channel. The transmission of equity price shocks comes directly through asset price channels and indirectly through trade effects, and appears to have a greater impact in countries with more efficient and developed financial markets. The magnitude of the response depends on several factors, including the degree of domestic stock market

Global versus single country equity price multipliers



capitalisation, the proportion of equities owned abroad, the number of liquidity constrained consumers, and the short- and long-run wealth effects in consumption and investment.

The impact on GDP of a temporary rise in equity prices in one country at a time is illustrated below. Clearly there is only a small impact on the domestic economy, as wealth effects on consumption are small and some equities are owned by foreigners. The equity leakages abroad have a small positive impact on output in the rest of the world, as does the rise in import demand in the shocked economy. But again, these effects are very small when equity price rises take place in one country at a time.

Coordinated equity price movements are likely to have much larger effects. Rising European and global financial integration has contributed to a significant rise in the correlation of global equity market shocks in recent years. The figure illustrates the impact of a coordinated global rise in equity prices, and spillover effects magnify the impact on output significantly. The impact tends to be higher in countries that are more open, both in terms of trade and financial markets. Exposure to countries outside the Euro Area is particularly important, reflecting the fact that equity price impacts in countries such as the US and the UK tend to be somewhat higher than they are in the larger Euro Area economies.

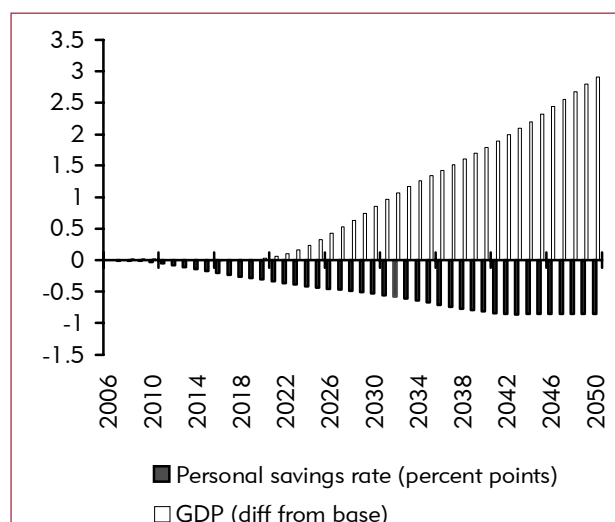
This work was undertaken by Ali Al-Eyd, Ray Barrell and Dawn Holland and was financed by the European Commission's 6th Framework Programme. The results are discussed in more detail in NIESR Discussion Paper No. 271, 'The role of financial markets' openness in the transmission of shocks in Europe'. Enquiries to Ray Barrell (r.barrell@niesr.ac.uk) or to Dawn Holland (d.holland@niesr.ac.uk).

EXTENDING WORKING LIVES

Life expectancy has been rising markedly over the past few decades, and the retirement ages built into the state pensions system look increasingly out of date. The Turner report on pensions suggested that there was a need to increase saving for retirement. The perceived lack of savings in the economy could be the result of a misperception of life expectancy. The report also suggested that it would be wise to raise the state pension retirement age in order that savings for retirement could be spread over a smaller period of inactivity.

The Institute has undertaken work for the Department of Work and Pensions on increased savings and on extending working lives. They have involved the use of the UK model in NiGEM, and a forecast to 2059 in order to analyse the effects of raising the state retirement age between 2020 and 2046. When one analyses a policy that is clearly announced in advance and affects the income flow of much of the population, it is unwise to assume that producers and consumers will act in a myopic way. The project was therefore undertaken with the model 'switched' into a fully forward looking mode equivalent to modern Dynamic Stochastic General Equilibrium (DSGE) models. Producers use forward looking output and user cost of capital in a Constant Elasticity of Substitution (CES) production

The impacts of extending working lives (3 per cent more labour input)



structure to set factor demands and prices.

Consumers look at the net present discounted value of their income flows as well as their wealth to help decide on consumption. Governments are bound by budget constraints and the Bank targets inflation.

We use a model of perpetual youth, where individuals have a constant probability of death, and the propensity to consume depends on this probability, and on the innate rate of time preference. If the debate on pensions persuades people that their life expectancy is greater than they had presumed, they will raise their saving. As the UK is a small open economy without capital controls, the increase in savings will involve a rise in foreign assets and an increase in GNP relative to GDP.

If people work longer, output (GDP) and incomes will be higher in the future as labour inputs (and incomes) will be higher. If consumers look forward, they will recognise that they will require lower levels of saving to cover a shorter retirement. As the net present value of their future incomes has risen, their permanent income will be higher, and we could expect a (marginal) rise in consumption from the date at which the policy is implemented, with an eventual fall in the savings ratio of almost 1 per cent for every 3 per cent increase in the effective labour input. The potential profiles of increased output and the savings ratio are plotted in the figure.

The current discussion is meant to induce people both to recognise that they will live longer and that they will have to work longer. The first might raise savings and the second reduce it, hence the overall impact should be that the savings rate rises by over $\frac{1}{2}$ a per cent.

This research was carried out by Ray Barrell.
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MODELLING THE ECONOMY

The Institute maintains a macroeconomic model of the world economy, NiGEM. The model has descriptions of over thirty countries, and is widely used in Finance Ministries and Central Banks, in Economic Research Institutes and in commercial institutions. The Institute publishes four forecasts a year with this model, and a further two are constructed for the European Commission with a group of cooperating institutes in the EFN EUROFRAME network. A major use of the model is in policy analysis. Over the past twelve months NIESR has made a number of interventions in the policy debate based on its research on the world economy. The most significant have been on the US current account and on migration within Europe.

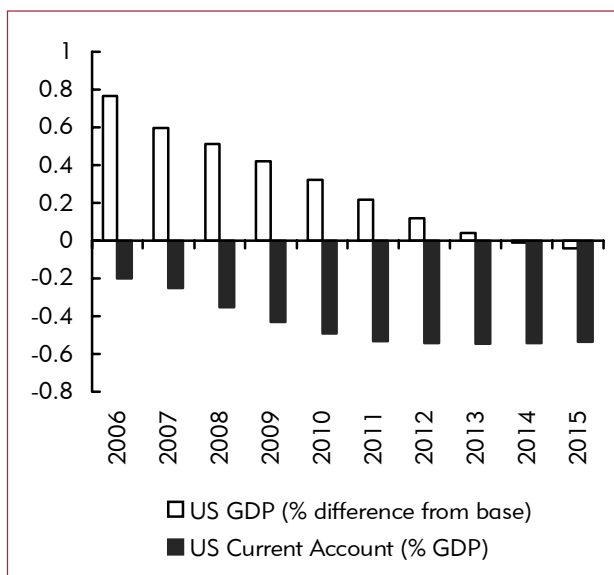
THE US CURRENT ACCOUNT

The US is currently running a large current account deficit, and its asset position may be becoming unsustainable. If financial markets become persuaded of this the risk premium on the dollar will rise, and this will both induce a realignment and have real effects. Al Eyd, Barrell and Holland (2006) published empirical work suggesting that risk premia are related to net foreign asset positions, and in the July 2006 Review Barrell and Holland used these results in NiGEM to analyse the impacts of a rise in the risk

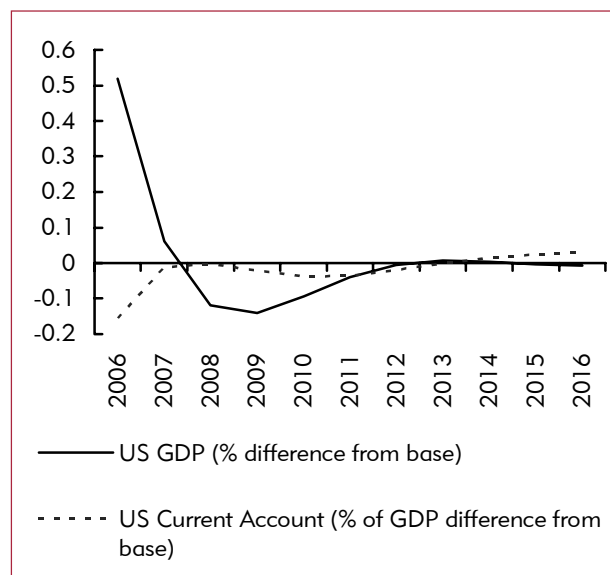
premium on the US dollar. They suggested that a rise in the risk premium of 1 percentage point on US assets would be associated with an improvement in the US current account of around 0.6 per cent of GDP and a fall in the effective exchange rate of 5 per cent. A risk premium adjustment of 5 per cent might therefore be needed to bring the US current account within reasonable bounds.

The US external deficit may be augmented by high levels of government borrowing, and it might be considered that a tightening of fiscal policy would improve the current account position. Simulations of a fiscal tightening on NiGEM suggest that over half of a change in fiscal policy stance might be reflected in the current account. However, this proposition depends upon the view taken of private sector behaviour. If consumers are fully forward looking and discount the changes in future tax liabilities that go with a change in fiscal stance, then results may be different. It is possible to 'switch' NiGEM into a fully forward looking model with forward looking consumers. If one does this then the impacts of a change in fiscal stance are fully offset, as we can see from the charts below. This gives the same style of results as Dynamic Stochastic

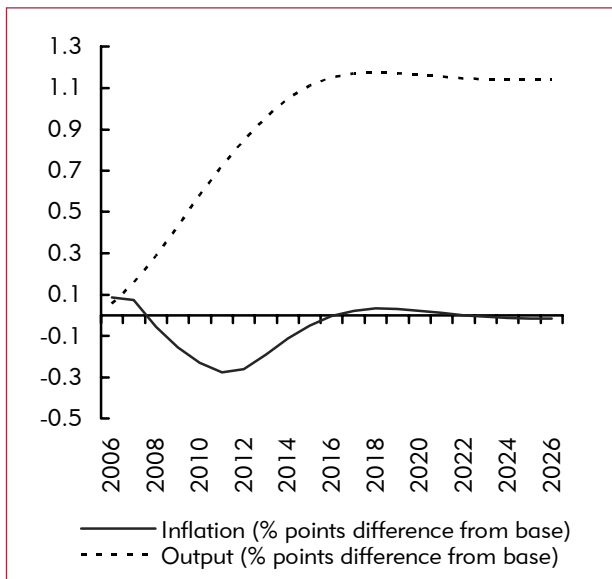
The impacts of a US fiscal expansion (a 1% of GDP rise in spending financed by borrowing)



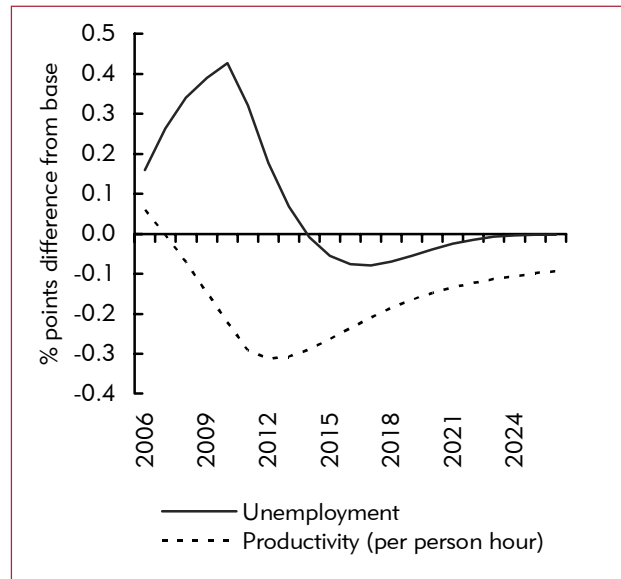
Forward looking consumers and a permanent US fiscal expansion (1% of GDP)



Impacts of inward migration on output and inflation in the UK



Impacts of inward migration on productivity and unemployment in the UK



General Equilibrium models, such as those being constructed by the IMF.

MIGRATION IN EUROPE

Changes in patterns of migration have been important in the past two years in the UK and in Europe, and in the October 2006 *Review* Barrell, Guillemineau and Liadze analyse the impacts on home and host economies of a movement of one million Polish workers mainly to the UK and Germany. The results suggest that output will rise in Germany and the UK in the longer run and fall in Poland. Unemployment will be unaffected in the long run in all countries but in the very short run it is likely to fall markedly in the home country and rise marginally in the host countries, putting downward pressure on inflation and wages in the host economies. As the population

shift is assumed not to be fully anticipated, capital is not likely to be initially in place to absorb new workers, so productivity is likely to grow more slowly as they are absorbed. These patterns are observable in the UK and Germany as both have recently received a large number of new workers. In the longer run the level of productivity per person in the UK and Germany is likely to be little affected by inward migration, but it is likely to be higher in Poland as fewer workers can use the existing infrastructure. The impacts of an increase of 500,000 in the UK population of working age are plotted in the figures above.

Reference:

Al-Eyd, A., Barrell, R.J. and Holland, D. (2006), 'A portfolio balance explanation of the euro dollar rate', in Cobham, D. (ed.), *The Travails of the Eurozone*, Basingstoke, Palgrave.

Work with NiGEM was undertaken by Ray Barrell, Dawn Holland, Rebecca Riley, Simon Kirby, Amanda Choy, Ali Al Eyd, Olga Pomerantz, Iana Liadze, Catherine Guillemineau and Ian Hurst. Enquiries about NiGEM should be addressed to r.barrell@niesr.ac.uk.

AGGREGATE MORTALITY RISK AND THE ANNUITY MARKET

It is plain that the annuity market is affected by aggregate mortality risk. Insurance companies promise pay-outs based on their forecasts of the mortality rates of their annuitants. These forecasts are, in their nature, uncertain and sellers of annuities enjoy profits if mortality rates are higher than forecast at the risk of losses should they turn out to be lower.

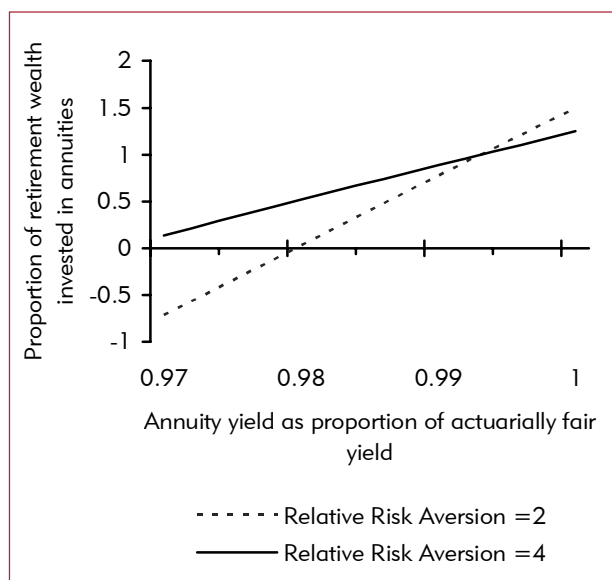
It is, however, also possible for people to enjoy the protection against the individual risk of longevity afforded by the insurance principle while carrying the aggregate mortality risk themselves. Purchasers of tontines put themselves in exactly this position. If tontines and annuities offer equal yields, then annuities will be preferred to tontines by risk-averse investors wishing to protect themselves against longevity risk. If, however, the yields on annuities are depressed by a charge levied to compensate the seller for the aggregate mortality risk, then the situation is less clear-cut. A risk-averse individual will probably want to carry at least some of the aggregate mortality risk instead of paying the risk premium demanded by the insurance company.

Formal examination of this using a theoretical model suggests that if annuities and tontines have the same yield, an investor will want to be a seller

This work is funded by the ESRC. For more information please contact Martin Weale on 020 7654 1945.

of tontines and use the proceeds to purchase extra annuities. The reason for this is that, in the event of the cohort having a high mortality rate, the seller of tontines is compensated for a shortened life-span by the profit earned on tontines in such circumstances.

The graph shows estimates of the proportion of wealth an individual might wish to invest in an annuity rather than a tontine on retirement as a function of the extent to which the annuity yield is depressed to compensate the seller for carrying aggregate mortality risk. It is clear that the demand for annuities is very sensitive to small reductions in yield. Thus if insurance companies feel that they have to levy large charges for carrying mortality risk, there is likely to be a ready market for tontines because retirees would prefer these to surcharged annuities.



2006 has seen both the introduction of themed articles for each issue of the Review and an on-line forum where subscribers are able to engage in academic debate with authors. See www.sagepub.co.uk/forum/nier for details.

Articles which appeared during 2006 were as follows:

No. 195 (January)

Employment and childcare: introduction

Heather Rolfe

Farewell to childcare

Peter Moss

Childcare and mothers' employment: approaching the millennium

Kirstine Hansen, Heather Joshi and Georgia

Verropoulou

Where are the men? Gender segregation in the childcare and early years sector

Heather Rolfe

Stability and change in childcare and employment: evidence from the United States

Cynthia Miller

No. 196 (April)

The new monetary regime: introduction

Stephen Hall and Brian Henry

Central bank independence: economic and political dimensions

Otmar Issing

The Bank of England's Monetary Policy

Committee: a view from a parliamentary specialist adviser

Mike Wickens

What are the right models and policies for a world of low inflation?

Patrick Minford

The brave new world of central banking: the policy challenges posed by asset price booms and busts

Stephen G. Cecchetti

An independent Bank of England: is that enough?

S.G. Hall and S.G.B. Henry

No. 197 (July)

Public sector performance: introduction

Philip Stevens

Setting targets for health care performance: lessons from a case study of the English NHS

Gwyn Bevan

Metrics, targets and performance

Philip Stevens, Lucy Stokes and Mary O'Mahony

Assessing public service performance in local authorities through CPA – a research note on deprivation

Dirk Haubrich and Iain McLean

The tax man cometh – but is he efficient?

Finn R. Førsund, Sverre A.C. Kittelsen, Frode

Lindseth and Dag Fjeld Edvardsen

No. 198 (October)

Savings and the economy: introduction

Martin Weale

Household saving rates and the design of public pension programmes: cross-country evidence

Richard Disney

Saving and life insurance holdings at Boston University – a unique case study

B. Douglas Bernheim, Solange Berstein, Jagadeesh

Gokhale and Laurence J. Kotlikoff

The UK savings gap

Ehsan Khoman and Martin Weale

When to give? A note on the timing of gifts and bequests

Alain Jousten



Martin Weale, Dawn Holland and Rebecca Riley answer journalists' questions at the Press Conference for the October 2006 Review.

NATIONAL INSTITUTE DISCUSSION PAPERS

Discussion papers exist to foster debate on Institute research. Recent papers listed below are available on our website www.niesr.ac.uk or free on request.

266. Uncertainty in UK manufacturing: evidence from qualitative survey data

James Mitchell, Kostas Mouratidis and Martin Weale

267. The impact of changing demographics and pensions on the demand for housing and financial assets

Lubo Schmidt, Ales Černý and David Miles

268. Welfare or farewell? Mental health and stress in the workplace

J. Foreman, H. Rolfe and A. Tylee

269. The impacts of capital adequacy requirements of emerging markets

R. Barrell and S. Gottschalk

270. Incidence-based estimates of healthy life expectancy for the United Kingdom: coherence between transition probabilities and aggregate life tables

E. Khoman and M. Weale

271. The role of financial markets' openness in the transmission of shocks in Europe

A. Al-Eyd, R. Barrell and D. Holland

272. Financial crisis, effective policy rules and bounded rationality in a New Keynesian framework

A. Al-Eyd and S. Hall

273. Equality and efficiency: policy for globalisation

M. Weale

274. The returns to general versus job-specific skills: the role of information and communication technology

S. Kirby and R. Riley

275. Entry rates and the risks of misalignment in the EU8

T. Fic, R. Barrell and D. Holland

276. Simulating cohort labour earnings for Australia

J. van de Ven

277. The distributional effects of taxation in Australia and the United Kingdom: evidence from microsimulations

J. van de Ven

278. A comparison of national saving rates in the UK, US and Italy

T. Kirsanova and J. Sefton

279. Fiscal implications of demographic uncertainty: comparisons across the European Union

M. Weale

280. Employability skills initiatives in higher education: what effects do they have on graduate labour market outcomes?

G. Mason, G. Williams and S. Cranmer

281. Do ICT skill shortages hamper firms' performance?

J. Forth and G. Mason

282. A general equilibrium analysis of annuity rates in the presence of aggregate mortality risk

M. Weale and J. van de Ven

283. Means testing retirement benefits: fostering equity or discouraging savings?

J. Sefton, J. van de Ven and M. Weale

284. The incentive effects of means tested UK retirement benefits – has the Pension Credit gone too far?

J. van de Ven

285. The theory and practice of pay setting

J. Forth and A. Bryson

MONTHLY GDP

The National Institute publishes monthly and rolling quarterly estimates of UK GDP. Estimates of growth in calendar quarters are published about three weeks ahead of official data. Subscribers are notified of the estimates ahead of public release. Further information can be obtained from Rose Stankov at r.stankov@niesr.ac.uk or by telephone on 020 7654 1901.

OTHER PUBLISHED REPORTS AND ARTICLES

- Al-Eyd, A., Barrell, R. and Holland, D., 'A portfolio balance explanation of the euro dollar rate', in Cobham, D. (ed.), *The Travails of the Eurozone*, Basingstoke, Palgrave.
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PAPERS PRESENTED

- Al-Eyd, A., Barrell, R. and Holland, D., 'A portfolio based analysis of movements in the euro dollar rate', Conference on The Travails of the Eurozone, Money, Macro and Finance Research Group (MMF) and University Association for Contemporary European Studies (UACES), Edinburgh Business School, Heriot-Watt University, March.
- Al-Eyd, A., Barrell, R., Davis, E. and Pomerantz, O., 'Consumption in the Euro Area', HM Treasury EMU Seminar Series, January and Sussex University, February.
- Barrell, R., 'Economic policy in the UK', Hansard Society, LSE, March, November.
- , 'Monetary union in Europe', IPPR Conference, London, March.
- , 'Policy frameworks and the supply side – the Lisbon process', Seminar CAS (CGP), Paris, May.
- , 'Trends and cycles in the Euro Area economy – an overview', EUROFRAME Conference, Berlin, June.
- , 'Recent experience of forecasting with DSGE models: a critical review', Bank of England CCBS Workshop, June.
- , 'Forecasting and modelling – an assessment of SARB models in a comparative perspective', South African Reserve Bank MPC meeting, South Africa, 30 September.
- , 'Performance and convergence in EMU – Germany and Spain', DGEFCFIN Experts meeting, Brussels, 18 October.
- , 'Policy coordination and the supply side in Europe', United Nations Project LINK Conference, UNCTAD, Geneva, 1 November.
- Barrell, R., Davis, E. and Pomerantz, O., 'Costs of financial instability, household-sector balance sheets and consumption', SUERF conference, NIESR, March.
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- Barrell, R., Hurst, I. and Mitchell, J., 'Uncertainty bounds for cyclically adjusted budget deficits', Workshop on Fiscal indicators in the EU budgetary surveillance, European Commission (DG-ECFIN), Brussels, 22 September.
- Bloom, N., 'The impact of competition and globalisation on work-life balance and management practices', Westminster Economics Forum, DTI Conference Centre, 21 April.
- Carter, S., 'The state of small business in the UK', Westminster Economics Forum seminar, DTI Conference Centre, 10 February.
- Forth, J., 'First findings from the 2004 Workplace Employment Relations Survey, Third Korean Workplace Panel Survey Conference, Seoul, February.
- , 'The 2004 Workplace Employment Relations Survey: available data', Work, Pensions and Labour Economics Study Group (WPEG) Annual Conference, University of Kent, July.
- , 'Employment relations in small and medium-sized enterprises (SMEs)', Work, Pensions and Labour Economics Study Group (WPEG) Annual Conference, University of Kent, July.
- , 'Inside the workplace: skills-related findings from the 2004 Workplace Employee Relations Survey', Sector Skills Development Agency (SSDA) Intelligence Network Conference, Leeds, September.
- Forth, J. and McNabb, R., 'Financial performance data in WERS 2004', Annual Conference of the Cardiff University Employment Research Unit, September.
- Forth, J. and Stokes, L., 'An introduction to the analysis of WERS 2004', Annual Conference of the Cardiff University Employment Research Unit, September.

- Hall, S., 'Keynote Lecture at the African Econometric Society meeting in Nairobi, June.
- Hall, S. and Mitchell, J., 'Optimal combination of density forecasts', The interface between monetary policy and macro modelling, Reserve Bank of New Zealand, 13–15 March.
- Mason, G., 'Encouraging firms to move up the 'value added' chain: what policies are likely to be effective?', Westminster Economics Forum, February.
- Mason, G., Osborne, M. and Mayhew, K., 'Low-wage employment in the UK', Conference on Work and Opportunity in Europe, University of Amsterdam, September.
- Mason, G., Osborne, M. and Voss-Dahm, D., 'Labour market outcomes in different national settings: UK-German comparisons in retailing', Society for the Advancement of Socio-Economics Annual Conference, Trier, July.
- Metcalf, H., 'Age discrimination in the workplace', Plenary session to DTI/DWP Opportunity Age at Work: Age and the Workforce. Business Design Centre, London 27 April.
- , NIESR Conference on Tackling Age Discrimination in Britain – the Employment Equality (Age) Regulations and Beyond, British Academy, September.
- Metcalf, H. and Meadows, P., 'How entrenched is ageism at work?', DTI Lunchtime Seminar Series, 2006: Mapping the World of Work, March.
- Metcalf, H., Meadows, P. and Rolfe, H., 'Tackling age discrimination in Britain – the employment equality (age) regulations and beyond', NIESR Conference on Tackling Age Discrimination in Britain – the Employment Equality (Age) Regulations and Beyond, British Academy, September.
- Mitchell, J., 'Density forecasting: combination and dependence, Seminar, Norges Bank, Oslo, Norway, 4 December.
- Mitchell, J., Smith, R. and Weale, M., 'A Bayesian indicator of manufacturing output from qualitative business panel survey data', HM Treasury, London, 7 March, and Reserve Bank of New Zealand, Wellington, New Zealand, 30 March and Royal Economic Society Conference, Nottingham, April.
- Mitchell, J. and Weale, M., 'Flash estimates of some PEEIs', Euroindicators Working Group, Eurostat, Luxembourg, December
- , 'Alternative trend-cycle decompositions', Euroindicators Working Group, Eurostat, Luxembourg, December.
- Nadeem, S., Metcalf, H. and Rolfe, H., 'Case studies into the recruitment, retention and progression of Black and Minority Ethnic (BME) staff', presentations to six seminars organised by the Office of Criminal Justice Reform (Oxford, Manchester, Birmingham, Leeds, Cambridge and Basingstoke), May and June.
- O'Mahony, M., 'Outputs, inputs and productivity in the NHS', Fourth NIESR Public Sector Performance Conference, British Academy, January.
- , 'Measuring public sector productivity: the case of NHS Trusts', ESRC and CMPO conference, 'Do you get what you pay for? Getting to grips with public service productivity', Local Government House, London, September.
- Riley, R., 'Prospects for the UK economy', 74th Kieler Konjunkturgespräch, Kiel University, September.
- Riley, R. and Young, G., 'Skill heterogeneity and equilibrium unemployment', lunchtime seminar, Bank of England, November.
- Robinson, C., O'Leary, B., Rincon-Aznar, A., Driver, C., Haskel, J., Harris, R., Storey, D.

- and Temple, P., 'Business entry and exit – is there an optimal rate of churn?', NIESR, 16 May.
- Sefton, J., van de Ven, J. and Weale, M., 'Means testing retirement benefits: fostering equity or discouraging savings?', Melbourne Institute of Applied Economic and Social Research, Melbourne, January.
- , 'The effects of means testing pensions on savings and retirement', WPEG Study Group, London, March.
- Sefton, J. and Weale, M., 'Savings and pensions policy: impact on household saving decisions. Results from NIESR Research', HMRC and HM Treasury, London, March.
- Stevens, P., 'Metrics, targets and performance: hospital star ratings', Fourth NIESR Public Sector Performance Conference, British Academy, January and ESRC Public Services Programme Seminar, Audit Commission, March.
- van de Ven, J. and Weale, M., 'A general equilibrium analysis of annuity rates in the presence of aggregate mortality risk', Conference presentation of an Overlapping Generations Model for the demand and supply of annuities, March.
- , 'Fiscal policy and aggregate mortality risk', Conference on Fiscal Policy, HM Treasury, June.
- Weale, M., 'Public sector output', Official Statistics Section, Royal Statistical Society, July.
- , 'Key economic issues', Liberal Party Treasury Team, July.
- , 'Public sector output: output indicators and welfare indicators', OECD Conference, October.
- , 'Weighted indices of crime', Matrix Research and Consultancy Seminar on Measures of Crime, October.
- Weale, M. and Khoman, E., 'Adequacy of old-age income maintenance in the EU', AIM/ ENEPRI/NIESR Conference, 4–5 May.

NIESR IN THE NEWS

NIESR was widely reported throughout the year. A small selection of this coverage follows.

Replace council tax with 1% property levy – NIESR

Ashley Seager

Friday, 27 January, 2006

The government should scrap council tax and replace it with a 1% tax on the value of property, a leading think-tank proposes. Releasing its latest quarterly economic forecasts, the National Institute of Economic and Social Research admitted that its idea would hit owners of expensive properties harder than a council tax would, but said this would be fairer.

"The people most affected would be those who bought expensive properties at the top of the market, such as the Blairs," said NIESR director Martin Weale, referring to the large house the prime minister and his wife bought in central London.

The Guardian

<http://society.guardian.co.uk/publicfinances/story/0,,1696207,00.html>

Think-tank renews call for rates rise

Scheherazade Daneshkhu, Economics

Correspondent

28 July, 2006

The National Institute of Economic and Social Research, a leading think-tank, cut its growth forecasts for the economy yesterday because of higher oil prices, a stronger pound and expected rises in interest rates.

The institute reiterated its call on the Bank of England to raise interest rates when it meets next week.

It forecast consumer price inflation staying above the Bank's 2 per cent target for the next two years because of strengthening inflationary pressures from abroad, including more expensive oil and goods imports.

Martin Weale, Niesr director, said: "Given that we have inflation above target and economic growth above trend, there is little to be gained by delaying a rise until later in the year."

The Financial Times

<http://www.ft.com/cms/s/8d433c5a-1dd5-11db-bf06-0000779e2340.html>

National debt may soar above £1,000bn

Edmund Conway, Economics Editor

1 August, 2006

The national debt could swell to well over £1,000bn if the Government goes ahead with a plan to incorporate the huge public sector pensions liability in its accounts....

.....Martin Weale, director of the National Institute of Economic and Social Research, warned that the plan may struggle to get off the ground due to the immensely complex differences in the way various European countries – particularly the French – calculate their pension deficits.

"Maybe the European Commission is keen on the idea because it wants to frighten countries with big liabilities," he said.

The public sector is not the only one with large deficits. The pension regulator's first annual report, published yesterday, estimated that the UK's top 350 listed companies have a combined deficit of between £250bn and £350bn.

Mr Weale said: "My preferred arrangement would be to make it illegal to remunerate people except through their pay packet. "That would be completely transparent and people in the public sector would be able to see whether they really are better or worse paid than in the private sector.

"At the moment there's this strange notion that employees' contributions are paid out of a company's profits. That seems unlikely – it almost certainly comes out of the wages."

The Telegraph

<http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2006/08/01/cndebt01.xml>

UK interest rates 'to hit 5.25%'

UK interest rates should rise to 5.25% and are likely to remain above 5% for the foreseeable future, a leading think-tank has said. Borrowing costs should rise from 4.75% now to 5% next month and then to 5.25%, early next year, the National Institute for Economic and Social Research said.

Rates were set to stay above 5% despite inflation easing in 2007, it added. NIESR said it expected the economy to grow by 2.5% in 2006, rising to 2.6% next year – in line with most analysts' forecasts.

In a separate analysis of the economic impact of immigration, NIESR found that immigration had boosted economic output by 3% since 1997. Despite this economic benefit, NIESR said the large

influx of foreign workers since 2004 was likely to reduce wages in low-skill jobs and could potentially push up unemployment in the long term. "The economy has probably adjusted to immigration of the type which began in 1998 but the recent inflow from central and eastern Europe can be seen as an economic shock," it noted.

BBC

<http://news.bbc.co.uk/1/hi/business/6090754.stm>

Friday, 27 October 2006

Britons falling £87bn short in retirement savings

Philip Thornton, Economics Correspondent
27 October, 2006

Britons will have to find an extra £87bn of savings to fund a comfortable retirement unless they want to sell their homes, a leading think tank has announced in a report published today.

The National Institute of Economic Research said households were saving just a third of the amount they needed to.

The Independent

<http://news.independent.co.uk/business/news/article1932767.ece>

Immigrants 'help the economy grow by 3%'

Angela Balakrishnan
Friday 27 October, 2006

- Research finds net gain to Treasury from tax receipts
- Author describes recent inflow as 'economic shock'

Large inflows of migrant workers in recent years have provided a significant boost to UK economic growth, a report by a leading think tank said yesterday.

The National Institute of Economic and Social Research (NIESR) weighed into the growing debate about the impact of immigration on Britain by saying the big influx of people in the past eight years had expanded the economy by a hefty 3%. In 2004-05, immigration contributed about one percentage point to growth of 5.3%.

The Guardian

<http://business.guardian.co.uk/story/0,,1932737,00.html>

Flat September raises fears that production has passed its peak

Scheherazade Daneshkhu, Economics Correspondent
7 November, 2006

Manufacturing output stagnated in September, ending four months of expansion and raising fears that the sector had passed its peak, according to official figures published yesterday... However, the National Institute of Economic and Social Research will today urge the Bank to raise rates next year, after forecasting economic growth of 0.7 per cent in the three months to October.

Simon Kirby, an economist for the NIESR, said: "The economy continues to grow at just above trend. Our forecast shows that interest rates need to be raised now and probably again in February."

The Financial Times

http://www.ft.com/cms/s/6695df42-6e05-11db-8725-0000779e2340,_i_rssPage=34c8a8a6-2f7b-11da-8b51-00000e2511c8.html

National Institute urges Bank to sanction 'pre-emptive' rate rise

Philip Thornton, Economics Correspondent
28 April, 2006

The Bank of England must raise interest rates next week to show it is prepared to take "pre-emptive" action to quash rising inflationary pressures, a leading independent think-tank said today.

Rising inflation, a fall in the pound's exchange rate and a rise in inflationary expectations among financial markets and UK households have made a rate increase an urgent necessity, the National Institute for Economic and Social Research said. "There is a strong case for the Bank to make a pre-emptive action to say 'we won't allow inflation to go up'," Professor Ray Barrell, at NIESR, said.

The Independent

<http://news.independent.co.uk/business/news/article360683.ece>

RESEARCH SUPPORTERS

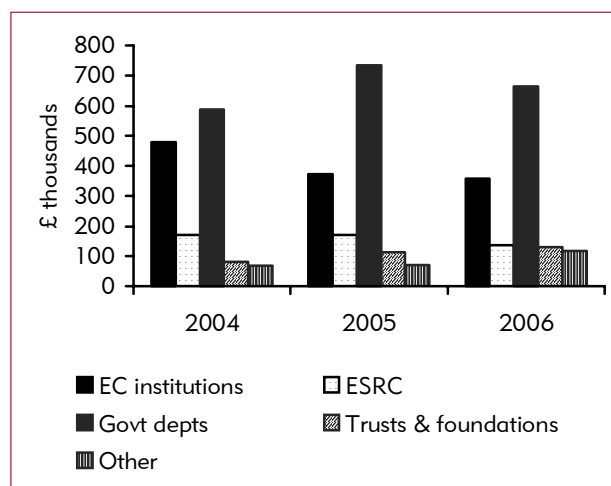
The following organisations have funded research at the National Institute during the year.

Advisory, Conciliation and Arbitration Service
 Anglo-German Foundation
 Barber White
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 Department for Education and Skills
 Department for Work and Pensions
 Department of Trade and Industry
 Economic and Social Research Council
 Equal Opportunities Commission
 European Commission
 Financial Reporting Council
 HM Revenue and Customs
 Home Office
 Institute of Development Studies, University
 of Sussex
 Middlesex University
 Nacro
 New Zealand Treasury
 Organisation for Economic Cooperation and
 Development
 Office of Fair Trading
 Office of National Statistics

NIESR has a corporate membership scheme which helps to fund the generic research of the Institute and in particular the economic forecasts contained in the National Institute Economic Review. The support of these organisations is vital in assuring our complete independence. All corporate member organisations are acknowledged in the forecast section of the Review.

Abbey plc
 Bank of England
 Barclays Bank plc
 Butterfield Private Bank
 Ernst & Young LLP
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 The National Grid Company plc
 Nomura Research Institute Europe Ltd
 Rio Tinto plc
 Slough Estates
 Trades Union Congress
 Unilever plc
 Watson Wyatt LLP

Split of funds between various research supporters



Pinnacle Insurance
 Reserve Bank of New Zealand
 Russell Sage Foundation
 Scottish Enterprise
 Scottish Executive
 Sector Skills Development Agency
 Statistics Commission

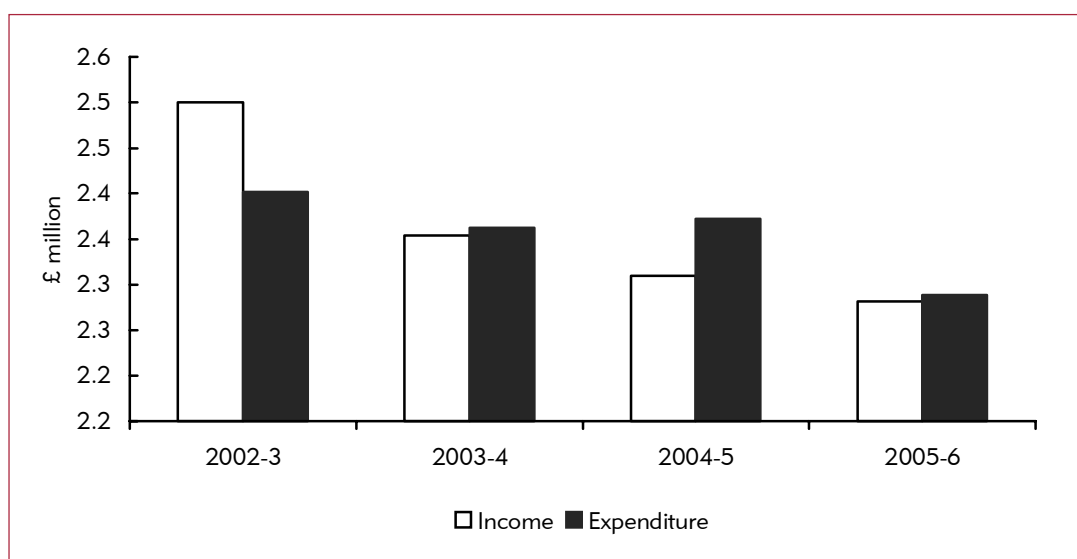
Further details about the Corporate Membership Scheme, or how to make a financial donation to NIESR, are available from the Secretary, Gill Clisham: telephone 020 7654 1920 or e-mail g.clisham@niesr.ac.uk.

FINANCIAL SUMMARY

In the year to 31 March 2006 the Institute reported a small operating deficit for the year. The policy of the Council is to balance income and expenditure over the long term, while recognising that fluctuations may occur in individual years. Full accounts for each of the years listed, including an unqualified audit report from KPMG Audit plc, have been filed at Companies House and the Charities Commission.

	2002/3	2003/4	2004/5	2005/6
Income				
Research	1,497,214	1,340,959	1,464,212	1,408,324
Publications & Misc	397,688	441,776	335,247	313,108
Model income	383,118	383,118	353,667	391,862
Corporate Supporters	88,422	67,835	51,900	35,000
Investments income	133,730	120,023	104,870	133,241
Total Income	2,500,172	2,353,711	2,309,896	2,281,535
Expenditure				
Research (incl Library)	1,682,776	1,509,359	1,771,615	1,549,687
Support Costs (incl non research salary)	629,499	684,482	486,726	630,102
Premises	52,650	95,216	51,800	51,465
Governance & professional costs	36,634	73,086	61,900	57,361
Total Expenditure	2,401,559	2,362,143	2,372,041	2,288,615
Operating Surplus/(Deficit)	98,613	(8,432)	(62,145)	(7,080)

Note: The categorisation of costs has been changed for 2004/5 onwards to comply with the new SORP on Charity accounts



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