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Executive Summary

The *Review* is the quarterly publication of the National Institute of Economic and Social Research. Each issue contains a survey of the economic situation and prospects in the UK and in the World. In addition there are articles which cover related issues in greater depth.

The latest issue is published on:

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The October 2003 edition is a special issue with research articles focused on policy evaluation:

- **An evaluation of business start-up support for young people**
by Nigel Meager, Peter Bates and Marc Cowling
- **Evaluation using random assignment experiments: demonstrating the effectiveness of earnings supplements**
by Doug Tattrie and Reuben Ford
- **Measuring the macroeconomic effects of reducing benefit dependency**
by Ray Barrell, Simon Kirby, Rebecca Riley and Desirée van Welsum
- **Economic evaluation of complex health and social care interventions**
by Sarah Byford and Tom Sefton

The world economy

Ray Barrell, Bettina Becker, Amanda Choy, Sylvia Gottschalk, Dawn Holland and Olga Pomerantz

- **The world outlook has brightened: we are now expecting global GDP growth of 3.5 per cent in 2003 and 4.0 per cent in 2004.**
- **World trade will rise by 5.7 per cent in 2003 and by 8.8 per cent in 2004.**
- **The United States will underpin the global upturn with GDP growth of 2.7 per cent this year and 3.4 per cent in 2004.**
- **The Euro Area will continue to disappoint, growing by just 0.4 per cent this year and 1.8 per cent in 2004.**
- **After unexpectedly rapid growth of 2.5 per cent in 2003, the Japanese economy will expand by only 0.9 per cent next year.**

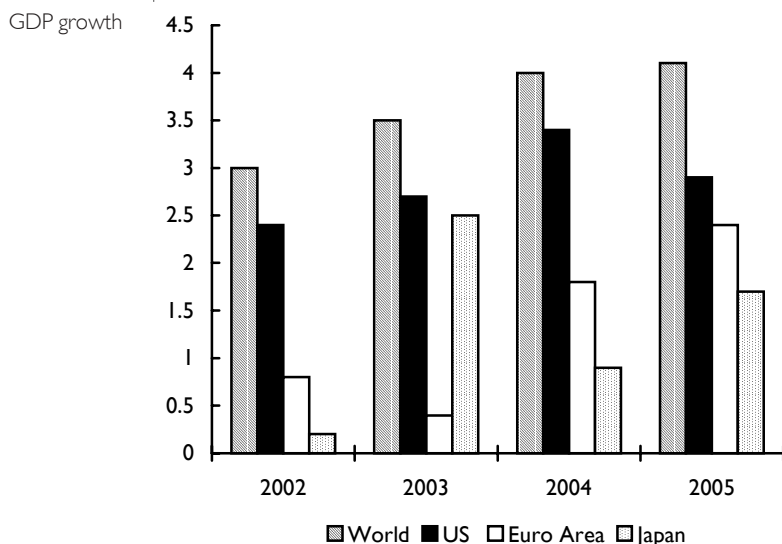
forecast for world economic growth in 2003 3.5 per cent; and 4.0 per cent in 2004

The prospects for the global economy have improved significantly since our last forecast in July. We have increased our forecast for world economic growth in 2003 from 2.9 to 3.5 per cent; and from 3.2 to 4.0 per cent in 2004. The improved outlook reflects a more rapid recovery in the United States, this year's rebound in the Japanese economy and the boom in China. Strong intra-Asian trade is stimulating a brisker-than-expected recovery in world trade, now forecast to grow by 5.7 per cent in 2003, up from 3.2 per cent in July.

The American recovery is looking increasingly robust. We are now forecasting GDP to grow in 2003 by 2.7 per cent, up from 2.4 per cent in July; and by 3.4 per cent in 2004, up from 3.0 per cent three months ago. The upward revisions reflect stronger domestic demand, somewhat offset by weaker net trade. Tax cuts and a buoyant housing market will sustain annual consumer spending

growth of around 3 per cent this year and next. Housing investment will expand rapidly and business investment is poised to grow by nearly 5 per cent next year. Vigorous growth in government consumption will also underpin the recovery.

In contrast, the outlook for the Euro Area has worsened rather than improved. GDP is now forecast to grow this year by only 0.4 per cent, down from 0.6 per cent in



July. The appreciation of the euro is continuing to inflict damage on the single currency zone. Exports will grow by less than 1 per cent in 2003 and private investment will decline by 0.6 per cent.

The German economy is forecast to contract by 0.2 per cent this year

The weakness of the Euro Area is mainly concentrated in Germany, which accounts for about 30 per cent of its output. The German economy is forecast to contract by 0.2 per cent this year and to expand by only 1.4 per cent in 2004.

The Japanese economy is exhibiting unexpected strength in 2003. One reason is that Japanese export industries are benefiting from the rapid rise in import demand from booming China. But the main driving force of the recovery has been business investment, which after declining by almost 5 per cent last year is set to grow by 10.5 per cent in 2003. However, this turnaround is likely to prove short-lived which is why GDP growth is forecast to relapse to 0.9 per cent next year.

The UK economy

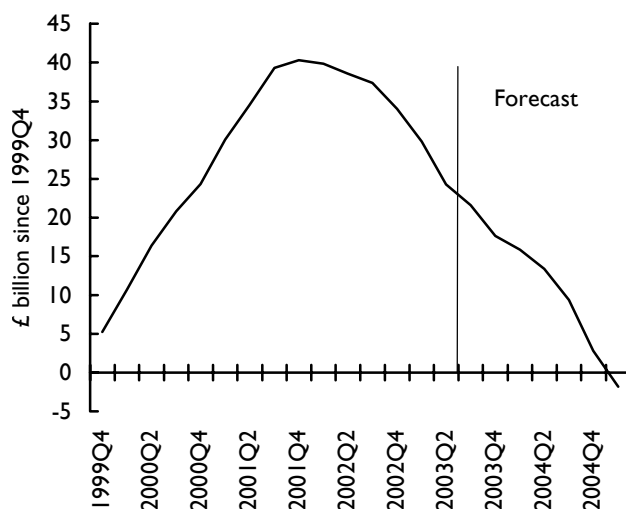
Ray Barrell, Simon Kirby, Rebecca Riley and Martin Weale

- **After growing by 2 per cent this year, the economy will expand by 2.6 per cent in 2004 and 2.7 per cent in 2005.**
- **Consumer spending will increase by 2.4 per cent this year, slowing to 2 per cent in 2004 and 1.7 per cent in 2005.**
- **The margin of spare capacity in the economy is currently around ½ per cent of potential GDP.**
- **A risk to the growth outlook is a setback to the housing market but the economy has become less vulnerable to falling house prices than it was at the end of the 1980s.**
- **Our central projection of the public finances shows that the government will narrowly breach its fiscal rule of borrowing only to invest over the economic cycle.**

Public spending will account for about 1 percentage point of annual GDP growth this year and next

The upswing now under way will gather momentum in 2004 and 2005. The profile of growth will be less lopsided than in the past few years, with domestic demand expanding more or less in line with GDP. However, we are now expecting somewhat more robust consumer spending growth in 2003 and 2004 than in our July forecast. Exports will fall by 1.9 per cent this year and increase by only 3.6 per cent in 2003. Public spending will account for about 1 percentage point of annual GDP growth this year and next; its contribution will be less if public-sector inflation continues to increase rapidly.

Cumulated surplus on the government current budget balance



The statistical fog that had been obscuring the economic landscape has now cleared following major revisions to the national accounts. These have pushed up economic growth both in the second quarter and in earlier years, especially in 1999 and 2000, although growth in 2002 was revised down.

The economy was therefore operating somewhat more above capacity in 2000 and 2001

than had previously been thought. But our estimate of the current output gap remains unchanged: actual GDP is only 0.4 per cent less than potential GDP.

We are now forecasting inflation of 2.4 per cent at the end of 2004

This gives the economy little headroom to expand faster than its trend growth rate of around 2.5 per cent a year without stoking up inflationary pressures. We are now forecasting inflation, measured as the retail price index excluding mortgage interest payments (RPIX) of 2.4 per cent at the end of 2004, just below the Government's present target. This forecast assumes that interest rates will be raised shortly and will be increased further next year.

One risk to the recovery is a possible fall in the housing market. The worry is that a decline in house prices could precipitate a more general contraction in consumer spending and output. However, our simulations suggest that the impact on GDP of a given decline in house prices – for example, 10 per cent – would now be about 40 per cent less than at the end of the 1980s boom.

the current-budget deficit will rise to £21.6bn in 2005–6

The outlook for the public finances has deteriorated further. We are now forecasting that the current-budget deficit will rise from £14bn in the current financial year to £21.6bn in 2005–6. There is a roughly even chance that the Chancellor will break his golden rule of balancing current spending with current revenues over the present cycle, which we judge started in the final quarter of 1999 and is due to end in spring 2005.

An evaluation of business start-up support for young people

by Nigel Meager, Peter Bates and Marc Cowling

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Since the 1980s, many governments have experimented with measures targeted at the unemployed and disadvantaged groups, which aim to support them to set up in self-employment. Usually such schemes provide a subsidy, in the form of a capital grant or soft loan, although some early variants such as the Enterprise Allowance Scheme involved an allowance paid during the early months of business start-up. Such schemes have been found to involve high levels of deadweight (*ie* the subsidy has gone to people who would have entered self-employment anyway), and many supported businesses have entered low margin, service sector activities where their survival rates have been poor, and they have tended to displace existing businesses.

New research focuses on a major programme to provide business start-up assistance to disadvantaged young people, through The Prince's Trust, with part-funding from the government. The Trust aims to act as a funder of last resort to potential entrepreneurs, and provides a mix of start-up loans and grants, along with mentoring support. The research looks not only at the experience of the start-up businesses, and whether they survive, but also at what happens to those whose businesses cease trading. A key question for evaluating such schemes as active labour market measures is whether the experience of starting a business with external support, adds to the 'employability' of the disadvantaged youngsters entering the programme. Does the self-employment experience increase their chances of finding work subsequently, or affect their subsequent earnings potential?

the study finds this kind
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young people

This study follows a representative sample of 2,000 young people supported by the Prince's Trust, over a 3-year period, and compares their experiences with those of a matched sample of young people who were not receiving Prince's Trust support. The study finds that although the intervention of the Prince's Trust had some positive effects (in particular, mentoring and business advice had a positive impact on business survival), many of those who started their businesses with Prince's Trust support would have done so anyway, and many had alternative sources of start-up funding. Survival rates of the businesses supported were not dissimilar to those of other business start-ups, but a high proportion of the businesses supported involved very long hours working and very low earnings for the young entrepreneurs. After controlling for other factors, however, those who left the programme were no more likely than those in the comparison group to be employed; and if they were employed, their earnings were no higher than those in the comparison group. Overall, the study finds no statistical evidence that supported entry to self-employment of this kind has an impact on participants' subsequent employability, and suggests that this kind of scheme is hard to justify as an employability measure for disadvantaged young people.

Evaluation using random assignment experiments: demonstrating the effectiveness of earnings supplements

by Doug Tattrie and Reuben Ford

Welfare recipients often face a stark choice: to continue their dependence on welfare or to accept a lower income in the work world. This is the classic “welfare trap.”

the UK is preparing to start one of the largest random assignment evaluations of a new social policy that has ever been undertaken in Europe or North America

Researchers and policy makers often have difficulty in knowing which programmes are most effective in alleviating the welfare trap. One method of evaluating these, and other social programmes, is random assignment evaluation. Random assignment evaluations have been widely used in North America to test welfare reform policies. This year, the UK is preparing to start one of the largest random assignment evaluations of a new social policy that has ever been undertaken in Europe or North America. The Employment Retention and Advancement Demonstration is planned to assign over 27,000 individuals randomly into programme and control groups between 2003 and 2005.

Tattrie and Ford discuss the advantages and disadvantages of this evaluation method while presenting the recently-released final results from the largest random assignment evaluations in Canada, the Self-Sufficiency Project (SSP). In this study, 3,315 single parent welfare applicants were randomly assigned into a control group, which received standard welfare benefits, and a programme group, which had the opportunity to receive generous earnings supplements. Programme group members who remained on welfare for one year were eligible for the earnings supplements if they left welfare within the subsequent year to obtain full-time employment. They could receive the supplement for up to three years in each subsequent month when they remained off welfare and worked full time.

the Self-Sufficiency Project helped single parent welfare applicants to substantially increase their employment

A comparison of the outcomes of the programme group with those of the control group showed that SSP helped single parent welfare applicants substantially to increase their employment while reducing their poverty and their use of welfare. For example, in the third year after random assignment, SSP increased full-time employment by nearly 12 percentage points and reduced welfare receipt by 10 percentage points. Over the six years of the study, SSP increased the earnings of programme group members by CDN \$7,859. One of the most striking results is that governments recovered most of the cost of the programme, including operating costs, through reduced welfare payments and increased taxes on earnings. SSP cost governments about \$110 per year for each programme group member or about \$1 in cost for every \$10 in after tax earnings and transfer payments received by programme group members.

Tattrie and Ford conclude that the results from SSP are particularly credible because the study used random assignment methodology. This methodology uses the control group to estimate what would have happened to programme group members if they had not received the program. A large body of statistical evidence shows that the difference between these two groups is a scientifically rigorous estimate of the effectiveness of the programme. In addition, policy makers and non-specialists can easily understand and discuss results from random assignment experiments, the authors conclude. However, Tattrie and Ford also note that random assignment demonstrations can be expensive and time consuming. In addition, they cannot be used to produce some evaluation results for statistical reasons and should not be used to evaluate some programmes for ethical reasons.

Measuring the macroeconomic effects of reducing benefit dependency

by Ray Barrell, Simon Kirby, Rebecca Riley and Desirée van Welsum

More than 14 per cent of the population of working age currently receive income from one of the main social security benefits in the UK. In this paper we construct a framework for evaluating the macroeconomic impact on the UK economy of policies that are aimed at reducing dependency on social security benefits by helping people to move from benefits into employment. Recent examples of such policies include the various New Deals, successive changes to in-work tax credits for low-income households, the introduction of Jobcentre Plus in April 2002 and the planned reforms to Incapacity Benefit announced in 2002.

For large scale policy interventions such as these one can expect the effects of the policy on its target group to have implications elsewhere in the economy. In order to evaluate fully their costs and benefits, it is necessary to use a model that takes account of the way that they affect the wider economy.

We use the National Institute Model (NiGEM) to evaluate the gains to the economy in terms of output, employment and improvements to the public finances of a policy that reduces the number of people claiming disability benefits or lone parents on Income Support by 5 per cent. These shifts in benefit claimant numbers are assumed to be costless to implement, and we do not discuss the methods that might be used to persuade claimants to enter the labour force. Clearly these issues are important when designing and evaluating specific programmes, and the costs may be such that the net benefits could be negative.

A programme that reduces the number of people claiming disability benefits by 5 per cent is associated with an increase in employment in the long run of 43,000

We find that a programme that reduces the number of lone parents claiming Income Support by 5 per cent is associated with an increase in employment in the long run of 20,000 and an increase in output of 0.06 per cent. A programme that reduces the number of people claiming disability benefits by 5 per cent is associated with an increase in employment in the long run of 43,000 and an increase in output of 0.15 per cent.

In these scenarios the public finances are improved noticeably. The policy targeted at lone parents results in a budgetary saving of £4,800 per person leaving benefit in the first year. This rises to £15,500 after 10 years as the economy expands and interest savings on government borrowing cumulate. The policy targeted at people claiming disability benefits results in a budgetary saving of £3,200 per person leaving benefit in the first year. This rises to £13,200 after 10 years as the economy expands and interest savings on government borrowing cumulate.

These gains can be regarded as significant and have to be offset against the costs of the policy. We conclude that it is possible to evaluate the impact of policies to enable benefit claimants to find work using a macroeconomic model, and that such an evaluation should be included in each assessment of policy change.

Economic evaluation of complex health and social care interventions

by Sarah Byford and Tom Sefton

Economic evaluation has played a significant role in the evaluation of health care services for many years, but its use has been more limited in complex areas of health care, such as mental health, and in the wider field of social care. The complexity inherent in such interventions results from multiple and variable components, multiple outcomes and a high degree of user involvement, and it is this complexity that, in the main, has hindered the application of traditional health economic techniques. In order to encourage greater use of economic evaluation, and thus improve the allocation of scarce health and social care resources, this paper describes the nature of complex interventions, explores the obstacles to economic evaluation that may arise and discusses techniques that can be used to address them.

Efforts need to be made to ensure scientific validity of evaluations, whilst recognising that the complexity of many health and social care interventions may require deviations from traditional evaluation models, such as qualitative research methods and flexibility in the design of evaluations. Although movements away from scientifically robust designs will undoubtedly have a negative impact upon the robustness and validity of the results, this must be balanced against the likelihood of meaningless results from the imposition of rigid scientific techniques that are inappropriate, given the nature of the interventions under evaluation.

Complex interventions require complex evaluation and, fundamentally, the net effect will be the need for more careful planning, additional evaluation techniques, additional data, and more time and money than would perhaps be required for the evaluation of a simpler intervention.