

REVIEW2005

STICERD

Suntory and Toyota International Centres
for Economics and Related Disciplines



Suntory and Toyota International Centres for Economics and Related Disciplines

The Suntory Centre:

Econometrics Programme
Economic Organisation and Public Policy Programme
Japanese Studies Programme
Theory Group

The Toyota Centre:

Centre for Analysis of Social Exclusion
Distributional Analysis Research Programme
Economics of Industry Programme

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The Suntory and Toyota International Centres for Economics and Related Disciplines (STICERD) at the London School of Economics and Political Science (LSE) were established in 1978 with funds donated by Suntory and the (then) Toyota Motor Company Limited of Japan. In 1984 and 1989 Suntory Limited gave further donations to STICERD to support new research programmes and the Saji Research Lectureship in Japanese Economic and Social History. In 1995 Toyota Motor Corporation provided additional funds towards the endowment. **Since April 2001, STICERD has been part of the LSE Research Lab.**

STICERD finances a wide variety of research by members of the staff of LSE, both inside and outside the Centres. The Centres also provide accommodation and facilities for research programmes funded from a variety of sources. Support for postgraduate students is offered annually in the form of the Suntory and Toyota studentships.

Various seminars are organised by STICERD. These include CASE Social Exclusion Seminars and Welfare Policy and Analysis Seminars, LSE/UCL Development and Growth Seminars, STICERD Economics of Industry Seminars, Economic Theory Seminars, Econometrics Seminars, International and Japanese Studies Symposia and Work in Progress Seminars. Financial support is provided for a number of seminar series within LSE, and for public lectures. STICERD hosts distinguished visitors, academic visitors and research associates from all over the world. ■

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Foreword



The STICERD Review is our annual effort to convey some of the research that goes on in the Centres for a wider audience. As well as reports on specific research, we have a number of articles which look at the LSE in a wider perspective. The Review's contributors comprise resident members of the research community at all levels – from Professors to PhD students. We make no effort as Centres to

shape research, working on the principle that putting excellent people together and giving them an enabling environment is the best context in which to produce their best research. Our researchers are often seen discussing their work over coffee and lunch and the sense of passionate commitment to discovery is palpable. In STICERD, we enjoy some of the best facilities for research in the country. These include not just the excellent IT and building fabric, but also the camaraderie of all STICERD's members. At the core of STICERD is a group of economists inspired by Michio Morishima's original vision for a multi-disciplinary research centre organized around economics. Thus our community is intellectually much broader than pure economics. From this Review I am sure that readers will get a sense of engagement of STICERD's members. It remains a privilege to be a member of STICERD and reading this Review only reinforces that sense. ■

Tim Besley
Director of STICERD

Suntory and Toyota Lectures



STICERD gave support to one Public Lecture at LSE this academic year.

On 2 November 2004, **John Vickers**, Chairman of the Office of Fair Trading, gave a lecture entitled **The Abuse of Market Power**. He was previously chief economist at the Bank of England and a member of the Monetary Policy Committee. The lecture discussed how competition law should deal with anti-competitive behaviour by firms with market power. In the light of recent EU and US cases, this is perhaps the most controversial current issue for competition policy. Lax policy would jeopardise the competitiveness of markets, but rigid policy would chill pro-competitive, pro-consumer conduct. The lecture provided an economic discussion of evolving legal standards of what is abuse of market power. ■

STICERD Visitors

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Matthew Rabin, Edward G. and Nancy S. Jordan Professor of Economics at the University of California, Berkeley, visited STICERD for parts of January, May and June; in June he gave a series of lectures for PhD students on psychological models of risk attitudes. He writes: 'During my visits I collaborated on joint work with LSE staff Erik Eyster, Dimitri Vayanos, and Georg Weizsacker. Erik and I worked on several projects relating to the limits of sophistication of economic agents in interpreting the informational content of others' behaviour. We completed final revisions of our paper 'cursed equilibrium', and worked on new projects developing a theory of inferential naivete, whereby economic actors don't fully appreciate that others' behaviour may involve attempts to

extract information and signal information rather than solely a straightforward pursuit of their goals. Dimitri and Erik and I continued work trying to understand the dynamics of financial markets when some traders under-appreciate the informational content of prices. With Dimitri I also worked on our project understanding the mis-inferences people make when they suffer from the gambler's fallacy - the belief that if a coin comes up heads three times in a row then with greater than 50 per cent probability it is 'due' for tails. With Georg Weizsacker I worked on a theoretical and experimental project about how people tend to make decisions over risk separately when they would be better off integrating these decisions. I also worked on other projects in the broad area of psychology

and economic theory. Finally, during my stay I worked tirelessly to help bring the 2012 summer Olympics to London. As I write this, we do not yet know whether this effort paid off.'

The Hayek Fellows

Peter J. Boettke is the Deputy Director of the James M. Buchanan Center for Political Economy, a Senior Research Fellow at the Mercatus Center, and a professor in the economics department at George Mason University. He visited STICERD as the second Hayek Fellow in October 2004. Boettke is the author of several books on the history, collapse and transition from socialism in the former Soviet Union – *The Political Economy of Soviet Socialism: The Formative Years*,

1918-1928 (Kluwer, 1990); *Why Perestroika Failed: The Economics and Politics of Socialism Transformation* (Routledge, 1993); and *Calculation and Coordination: Essays on Socialism and Transitional Political Economy* (Routledge, 2001). He is also now the co-author, along with David Prychitko, of the classic principles of economics texts of Paul Heyne's *The Economic Way of Thinking* (10th Edition, Prentice Hall, 2002). While here, he gave the Hayek Lecture, entitled 'Hayek and Market Socialism: Science, Ideology and Public Policy'. In this lecture, he argued that Hayek is better appreciated for his ideological stance than his scientific contribution. While this is understandable given the ideological nature of the debates within which he made his main contributions to economics (eg, his dispute with Keynes and the dispute with Lange/Lerner), he contended that it is mistaken. Hayek's ideological position in these debates is derived from his scientific understanding of economics, not the other way around, and that we disregard his science to our detriment as scientific economists. He argued that if Hayek's message is understood it will demand a reorientation in economics (both theoretically and empirically) and will result in radical change in our self-understanding and our role in public policy discourse.

Peter Leeson, a fellow of the James M. Buchanan Center for Political Economy at George Mason University where he is a doctoral candidate in economics, visited STICERD in May/June of 2005 as the third Hayek Fellow. He reports: 'My time there was divided between two major research projects and interacting with the students who comprise the LSE's Hayek Society. The first research project I turned my attention to considers the impact of media freedom

on citizens' political knowledge and participation. I gained invaluable input and assistance on this project from several STICERD researchers, including Tim Besley and Robin Burgess, who have helped to pioneer this burgeoning field, which investigates mass media's impact on economic outcomes.

The second main project I devoted attention to explores the role of self-governance in developing economies. Developing countries are characterized by weak or failed governments. In the absence of effective formal governance, private individuals must be entrepreneurial and find innovative informal solutions to help them realize the gains from trade. My project considered what kinds of informal institutions have been used for this purpose where state enforcement is weak, with a particular eye to what development community policy makers can learn from these applications in thinking about improving the state of economic performance in impoverished parts of the world. STICERD provided a superb research atmosphere for this project and I benefited tremendously from the opportunity to write and discuss with others about my ongoing work in this area.

The remainder of my time at STICERD was spent meeting and talking with LSE students in both formal and informal settings. I was thoroughly impressed with the students I spoke with and greatly enjoyed the opportunity to discuss a broad range of topics in the social sciences, from economics to the philosophy of science. A conversation about the philosophy of economic science with one LSE philosophy student has turned into a jointly authored paper in progress, which I am delighted

with. I was also extremely pleased with the student response to a seminar I presented on Austrian economics, its relevance for young economists, and new directions the Austrian School is headed in as part of the contemporary Austrian research program.

STICERD is an outstanding environment for research and collaboration, and I am extremely grateful for the opportunity I was given to interact with its faculty, students, and the students of LSE more generally. I want to thank STICERD for my productive time there and for its role in advancing economics.' ■

Why economics is good for your health

Economists are often stereotyped as only being interested in money. In the health field, this stereotype takes the form that economists are only concerned with costs: if some new medical technology is introduced, nine out of ten economists will block it on grounds of expense. But this view misses the power – and the interest – of economic analysis. Economic analysis is far broader than simply counting the costs of activities in hospitals or that of new drug developments. Central to economic analysis is the idea that individuals make trade-offs based on relative prices. This idea is key to understanding why we are getting fatter, why nurses fiddle the figures in A and E departments and why the introduction of competition in the NHS will mean hospitals will want to merge. Below I'm going to discuss a couple of areas where an economic approach has been applied, sometimes leading to surprising conclusions.

Economics and obesity

Obesity – being too heavy for your height – is fast becoming the number 1 public health issue in the Western World. The US leads the way in the world league tables of obesity and the UK is not far behind, with an estimated one in five adults being overweight. In England, around 30,000 deaths a year have been attributed to obesity: the National Audit Office estimated the condition costs the NHS £500 million a year and the economy £2 billion. The rise of obesity has been blamed on a host of factors, including genetics, fast food outlets, cars, TV viewing, a lack of participation in sports, and working women. With the exception of genetics, all of these factors exhibit upward trends. However, just because they increase at the same time as obesity has risen does not mean that they cause increases in obesity:

'The rise of obesity has been blamed on a host of factors, including genetics, fast food outlets, cars, TV viewing, a lack of participation in sports, and working women.'

some may well be the outcome of increased obesity rather than the determinants. Economists have argued that technology may be fattening. This possibly surprising argument goes as follows.

Weight is the outcome of consuming and expending calories. If calorie consumption is greater than that needed to maintain current weight, people will gain weight and vice versa. Technological change has altered the relative prices of consuming calories and spending calories¹. Technological change on the supply side, through agricultural innovation, has lowered the price of food, making the price of calorie consumption cheaper. At the same time, technological innovation has changed the nature of work. In agricultural and early industrial societies, work is strenuous; in effect, workers are paid to exercise. In a post-industrial society, work entails relatively little exercise. Payment is mostly in terms of foregone leisure, because leisure based exercise must be substituted for exercise on the job. So the cost of expending calories has increased. Together this means weight has risen.

This technology explanation has different implications for prices than alternative explanations for the rise in weight. If obesity is due to a growth in the demand for food or a growth in the demand for fast food, a change in attitude towards obesity or reduced parental oversight of children, these would all increase the demand for food. This would mean that weight would rise, but as demand for food shifts outwards for a given supply, so prices and food consumption would unambiguously rise. Yet the long run trends indicate some periods in the last century in which there have been declining calorie intake, declining prices and yet growth in weight. This can be explained by a combination of sedentary technological that lowers the demand for food, while agricultural technology expands its supply. The impact on quantity will be ambiguous, but the price effect will be unambiguously negative. Estimates for the US suggest that around 40 per cent of the recent growth in weight in the US is due to agricultural innovation that has lowered food prices and 60 per cent is due to demand factors such as declining physical activity from technological changes in home and market production².

‘We eat more because improved technology – from the microwave oven to flavour protecting preservatives to packaging – has cut the time taken to prepare food.’

This approach may help us understand long run changes (and to explain why obesity is rising in countries where malnutrition is also a problem), but cannot explain the continued rise in US weight since the 1980s as most of the changes in energy expenditure – TV watching, travel to work etc – occurred earlier. Other economists have argued that obesity has risen because of the price of food consumption following technological changes that have drastically reduced the time costs of food preparation³. We eat more because improved technology – from the microwave oven to flavour protecting preservatives to packaging – has cut the time taken to prepare food. Thus food is cheaper, not only in the hours on the job it takes to earn money to buy dinner (its direct price), but also in the minutes needed to make it. In 1965 in the US non-working married women spent over two hours per day cooking and cleaning up from meals. In 1995 the same tasks take less than one hour.

This fall in time price has led to an increase in the quantity and variety of food consumed. Consider the case of the potato. Before World War II, Americans ate massive amounts of potatoes: largely baked, boiled or mashed. Chips (French fries) were rare, because the preparation time was high. French fries are now peeled, cut and cooked in factories, then shipped frozen, to be reheated in kitchen microwaves or a fast food fryer. The French fry is now the dominant form of potato in the US and between 1977 and 1995, Americans ate 30 per cent more potatoes, most in the form of fattening French fries.

This theory has several implications. First, increased calorie consumption comes from consuming more meals rather than more at a meal, because of lower fixed costs of food preparation. Second, consumption of mass produced food has increased the most. Third, groups in the population that have had greatest ability to take advantage of the drop in price of food preparation have gained most weight. And these findings are broadly confirmed for the US: we await similar tests for the UK.

These economic analyses can also explain why there are differences across income groups in weight gain. In the US, the rich tend to be thin, the poor overweight. One in four adults below the poverty line is obese, compared to one in six in richer households. In post-industrial society, people must pay for, rather than be paid to, undertake exercise. If work is sedentary, an increase in earned income will have a larger effect on weight than an increase in unearned income, because earned income also reduces physical activity. Exercise is also more expensive for those who have earned income, because they must give up time that could be spent in work. Therefore those with greater income from asset markets may be less obese than those who get income from employment markets. Further, in terms of food prices, calorifically speaking, the best bargains are packed with sugar, fat and refined grains. Processed foods are also more accessible: their long shelf life means they can be found in most stores, so the travel costs to access them are less. This is perhaps

less a European problem – where the density of living and food outlets in urban areas is high – than a US one – where many people don’t have close markets, but do have petrol stations and small convenience stores close by. But it has also been put forward as relevant for the UK, where for poorer individuals the cost of using such stores and buying such foods is lower than the cost of searching out the healthy and more expensive alternatives. Poor children – at least those in urban areas – also face higher costs of exercise: green spaces are further away; the streets are less safe.

The implication of economic analysis is that some of the culprits blamed for the increase in obesity – the rise in restaurants and fast food outlets the greater amount of pre-prepared food in supermarkets – are not the causes of the increase in obesity, but are the correlates. Faster food is a natural response to the increased value of time induced by technological change: the output foregone by a meal produced at home has risen, so individuals will demand faster food, both at home and in the market. Economic analyses also cast doubt on the usefulness of some policies that have been advocated to combat obesity and also raise questions about the appropriateness of imposing taxes to combat weight gain. If health isn’t everything, the interplay of preferences and technology may mean that people are better off being above their own ideal weight. People are likely to prefer higher paying sedentary jobs to more physically demanding ones with lower pay. In general, when technology makes something easier, quicker or cheaper, we consume more of it, and that’s generally a plus. Think broadband, faster planes, heart surgery. The standard rationale for government intervention to alter prices, through taxes or subsidies, is market failure.

‘We cannot assume that the responses of health care suppliers to incentives will be as the body that sets the incentives (generally the government) wishes.’

A common form of market failure that may warrant taxes is that where private costs diverge from social costs. But this doesn't seem so pertinent in the case of obesity (as distinct say from alcohol consumption). The private benefits of (lack of) obesity far outweigh the social benefits. In a world in which being slim, even thin, is seen as beautiful, there are large private gains to being thin but few external benefits to others. Taxing obesity would reduce the costs, borne by all of society in a tax-financed system, of the medical care that is associated with obesity. But there is a trade-off between health expenditure per period and the number of periods over which that health expenditure is incurred. If reductions in obesity cause longer life then the number of periods for which subsidies will be paid will increase. Taxing fast food would also have distributional consequences: the poorest in (Western) societies are the biggest consumers of such food.

There may be two groups of people for whom changes in price based incentives are useful. If certain people have trouble controlling how much they eat, then technological changes that have lowered the costs of calorie consumption may exacerbate these problems. For these people, increasing prices may increase welfare. There may also be grounds for changing prices to change the choices children make. Children may be less able to make rational, well informed choices than adults and health in childhood is an important foundation for health in later life.

Economics and health care reform

Health care reform has become a perpetual activity of the UK – and other – governments. One reason for this is the large (and growing) amount of public money spent on health. To get maximum value from this expenditure, we need to understand how suppliers of health care respond to changes in incentives. Again, economics is helpful in this.

Several arguments have been made against the use of economic analysis; these include medicine being a ‘caring profession’; that healthcare is often funded by the state so that doctors and hospitals operate in the public sector and therefore have ‘public sector’ motivation, or that even where there are few public hospitals, an important role is played by not-for-profits. So, for example, a recent federal court judgement on a merger case in the USA concluded:

‘The board of University Hospital is quite simply above collusion’⁴.

It is certainly true that the sector is one to which individuals who care about individuals’ outcomes are attracted. It is also the case that the state plays a large role in the provision as well as funding of health care. It is also true that the organisation of suppliers is such that not-for-profits play a large role. But it is also an incorrect and unhelpful view to argue that financial and other incentives are not important. When we look at the behaviour of doctors or hospitals we can

observe that they respond to financial and other incentives, and further that they respond in ways that can be predicted by economic analysis. This has implications for the design of health care institutions, of payments systems, for the use by government of financial incentives and for the regulation of health care markets.

We cannot assume that the responses of health care suppliers to incentives will be as the body that sets the incentives (generally the government) wishes. The economic literature stresses that individuals will respond in ways that maximise their own net benefits. This response may or may not maximise the net benefit to society. What a financial or other incentive will do is to increase the reward from undertaking the task that the government has decided to reward. Whether this increased activity on the part of the health care supplier will lead to the results government desires depends on, amongst other things, how precisely the government can specify the task it is increasing the reward for; what other tasks the supplier undertakes (that are now less rewarded); and on the strength of the incentive.

In many cases, it may not be possible to define the task to be undertaken very precisely. This is particularly likely to be the case in the public sector, and in health care too, where precise measures of output are difficult to define⁵. So the government may have to rely on proxies for increased activity on the task. This means that suppliers who are given stronger incentives will focus on increasing output of these proxies. This may lead to better health care, but it may also result in suppliers ‘gaming’: altering their activity to increase the measured output, but not real output.

Increasing the incentive to do one task alters the relative prices facing the health care supplier: the other tasks that they may do are now relatively less rewarded. In response to this relative price change, as suppliers only have limited time, they will switch their effort patterns towards the better rewarded task and away from the less rewarded tasks. This switching of effort will be more likely the less well these other tasks can be measured and the bigger is the reward for the incentivised task relative to the other tasks the supplier carries out.

We can see examples of this in the responses of family doctors to the GP fundholder reforms of the 1990s. The reforms created, out of the public sector, separate sellers and buyers of hospital-based health care⁶. The sellers were to compete with each other to win contracts for care from the buyers. There were two types of buyers: buyers responsible for all the population in their area and a smaller group of buyers, who were family doctors, who were given more limited budgets to buy care for their practice populations. These were called General Practice Fundholders (GPFHs). Crucially, GPFHs were able to keep any surplus from their budget at the level of the practice. The GP benefits from this when they come to sell the practice on leaving the profession.

‘Performance monitoring takes many forms, but at its core is the idea of measuring output in some way and setting targets based on these measures.’

When GPs wished to become fundholders, they announced their intention and then waited a year whilst their referrals to hospitals were counted in order to work out their budget. So the obvious question to ask was whether GPFHs increased their referrals in the year before becoming a fundholder in order to increase the size of their budget once they became a fundholder. In a study of GPs located in one area of the UK, researchers found that GPFHs did exactly that: they increased their referrals to hospitals relative to their previous referral patterns by about ten per cent. Once they became fundholders, their referral patterns dropped by about 10 per cent and thereafter appeared to revert to their long run normal levels⁷. We can’t tell precisely whether this was to benefit their patients or the GPFHs themselves, but can see that the GPFHs did respond to financial incentives. And in the process, because the total pot for buying hospital care was finite, they also took monies away from practices that weren’t fundholding.

We can also see examples of similar behaviour in the response to increased performance monitoring in the NHS. Performance monitoring takes many forms, but at its core is the idea of measuring output in some way and setting targets based on these measures. The idea is that such targets will make people work harder. However, because the output of the sector is often hard to measure, the measures are imperfect. This gives the people being monitored incentives to alter their activities – not only to work harder which is what the government wants – but also to manipulate the targets. There is no reason why people in the health service should be any more immune to this than anyone else.



Two TV interviews illustrate these points. The first is a conversation between the manager of an Accident and Emergency department of a London hospital (JC) and the interviewer (Dennis) about the meeting of waiting time targets:

JC: 'We met the target in the week that it was measured, and as expected our performance against that target has fallen away since the week of monitoring.'

Dennis: 'So the whole thing is a bit artificial?'

JC: 'The whole thing is a bit artificial if you look at it one way. Because it was... yes clearly it was artificial, and we put in a lot of additional resources. I think one thing that has been very helpful, is for that week we've actually measured what additional resources we put in.' (Newsnight (BBC), 'Health Delivery', May 2004).

Or there's James Strachan of the Audit Commission:

'The system is being distorted to meet those targets in the sense that money that was intended for longer term purposes, like buying medical equipment, buying computers, simply maintaining the buildings, that's being diverted in order to be able to meet waiting time targets'. (Panorama (BBC), 'Fiddling the Figures', June 2004).

In summary, while economics doesn't have all the answers, I would argue that there are many more areas in the health and health care field where an economic approach is helpful. On the future research agenda are such topics as understanding whether restricting fast food outlets will curb the growth in obesity, whether bans on smoking in public places will stop people starting smoking, and whether the new market reforms in health care in the UK will do all that the politicians claim. ■

[This is based on the 4th Royal Economic Society Public Lecture, given in December 2005. A full text is available at www.bris.ac.uk/Depts/CMPO/workingpapers/wp116.pdf]

[See Appendices on page 28 for references]



Carol Propper
Co-Director of CASE and Professor of Economics of Public Policy at the University of Bristol

Cooperation in the workplace: evidence from the field

The success of many economic endeavours depends on people's ability to cooperate, namely to refrain from individually profitable actions for the sake of a common good. Such collective action problems have the key characteristic that, because individual actions have externalities on others, private and social optima do not coincide; in other words, what is best for the single individual might not be optimal for the society as a whole.

Key examples are the use of common property resources (eg firewood from forests) – where the actions of individuals impose negative externalities on others, and the provision of public goods (eg recycling) - where the actions of individuals impose positive externalities on others.

While extensive evidence from experimental economics indicates that individuals do take account of the effect of their actions on others in laboratory games, whether individuals cooperate in the workplace is largely unknown.

The issue is of great practical relevance since workers' productivity under several incentive schemes, such as relative performance evaluation and team pay, depends crucially on whether and to what extent they internalize the effects of their actions on co-workers' payoffs.

To present evidence on cooperation in the workplace, Iwan Barankay (University of Essex), Imran Rasul (University College London) and myself have designed and run a field experiment on a leading farm in the United Kingdom. Our aim is to assess whether workers cooperate, why they do so, how the cooperative norm is established and whether the composition of the group matters for cooperation, for instance whether workers cooperate more with colleagues of the same nationality.

The experiment

Our subjects are farm workers, whose main task is to pick fruit. In the experiment the incentive scheme according to which they

'The success of many economic endeavours depends on people's ability to cooperate, namely to refrain from individually profitable actions for the sake of a common good.'

are paid is changed from relative incentives to piece rates. Under relative incentives, workers' daily pay depends on the ratio of individual productivity to average productivity among all co-workers on the same field and day. In contrast, under piece rates individual pay only depends on individual productivity.

Do workers cooperate?

To identify whether workers cooperate we compare their productivity under relative incentives to their productivity under piece rates. The comparison is revealing because under relative incentives individual effort imposes a negative externality on co-workers' pay whereas under piece rates individual effort has no effect on others' pay. This implies that under relative incentives the welfare of the group is maximized when workers fully internalize the negative externality their effort places on others and cooperate to exert the minimum feasible level of effort. Under piece rates, in contrast, the individual and social optima coincide.

The difference in workers' performance under the two schemes, if any, then provides evidence on whether and to what extent workers internalize the externality they impose on their colleagues, namely on whether they cooperate.

Our analysis shows that, on average, workers manage to cooperate to some extent. In other words, the productivity of the average worker lies between those predicted in two benchmark models of worker behaviour – the individualistic Nash equilibrium, and the fully cooperative

equilibrium. The analysis thus shows that workers internalize the externality they impose on others under relative incentives.

Why do workers cooperate?

It is important to stress that cooperation might arise either because of altruism or collusion. Namely, workers might internalize the externality either because they truly care about colleagues' payoffs, or because they fear punishment and retaliation. To shed light on their underlying motives, we exploit the fact that the ability to monitor co-workers creates differences in observed behaviour depending on whether workers cooperate because of collusion or altruism.

To sustain a collusive agreement workers must necessarily be able to monitor each other's behaviour on the field-day. In contrast, the ability to monitor co-workers is irrelevant if workers' behaviour is driven by pure altruism. Under altruism, workers take into account the effect their effort has on others because it affects their own utility directly. Hence they cooperate regardless of whether they are monitored by others, and regardless of whether they can monitor co-workers' performance.

The empirical analysis indicates that workers internalize the externality only when they pick a type of fruit which allows them to monitor each other. This evidence thus rules out pure altruism as the underlying cause of workers' behaviour.

Group characteristics that foster cooperation

To identify the effect of group characteristics on the cooperative behaviour of individuals we compare the behaviour of the same individual when she is exogenously assigned to different groups of co-workers.

We find that a given worker cooperates more, namely her productivity is significantly lower under relative incentives, when (i) she works in smaller groups; (ii) she works alongside her friends; (iii) the share of co-workers of the same nationality is higher; (iv) the group is more homogeneous in terms of their ability (or distribution of net benefits); and (v) she works alongside more co-workers who have less to lose from being caught shirking.

The establishment and evolution of the cooperative norm

Finally, we exploit the fact that workers arrive at different points in time, and hence differ in their exposure to the relative scheme, to document how the cooperative norm is established and how it evolves. Our main results are as follows:

- First, individuals cooperate more as their exposure to the relative incentive scheme increases. This effect is significantly larger for the cohort of early worker arrivals,

namely individuals who started working at the beginning of the peak season when the scheme was first introduced.

- Second, individuals cooperate more when they work with co-workers who have been exposed to the scheme for longer and hence are more familiar with the norm. This effect is larger for the cohort of late worker arrivals, namely individuals who arrive after the cooperative norm has been established. Individual and group exposure are thus substitutes, namely individuals either learn how to cooperate from experience or from other workers who have already been exposed to the norm.
- Third, the arrival of new workers who are unaware of the norm disrupts cooperation. The disruption is however short-lived – on average new workers learn to behave according to the cooperative norm within a week of their arrival. Moreover, the disruptive effect of new arrivals becomes weaker as the average exposure of the group they join increases.

In conclusion

Using data from a field experiment, we have shown that workers are able to cooperate, especially if they can monitor each other and if they work with colleagues to whom they are socially connected. We have also shown that workers learn how to cooperate either from personal experience or from others who are already aware of the cooperative norm.

The analysis emphasizes that understanding whether workers cooperate is key for the optimal choice between alternative incentive schemes and hence an important determinant of productivity. The findings show that to the extent that workers place some weight, either positive or negative, on the effect of their actions on the other workers' pay, group or relative incentive schemes can outperform piece rates in terms of productivity. The findings thus provide specific insights for further developments of incentive theory and shed new light on an old idea – the interplay between social effects and the provision of incentives within firms. ■

[See Appendices on page 28 for references]



Oriana Bandiera
Economic Organisation and Public
Policy Programme

The LSE approach to political economy

Introduction and historical background

Political economy can be defined on the basis of its objects of analysis and of the methods being used for such analysis. The typical objects of study are political institutions by themselves, or in their interaction with economic variables: the first object is clearly shared with political science proper. The methods adopted by political economy scholars generally consist of the construction of game-theoretic mathematical models and in the use of statistical tools for testing the implications of such models. These methods clearly derive from the discipline of economics itself.

One can safely attribute primacy in the systematic use of economics' tools in the analysis of political institutions to the Public Choice School, as initiated by James Buchanan and Gordon Tullock in the late 1940s and early 1950s.¹

Before the Public Choice 'revolution', whenever politicians entered into (public) economics models, the standard assumption was to imagine them as benevolent agents who would use their policy tools in order to solve market failures in an efficient way. James Buchanan strongly criticised such assumption as methodologically inconsistent. If private agents are represented as rational and selfish beings who maximise their perceived utility, there is no *a priori* reason why public agents should be assumed to be Kantian altruists, who by default adamantly care about the total welfare of the population. If on the contrary individuals are thought of as selfish and rational whichever role they play, either private or public, then political

institutions should be analysed in the same way as economists study private choices in the market, and their efficiency scrutinised.

The typical conclusion reached by Public Choice scholars (the so-called 'Virginia School') is that, because of the poor incentives faced by voters and politicians and bureaucrats, political institutions systematically fall short of the efficiency displayed by market ones.

On the contrary, according to the Chicago School, as exemplified by Wittman (1989), the incentives faced by politicians through the electoral process are able to guarantee a satisfactory degree of efficiency in the field of public choices: therefore political institutions are almost as efficient as market ones. For example, incumbent politicians must deliver policies that are appreciated by the generality of voters, to the extent that they care about their chances of being re-elected.

The discipline of political economy, as developed in the macroeconomics area by Alesina, Persson, Rodrik and Tabellini², shares with the Virginia and the Chicago Schools the focus on the interaction between political institutions and economic variables, but is not explicitly concerned with the construction of a grand philosophical theory about the relationship between market and political interactions. Instead, as explained in the introduction to the Persson and Tabellini (2000) textbook, the purpose of the so called macro political economics literature is to **systematically** use game theoretic tools and general equilibrium models in the analysis of those issues originally tackled by the Public Choice school.

Main features of the LSE approach

Given the brief methodological and historical background I have sketched above, there are four main features that characterise the LSE approach to political economy (henceforth: LSE atPE), and distinguish it from other schools of thought in the field.

- a) First of all, there is a strong tendency to **combine theory and evidence**. While the traditional Public Choice literature (with some notable exceptions, eg the work of Bruno Frey) was mainly focused on the construction of intellectually provocative theoretical models, the recent political economy literature shows a systematic move towards the empirical testing of models, not necessarily provocative. This is a general trend, which the LSE atPE shares with the macro political economics school of Alesina, Rodrik, Persson and Tabellini. This in turn is confirmed by the subtitle 'theory and evidence', which frequently appears in papers produced by the LSE school: the idea is exactly that theories about the functioning of the political system and/or its economic effects are systematically confronted with some relevant empirical evidence, in order to confirm or reject them. Theory and evidence are in fact complementary in the construction of a cumulative *corpus* of knowledge, which pretends to be scientific, or not terribly un-scientific.



‘According to the political agency model, incumbent politicians are induced to deliver policies which voters like, because any bad performance on this account would be punished by the credible threat of not re-electing them.’

b) As a first point of separation from the macro political economics approach, the LSE atPE is characterised by its focus on **little and meaningful objects**, within the space of potential objects of analysis in the political economy field. In particular, with the adjective ‘little’, I am referring to objects and aspects of political institutions that are not grand and all-encompassing. In fact, almost by definition the macro political economics school is concerned with very fundamental matters such as the differences between parliamentary and presidential systems of political governance, and/or between proportional and majoritarian mechanisms of electoral representation. Typically, the focus of the macro school is on the economic consequences of these differences. It is therefore very arduous to apply the *ceteris paribus* assumption to these grand comparisons, just because a presidential and a parliamentary system may not simply differ in the presence of a vote of confidence for the government. There could be other elements of differentiation which to some extent overlap with the parliamentary-presidential cleavage, and would confound the identification of the effects *per se* produced by this primary cleavage³.

On the contrary, the LSE atPE has a particular taste for smaller, more self-contained political economy objects, whose relevance is empirically tested.

As an example of this tendency, one can think about the Besley and Case (1995) paper on the effects of term limits on economic policy, which sheds some light on the principal-agent structure of electoral representation. According to the political agency model, incumbent politicians are induced to deliver policies which voters like, because any bad performance on this account would be punished by the credible threat of not re-electing them. When term limits are present and binding, such electoral incentive for ‘good’ performance is cancelled out. This theory is put to test against panel data on US governors. Another nice example is the Besley and Coate (2003) paper on elected versus appointed regulators, which focuses on the economic consequences of ‘unbundling’ a given political decision. The idea is to check whether elected regulators choose policies that are more consumer friendly than the ones appointed regulators would enact. This is the case, because elected regulators are directly responsive to the vote of citizens, while the performance of appointed ones would be only one of the many factors that drive the vote for the governors who appoint them.

The fact that a given object of analysis is not grand but in some way self-contained does not imply that this object has a negligible influence on citizens’ welfare. For example, the Besley and Burgess (2002) paper on the role of mass media in India is focused on a very specific point, namely whether mass

media outlets are capable of making the government promptly responsive to famines and natural catastrophes. The narrowness itself of its focus is perhaps a necessary condition – from a methodological point of view – to cast some light on a crucial aspect of modern political institutions, ie the role of mass communication.

Regarding the role of mass media outlets in the political process, subsequent papers produced by the LSE school are characterised by a similar focus on little and meaningful object of analysis. The Larcinese (2003) paper on demand for information and election closeness analyses the space devoted by the Guardian newspaper to different races during the 1997 UK General Election, and indeed finds that such space is an increasing function of the closeness of the race.

There is indeed some consistency between this survey and my research proper. My paper on the political behaviour of the New York Times (Puglisi (2004)) is in fact focused on a very self contained object: whether the New York Times strategically exploits its agenda-setting power during presidential campaigns, by publishing more stories about issues that would give an electoral advantage to the Democrats or to the Republicans. The main result of this analysis is that the New York Times indeed publishes more stories about Democratic issues like health care, civil rights and labour when the presidential campaign kicks in, but only so when the incumbent president is a Republican.

c) The LSE atPE gives a strong priority to the use of **sound empirical methods**. Cross country analyses of grand political economy issues quite intrinsically suffer from problems of omitted variables and in general of unobserved heterogeneity. As mentioned above, this muddles the attribution of causal effects to institutional variables. Moreover, the use of cross-country panels and fixed effects estimation very often is difficult or unfeasible, because of the scarcity (and sometimes lack) of time variation of such grand political economy objects, as is the case for the parliamentary-presidential dichotomy.

On the contrary, the LSE atPE, just because of its focus on self-contained and meaningful objects, can often rely for empirical testing on the panel data analysis of federal states, like India and the United States. Taking again the example of the term limits paper about US governors, there is a non negligible number of states which changed their term limit rules: it is therefore possible to exploit such 'within' variation in the institutional variable, i.e. check whether the switching states display some systematic difference in their political economy outcomes, as a function of the presence or lack of term limits. Secondly, the use of data about states within a given federation makes the problem of unobserved heterogeneity definitely less severe, just because states within the same federation share many political, social and economic aspects, to a much larger extent than independent states in a cross country study. Again, the possibility of using sound empirical methods is feasible, because of the choice of self-contained political economy objects for the analysis.

d) The methodological choice of focusing the analysis on self-contained and relevant political economy objects, and of using empirically sound methods, brings about the tendency to **search black holes** in the landscape of the existing literature. By this I mean exactly the search for unexplored areas of research, perhaps with a little bit of economic imperialism *à la* Chicago School, in the sense of entering areas that by themselves one would not include in the traditional economics (and political economy) field. This is certainly the case for the analysis of mass media, which for decades was firmly in the hands of public opinion and sociology scholars. In my view, the major risk involved in this exploration of unexplored research areas is some lack of direction, in the grand sense of this term. In other words, the risk is to work on some areas, just because (and only because) there is some scientific 'free lunch' available in these areas. But perhaps this is a general risk faced by scientific research, given the strength of such short term incentives as the need to publish papers in peer-reviewed journals being much greater than that to produce books. More on this in the last section.

A trade off

There is a trade off in the space of potential ways of doing research in political economy, which is implicit in the analysis performed above. One can try and build up a grand theory of political institutions and behaviour, as James Buchanan with Geoffrey Brennan and Gordon Tullock have accomplished with the Public Choice School. One can on the other hand decide to somewhat abstain from the philosophical analysis of political behaviour, and still focus on a grand theme like the economic effects of political institutions, as is witnessed by the last book by Persson and Tabellini (Persson and Tabellini (2003)).

The drawbacks of these approaches are intrinsically related to the amplitude of the chosen research object. On the one hand, there is the risk of allowing some ideological thoughts to strongly dictate the choice between relevant and negligible research issues, and how the former are framed. On the other, there is the risk of focusing on very interesting macro aspects of political institutions, whose likely influence on political and economic outcomes cannot be completely ascertained, given the inferential weaknesses of cross country studies.

On the contrary, the LSE atPE abdicates from pursuing a grand philosophical (and possibly ideological) agenda. At the same time, it renounces the project of reaching some final conclusions about the causal mapping that goes from political institutions of electoral representation and governance to macroeconomic outcomes, like the size of the public sector and economic growth. Rather, it follows the Descartes concept of 'clear and distinct ideas'⁴, and provides precise statements about self-contained and meaningful aspects of political institutions and interactions, which are backed up by sound empirical methods.

Politically feasible political economy

One of the main roles played by economists, and social scientists in general, is the one of providing informed advice to elected officials. Sometimes advice must be given about which specific policy to implement in a given situation; at other times politicians (and the general public) must decide on which rules of the political game are to be established, either at the ordinary or at the constitutional level.

Political economists should be ready to provide informed suggestions about which political rules to implement. Radical changes in the link between the executive and the legislative (as portrayed by the parliamentary-presidential dichotomy) or in the electoral system are pretty sporadic, and one could find reasonable political economy explanations for such sluggishness. In a somewhat Marxian sense, such changes are often a political consequence of ampler social and economic changes, over which little control can be exercised.

There are however other reforms in the rules of the political game, which are narrower in scope, still relevant for citizens' welfare, and more open to the informed advice provided by political economists. This advice about self-contained and relevant aspects of the political game must be supported by sound empirical evidence, such that decision makers can be confident enough (in a statistical sense!) in the existence of a causal link that goes from political rules to the political and economic outcomes that are of interest. The LSE atPE is well suited to supply this kind of advice.

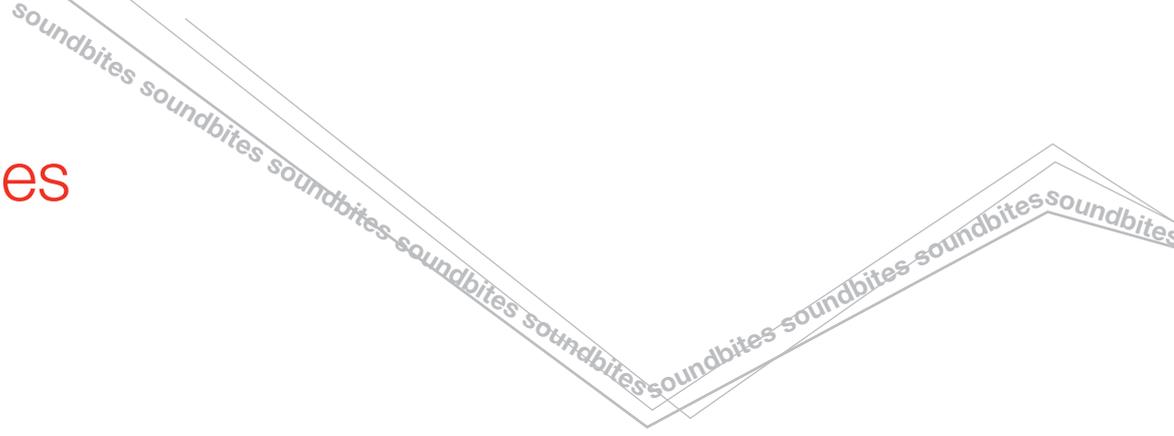
The idea is exactly to offer informed and empirically sound advice to elected officials and the general public about areas which are open to reforms and changes, without a complete overturn of the existing political structure. The LSE approach to political economy is indeed a way of doing **politically feasible political economy**. ■

[See Appendices on page 28 for references]



Riccardo Puglisi
Economic Organisation and Public Policy Programme

Soundbites



'I came away with a feeling that geography is somehow underestimated in today's development debate, where institutions and governance dominate the playing-field.'



Teaching maths in South Africa

As part of my stay in South Africa in the Lent Term of 2005, I spent two weeks teaching maths in a remote corner of KwaZulu-Natal. Npontshini primary school is in the countryside, about 10km from the nearest small town. In addition to teaching the maths classes for the school's seventh graders, I would help the kids from the local orphanage with their homework by gaslight in the evenings.

When I first arrived, I was a bit uncertain about how much I would be able to contribute to the teaching, since I would be taking over the classes from the school's principal, a very able woman who also helps run the charity I was volunteering for. But although I was only there for a short time, I think I did make a minor impact. When I first visited my classes, the pupils were reading off the blackboard in unison chanting, 'six times one is six, six times two is twelve, ...'. But, although it may be useful to learn multiplication tables by heart, as a general method for teaching maths rote learning leaves the students hopelessly unprepared for problem-solving, as I quickly realised when I saw their homework.

Coming from a different teaching culture, I would briefly explain a topic on the board, and then engage the students to apply the concept either in words or at the board. This puzzled them at first, but they quickly learnt the new game: maths is about thinking, not remembering! I never lacked volunteers for my problems. But my most important student was not a seventh-grader: the principal was sitting in on my classes, and on my last day she told me that she had learnt a lot about teaching maths! If I could help her improve her teaching by just a little bit, that may well be the longest-lasting impact of my brief stay.

My stay also shook up my thinking about economic development. I have had a tendency to think of development as something that will 'simply happen' in a region once proper infrastructure, public services and institutions are in place. As a thought experiment, I tried to imagine what the region I visited would be like if all the children went to schools of Western standard, everybody received world-class

healthcare and the financial system, roads, power lines, water supply, and sanitation were kept in tip-top shape. Even more of a miracle, I would imagine an efficient and well-run local public sector. But the truth is that even given all these things, I still have a hard time imagining the region as one of economic prosperity. It has few natural resources and poor soil. South Africa's mineral resources, game parks and streamlined farms are far away. Its remote inland location means it will probably remain a backwater, not a place where people will set up businesses or meet to trade. It's hard to imagine it ever playing an economic role other than that which it already plays: supplying migrant labour for more fortunate regions. I came away with a feeling that geography is somehow underestimated in today's development debate, where institutions and governance dominate the playing-field.

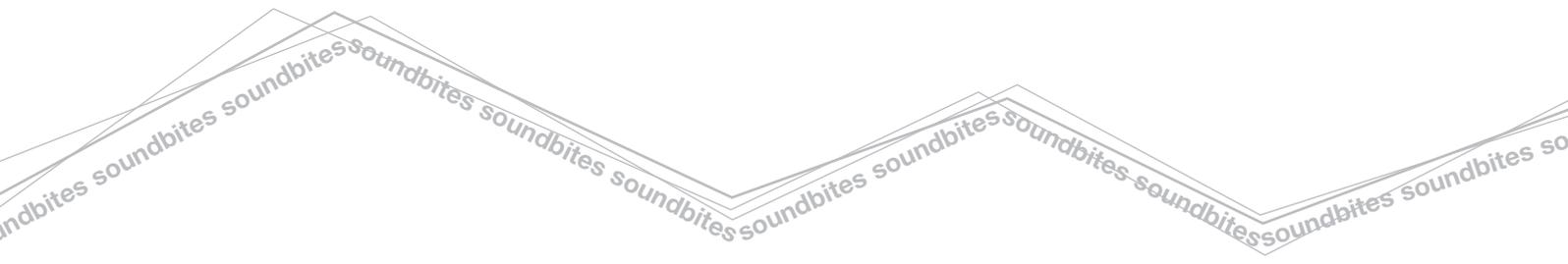
I left with memories for life. I will always remember the beautiful countryside, the glorious sunrises, the friendly locals and the eagerly learning school children, as well as the horrid poverty and the toll of AIDS on the entire community. But above all I will remember the kids at the charity's orphanage. Most of them have lost both parents to AIDS, but still displayed a playfulness, enthusiasm and optimism that would shame many a blasé, zombie-eyed Londoner. ■



Erlend Berg

Economic Organisation and Public Policy Programme

(For more information on the Zisize children's charity, contact me or visit www.zisize.org)



The effect of female representation on policy in Indian politics

Women politicians in Indian states make different decisions on public expenditure, redistribution and 'women-friendly' laws than their male counterparts. What's more, their decisions are influenced by whether or not they belong to a seat reserved for Scheduled Castes and Scheduled Tribes.

In India, as in many other countries, women are underrepresented in all political positions, even if they form approximately one half of the population. While the proportion of women who vote increased during the 1990s, women are still not well represented in political life.

In a representative democracy, all sectors of the society should have a voice in policy-making. But does women representation matter for policy determination? Do parliaments where women have higher representation adopt different policies?

This study identifies the effects of legislators' gender and caste in a country in which the issue of women representation has been increasingly important. In September 1996, the Indian government introduced a bill in Parliament, proposing the reservation of one third of the seats for women in the central government and the state assemblies. Since then, this proposal has been widely discussed in several parliamentary sessions, without an agreement being reached. Those in favour argue that increasing women's political representation will ensure a better representation of their needs. Even those who oppose the reservation acknowledge that women politicians behave differently than men politicians.

Clearly, reserving seats would change the nature of political competition, by changing the set of candidates available for each seat, by altering voters' preferences and/or by changing the candidates' quality. This study explores the effects of an exogenous increase in women representation by taking advantage of detailed data on women candidates in India since 1967. The fact that women candidates who won in a close election against a man will be elected in similar constituencies and under similar circumstances to men candidates who won in a close election against a woman makes them directly comparable. Whether a man or a woman candidate wins in a close election can be considered to a high extent random and, thus, the gender of the legislator effect can be correctly identified by comparing 'treated' constituencies where a woman was elected to its 'counterfactuals', where a man was elected.

In India, some seats can only be contested by Scheduled Castes or Scheduled Tribes candidates. These two population groups constitute the most disadvantaged sector of Indian society, both socially and economically. Thus, India provides the opportunity of identifying gender and caste/class effects separately.

The research combines expenditure, public goods and policy data from the 16 main states in India during the period 1967-99 with a very detailed dataset on state elections in the same time period.

It finds that: women legislators in Scheduled Caste and Scheduled Tribe seats favour capital investments, especially on irrigation and low tiers of education, and increased revenue expenditure on water supply. They also favour 'women-friendly' laws, such as amendments to the Hindu Succession Act, designed to give women the same inheritance rights as men. On the other hand, general women legislators do not have an impact on 'women-friendly' laws. They also oppose redistributive policies such as land reforms, favour pro-rich expenditure, invest in high tiers of education and reduce social expenditure. Thus, results suggest that the social and economic position of women legislators should also be taken into account when thinking about reserving seats. ■



Irma Clots-Figueras

Economic Organisation and Public Policy Programme

'HIV/AIDS is decimating Africa's communities and families. Kenya has been particularly hard hit and ranks fourth among all countries worldwide in the number of HIV/AIDS infected individuals, with 10-13 per cent of the population infected.'



Understanding the impacts of anti-retroviral treatment in Kenya

HIV/AIDS is decimating Africa's communities and families. Kenya has been particularly hard hit and ranks fourth among all countries worldwide in the number of HIV/AIDS infected individuals, with 10-13 per cent of the population infected. Infection rates are highest among young women (25-29) and men (30-34) of prime working age. Thus, the first stage of this epidemic is to hollow out the working population, crippling the economy. This is followed by knock-on effects that span generations – Kenya is home to 1.2 million children (under age 15) who have lost their mothers. These orphans (in addition to children who remain in infected households) are likely to have lower levels of education and other human capital, perpetuating poverty in the generations to come.

The current policy response to this epidemic consists of two main approaches: prevention and treatment through antiretroviral therapy. For Africans, the treatment option has only recently become a possibility through the availability of cheap generic versions of the antiretroviral (ARV) medicines. Nonetheless, costs are still staggeringly high (approximately US\$350 per year) in countries where health spending per capita is a fraction of this amount (approximately US\$20).

This study is designed to fill two critical gaps in the knowledge about HIV/AIDS and treatment policy. First, it goes beyond the existing studies, which measure the returns to treatment simply in terms of the value of the patient lives saved, to examine the welfare impacts of treatment on not only the individual, but their families and communities. In order to assess this, we also need to examine the counterfactual – what would happen to individuals, families and communities if they did not receive treatment. Hence, the second major theme of this project examines the economic impacts of the disease itself. While recent and ongoing research has started to deliver some results on the economic impact of HIV/AIDS, the recent advent of treatment, and the small scale of existing programs in Sub-Saharan Africa, means that we know very little about what the impacts of treatment are. This study provides one of the initial steps in dealing with this gap.

In March of 2004, a team of researchers from LSE, Columbia and Yale Universities in the US and Moi University in Kenya started a set of household surveys in rural Kenya to measure these issues.

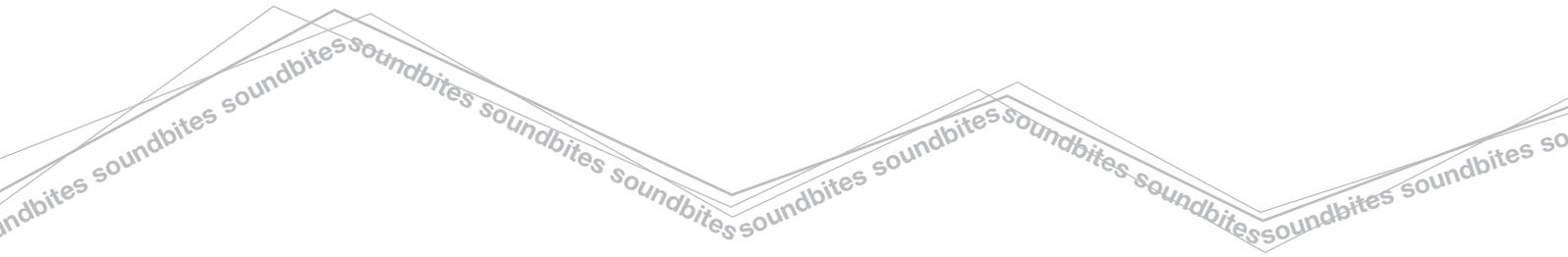
We worked with a team of doctors who were providing free antiretroviral treatment; surveying their patients and a random sample of households in a rural community in Western Kenya. This was the largest *rural* treatment program in Sub-Saharan Africa at the time, treating around 150 patients.

The first round of data collection ended in August 2004. Due to a dearth of funding during 2003 (which was reversed in 2004), the clinic had only recently started treating rural patients. This was reflected in the results of our analysis from this first round of data, which showed that the economic situation of HIV patient households was fundamentally different from those around them. They worked less overall, both in terms of participation in various income-earning activities as well as in number of hours. The difference is driven largely by the reduced participation of HIV households in agricultural activities. This translates into a lower level of reported income, even when we account for the number of household members.

Nonetheless, reported income does not give us a good sense of economic welfare in this developing country context. Asset holdings and food consumption levels are usually better indicators of welfare. Turning to the accumulated stock of household wealth, we can again observe the more precarious situation of HIV households. They held less of the major assets – land and cattle – than households in the random sample. However, when we examined a measure of *current* welfare – household expenditures on food and fuel – we found a surprising reversal. On average, HIV households consumed more per person than non-HIV households. This higher consumption may be explained by the higher frequency with which HIV households received transfers in cash and kind from individuals and organizations, combined with the fact they were less likely to give such transfers.

While current consumption per person may have been higher, results on child nutrition indicate that this may have been a fairly recent development. Children under 5 years in HIV households showed much lower levels of height for weight, a common anthropometric indicator. The education of children between the ages of 6 and 18 years had also suffered in the recent past as they are less likely to have been enrolled than their random sample counterparts. Even when enrolled, they were more likely to be absent from school.



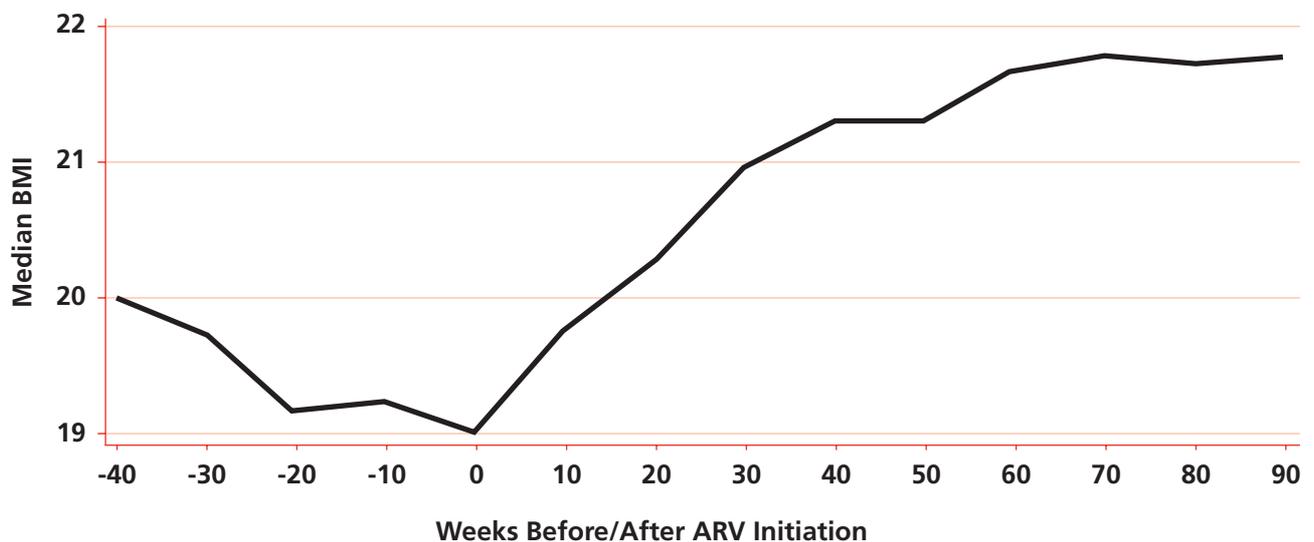


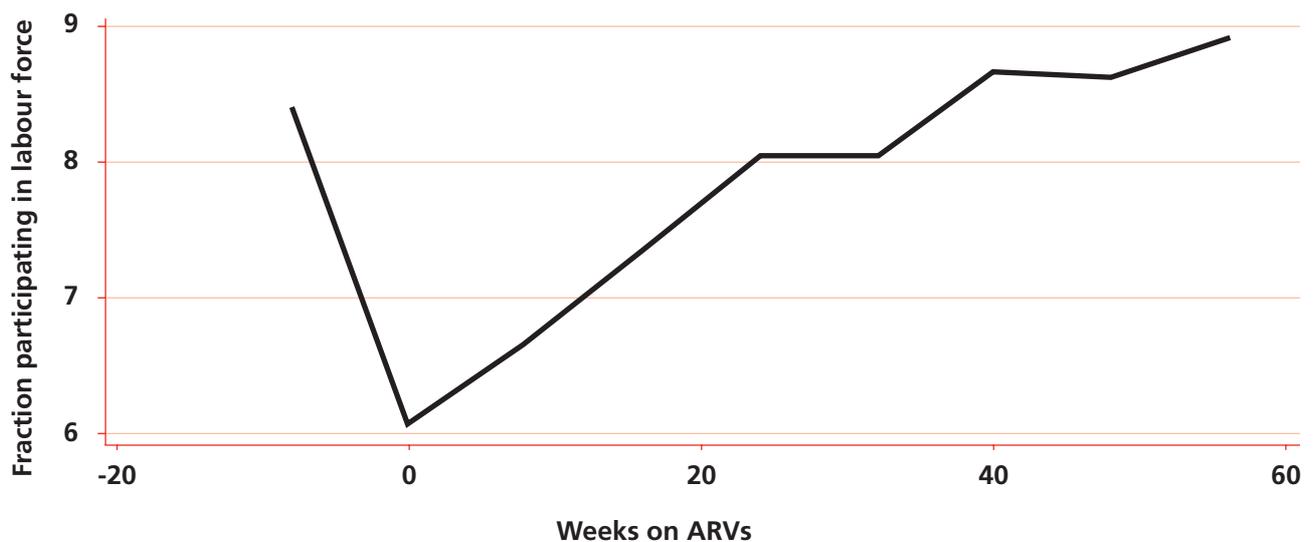
Turning to health status, we found a significant difference between HIV-diagnosed individuals and individuals who had not been diagnosed. HIV-diagnosed individuals were more likely to have an acute illness in the previous four weeks and were more likely to miss work as a result. Taking chronic and acute episodes together, HIV-diagnosed individuals had far higher medical expenses than others, spending 20 times as much in a month (or double the average food spending per capita). Against these burdens, they received more support: they received higher assistance with medical bills and were more likely to receive (non-remunerated) labor assistance from individuals outside the household than non-diagnosed individuals. This was supplemented by asset sales: HIV households were more likely to sell land and livestock for the purpose of covering health expenses than those in the random sample. Turning to comparisons within the group of non-HIV diagnosed individuals, those living with an HIV patient were less likely to report an acute illness, but when they did it was more severe (in terms of days of work missed). These individuals were also significantly more likely (ten times more likely) to report a case of tuberculosis in the past four years.

These results were alarming, indicating that despite the (then) recent initiation of free treatment, patients and their household members were still struggling with the burdens of disease. In September of 2004, we started a second round of surveys in order to capture the evolution of the socio economic effects of this treatment. We have recently begun to analyze these data and initial results show some encouraging signs. In a paper in progress, we look at the labour supply response of patients and those in their household.

One of the remarkable features of antiretroviral therapy is that it often results in a rapid response in patients. The following figure shows how patients' body mass index (a common basic measure of nutrition/health) recovers with the provision of treatment:

We can see the tail end of the steep decline brought on by the effects of AIDS, but after point 0, when treatment is initiated, we see a fairly rapid recovery. The results of our analysis indicate that this physical recovery is accompanied by the start of an economic recovery as many patients return to work. The next figure shows the labour force participation of patients at different stages in their treatment:





Here we can see a sharp increase in the likelihood that patients are participating in the labour force following treatment, with this probability steadily increasing over time. Preliminary analysis seems to indicate that the effects of the patients returning to work spills over into the household, with younger boys withdrawing from the labour market as the patient is treated. This suggests that these children were substituting for the patient in the labour market in order to make ends meet but, as the patient recovers, they can stop working.

Our analysis continues and will cover other areas that showed significant cause for concern in the first round of data, such as child nutrition and enrolment. We have also expanded our survey work to a planned third round with this community as well as survey work in another community which faces a much higher rate of HIV prevalence. Providing coherent data on the economic impacts of treatment and the disease are of crucial policy importance. On a global level, there is a debate as to whether treatment at such expense is warranted in an environment where there are a host of other significant health issues. Understanding the benefits of treatment to both the patient and his/her household will help inform this debate.

On a more local level, Kenya is in the process of designing national AIDS treatment strategy, and is grappling with the issues of not only what the benefits are, but how best to deliver treatment and evaluate its impact. This study will provide both an input (in terms of thinking about methodology) and an output (in terms of data/results) for this process. In addition, this study will provide critical information for other policy makers in Africa at a variety of levels. These range from providing real statistics on productivity and human capital choices of HIV infected individuals for macroeconomic modelling (to replace the assumed figures often used now), to quantification of the multifaceted poverty impacts of the disease in order to design more effective social policy. ■



Markus Goldstein
Economic Organisation and Public Policy Programme

‘In the main, the courses offered in economics in the opening session suggest a case of ‘all hands to the pumps’, with a selection of one-off courses on diverse subjects.’

Was there ever a ‘London’ School of Economics?

The name of ‘The London School of Economics and Political Science’ is routinely abbreviated to ‘The London School of Economics’ or ‘LSE’. When discussing the institution with people who know little about it, some are surprised to discover that economics is but one of the social sciences taught there, while others now associate ‘LSE’ with the London Stock Exchange. Some time ago I met a person who raised a different point relating to the use of ‘The London School of Economics’ by asking whether ‘London’ had any additional significance in the title. He knew that economics at Cambridge had been very distinctive under both Marshall and Keynes and everyone knew of the ‘Chicago School’, with its characteristics of free market, neo-con analysis. Was there, he wondered, or had there ever been a ‘London’ School of Economics in a similar way to Cambridge or Chicago? This is the question I have been considering in my work on the history of Economics at LSE. The work reported here covers the period from the founding of the School in 1895 to the late 1920s.

The story of the founding of the LSE is well known: in 1898 Henry Hutchinson bequeathed £10,000 to the Fabian Society to be used within ten years ‘to the propaganda and other purposes of the said Society and its Socialism’, with the money being administered by a committee headed by Sidney Webb. Some Fabians, such as George Bernard Shaw, wanted to use the money to fund short term activities, but Webb was determined to use the money to set up an institution as a centre for social research and teaching. Webb got his way and as the project developed there are several references in Beatrice Webb’s Diaries to Sidney’s ‘School of Economics’, so that subject was clearly of concern to him. What was the state of ‘Political Economy’ at the time of the founding of the School?

Following the appointment of Thomas Malthus to the first Chair in Political Economy in 1805, there had been other appointments elsewhere. The Drummond Professorship was established in Oxford in 1825 and a somewhat informal (unpaid) Chair was set up in Cambridge in 1828, the same year that a Chair was established at the newly opened University of London (later to become University College, London). In 1859 the Tooke Professorship in Economics

and Statistics was founded at King’s College, London, but the holder was merely required to give a few lectures. However, nowhere was the subject of Political Economy regarded as being of major importance, with the result that it was a marginal, often optional, component in Faculties of History, Philosophy or Law and taken by very few students. Nor was there a consensus over what constituted Political Economy, with a battle between theorists who followed in the line of Adam Smith, David Ricardo and John Stuart Mill and those who took a relativist position and argued that Political Economy should be primarily an historical subject. Some of the historical economists were suspicious of Alfred Marshall and he had to fight hard to develop his theoretical approach in Cambridge, especially with William Cunningham (Tooke Professor from 1891 to 1897).

What were Webb’s views on the kind of economics to be taught at LSE? While some Fabians, such as Shaw, were keen that ‘the School of Economics will have a Collectivist bias’, Webb disagreed and worked hard to counter suspicions that LSE had any socialist bias because of the Fabian money. The Hutchinson money was important as seed corn and helped Webb to raise funds elsewhere, but amounted to only £3,688 (about 8 per cent) out of the £45,000 the School received in the first seven years of its existence. Webb, who saw himself as an economist and published several articles in the *Economic Journal*, inclined more to the historical persuasion and one might have expected him to side with the historians in the battle for the future of Political Economy. To some extent this was the case through the establishment of a strong group of economic historians at the School, but economics took a different and seemingly less planned route, that perhaps reflected the haste with which the LSE was opened.

Only fourteen months elapsed between Sidney Webb receiving the news of the Hutchinson bequest on 3 August 1894 and the opening of the School with more than 200 students on 10 October 1895. In the main, the courses offered in economics in the opening session suggest a case of ‘all hands to the pumps’, with a selection of one-off courses on diverse subjects. William Cunningham gave three lectures on *The Economic Effect of Alien Immigrations*, W.M. Ackworth six on *Railway Economics* and Edwin Cannan four on *The History of Rating*. There was little formal teaching of economics in

the opening session, though one serious organised course in the 1895 session was taught by Herbert Foxwell, the Professor of Political Economy at UCL from 1881 to 1922, who offered 20 lectures on *The History and Principles of Banking in England*. He was to teach this course, or variants of it, annually until his retirement in 1922. This historical and institutional approach to the study of banking became a characteristic of the School and after Foxwell's retirement was continued by Theodore Gregory, Richard Sayers and, more recently, Leslie Pressnell and Roger Alford.

In 1896 Cannan's offer to teach a course in economic theory was accepted and in the Lent Term of 1897 he began a course in 'Economic Theory, to be studied mainly in Marshall's *Principles of Economics*'. Unlike Foxwell, who was a Cambridge man and a friend of Marshall, Cannan had studied in Oxford but, having considerable private means, never had formal links with that university after his graduation. His first major work, a *History of the Theories of Production and Distribution in English Political Economy from 1776 to 1848*, appeared in 1893 and his teaching combined a history of economic thought with a critical analysis of previous theories. Hugh Dalton, a pupil of John Maynard Keynes, who arrived at the School in 1911 and began research on inequality under Cannan (a suitable choice of subject for a future Labour Chancellor of the Exchequer), reported that Cannan's course was 'largely a running commentary on Marshall's *Principles*'. The commentary was not always positive and there were many acerbic remarks, such as the assertion that Marshall 'with that exaggerated 'youthful loyalty' from which age never released him' had given a new lease of life to a moribund doctrine or that 'he was encumbered by misplaced loyalty to the traditional doctrine' concerning differences in the treatment of capital and land. Despite this and some exasperation on Marshall's part, their relationship seems to have been reasonable and Cannan acted as an External Examiner in Cambridge for Marshall for a number of years.

After Cannan retired in 1926, his influence largely disappeared: while his approach to economic theory trained his students to be critical, it did not provide a positive and distinctive body of new theory to attract adherents, so there was no 'Cannan School'. The School appointed the Harvard economist Allyn Young to the vacant chair in 1927, but whether he would have had a long-term effect

on the development of economics at the School is a moot point, as he died suddenly in March 1929 of influenza that turned into pneumonia. Dalton, who had reached the rank of Reader in Economics and continued teaching Public Finance on a part-time basis until the 1930s, played an important role in persuading the School to invite Lionel Robbins to return to LSE and become professor there in 1929 at the age of 30, where he was to fill a dominant position that lasted well into the 1960s. After the arrival of Friedrich von Hayek in 1932, he and Robbins explored an Austrian approach to economic analysis and engaged in a losing battle with Keynes. But that is another story.

What is clear is that in the period following its founding in 1895, even if there was no 'London' School of Economics, the LSE provided a critical analysis of economics to large numbers of students within a framework of social investigation – a 'London' School of Social Science, in which the subject was taken seriously. In contrast, economics continued to be a minority subject in the provinces until the establishment of the Economic Tripos at Cambridge in 1905 and, given the lack of interest in university administration on the part of Edgeworth (the Drummond Professor), Oxford continued to lag behind until the PPE (Philosophy, Politics and Economics) Degree was introduced in the 1920s. ■

[This article is a considerably shortened version of a paper I presented to the History of Economics Society at the University of Puget Sound, Washington State, on 26 June 2005. The full version may be obtained on request to thomasj@lse.ac.uk]



Jim Thomas

Former member of the Economics Department, LSE, and a visitor to STICERD

‘Research in economics and psychology on the determinants of subjective well-being has found that there are strongly diminishing marginal returns to income, both on an individual and a national level.’

Happiness and social policy

Recognition of the limitations of traditional measures of disadvantage like low income and multiple deprivation have led to growing interest in subjective measures of well-being like happiness or life satisfaction. In a paper for the 2005 Social Policy Association conference, Tania Burchardt argued that although this move offers a useful corrective to narrowly materialistic conceptions of well-being it is not a suitable foundation for practical social policy.

Research in economics and psychology on the determinants of subjective well-being has found that there are strongly diminishing marginal returns to income, both on an individual and a national level. Income inequality matters, as does security of income. Non-income determinants which are important include children and intimate relationships, as well as a number of different indicators of personal autonomy and political freedom.

Clearly these insights have relevance for the design of a range of social policies – from international development, through social security and taxation, to family support and the promotion of civil and political liberties. However, adopting the promotion of subjective well-being as the goal for social policy is problematic for two reasons. Firstly, as illustrated in Huxley’s *Brave New World* and Nozick’s ‘experience machine’, subjective well-being achieved through pharmaceutical intervention is indistinguishable from well-being generated by actual improvements in standard of living, and most people regard social policy as being about more than the distribution of effective hallucigens! Secondly, because individuals become accustomed to their circumstances and a deterioration may be subjectively painful for rich and poor alike, regardless of the *level* to which they are now reduced. If subjective well-being were the only outcome measure employed, distributional policy would be required to compensate both parties. ■

[‘Just happiness? Subjective well-being and social policy’, presented at 2005 Social Policy Association annual conference in Bath, 27 June.]



Tania Burchardt
Centre for Analysis of Social Exclusion

A flexible force, or just ‘plastic police’? Initial observations on Police Community Support Officers

The public has long been concerned about the number of police on the street. From late 2001, this long-standing popular concern was increasingly mirrored in police considerations, as the Metropolitan Police in particular assessed how to increase their public profile in order to hinder terrorism. This new motivation, combined with the government’s emphasis on tackling ‘quality of life’ crime and disorder issues, revived a proposal to boost police presence by using non-commissioned staff to assist in monitoring and enforcement. In July 2002, the Police Reform Act¹ introduced the statutory role of the Police Community Support Officer, and the Home Office provided £41m for English and Welsh constabularies to employ ‘PCSOs’.

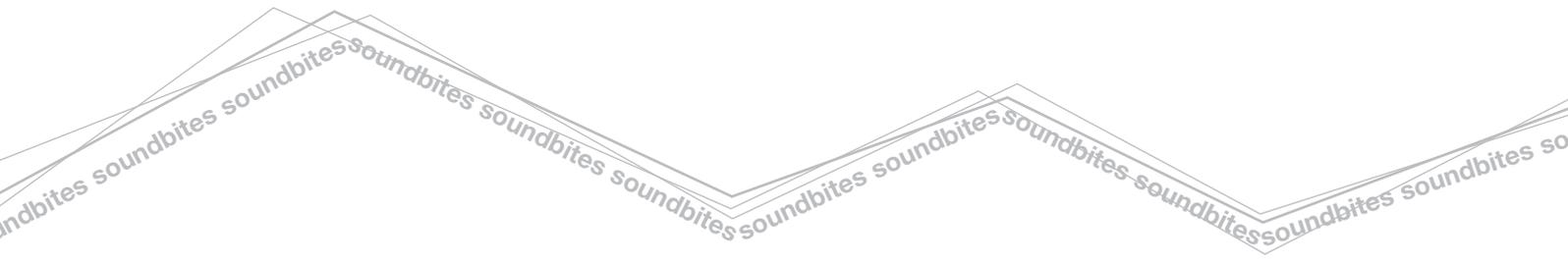
These uniformed support staff (also known as CSOs) are intended to provide a high-visibility local presence, in order to hinder crime or disorder and to reassure communities. They are not police (the crucial distinction being that police officers have the authority of their commission whether on duty or not, whereas PCSOs only have powers when on duty). Furthermore, their powers are very limited (the Act granted limited powers – eg fining for minor offences – and most Police Forces have not even taken these up in full, see Table 1²). Nevertheless, with 6,300 currently in post, and numbers intended to reach 24,000 by 2008, their introduction is a significant development for policing in general, and for local policing in particular. This brief piece uses initial data from the neighbourhoods of CASE’s *Dynamics of Low-Income Areas Study* to consider whether CSOs offer a flexible force for order and community-police liaison, or are likely to prove ineffective, ‘plastic police’.

The presence and role of PCSOs vary between and within forces. PCSOs were introduced first into London, and were then taken up at different rates and for different purposes across England and Wales. In most of our areas, as in general, PCSOs only came into post within the last year. In three of the areas, PCSOs started just weeks before I interviewed them this summer; and two areas still do not have PCSOs. Forces also vary in how they task the new staff: whether supporting police city-wide, for example, or within a neighbourhood. Some police forces, or sectors within them, have been using PCSOs to tackle crime ‘hotspots’ – sending the new staff to work with police in different areas as and when the need arises. Initially, most of the PCSOs in the study were itinerant. But now, at least within our study, PCSOs are more commonly working as part of neighbourhood policing teams, dedicated to particular local areas. Most of the ten study areas that have some PCSO support have only recently received dedicated Community Support Officers. In four of the seven areas with local CSOs, the staff came to the area with the introduction of neighbourhood policing³, a strategy to improve police impacts by re-structuring teams into local geographical units. Those of our areas with neighbourhood policing systems have two-to-six PCSOs, directed by a PCSO Sergeant. Even in those areas with dedicated PCSOs, however, the picture is one of variance, for PCSOs’ powers are designated by the force’s Chief Officer (see Table 1), and their exact roles and responsibilities are dependent on how the local Inspector and PCSO Sergeant decide to task them.



Selected powers that can be designated to PCSOs		PCSOs' powers in 10 case study areas									
		Birmingham	Blackburn	Caerphilly	Hackney	Knowsley	Leeds	Newcastle	Nottingham	Redcar	Sheffield
Environmental	To remove abandoned vehicles	✓	✓	✓			✓			✓	
	To issue fixed penalty notices for littering	✓			✓		✓		✓	✓	✓
	To issue fixed penalty notices for dog fouling	✓			✓		✓	✓	✓	✓	✓
	To issue fixed penalty notices for graffiti and fly-posting	✓			✓		✓		✓	✓	✓
Transport	To stop cycles			✓			✓				✓
	To carry out road checks	✓		✓			✓				
	To stop vehicles for testing			✓			✓				
	To seize vehicles used to cause alarm							✓		✓	✓
	To issue fixed penalty notices for cycling on a footpath		✓		✓			✓	✓		
	To direct traffic for the purposes of escorting abnormal loads										
Alcohol & Tobacco	To seize tobacco from a person aged under 16	✓	✓	✓			✓	✓		✓	✓
	To require persons aged under 18 to surrender alcohol	✓	✓	✓			✓	✓		✓	✓
	To require persons drinking in designated places to surrender alcohol	✓	✓				✓			✓	
ASB	To issue penalty notices for disorder				✓			✓			✓
	To require name and address for antisocial behaviour	✓	✓	✓	✓		✓	✓	✓	✓	✓
	To disperse groups and remove persons under 16 to their [home]			✓							
Enforcement	To enforce byelaws										
	To issue fixed penalty notices for truancy				✓				✓		
	To detain [someone until police arrive on the scene]		✓	✓	✓		✓				
	To use reasonable force [to detain someone until police arrive]						✓				
	Power to require name and address for relevant offences			✓	✓		✓		✓		
	To use reasonable force to prevent a detained person making off										
Security	To remove children in contravention of curfew notices to [home]			✓			✓				
	To enforce cordoned areas			✓							
	To stop and search in authorised areas										
	To enter and search premises [to prevent harm to people or property]		✓					✓		✓	
TOTAL (of 26 available powers)		9	8	12	9	0	15	8	7	10	9

Table 1: Powers available to PCSOs and powers designated within our study areas



In some ways, this variation has inhibited PCSOs' effectiveness. The degree of control given to individual forces, and delegated within them, was cited by police as having contributed to delays in employing PCSOs, and in establishing their role within the existing structure. Yet such control also allows these new staff to be tasked in ways that suit the specific context. For those police forces or sectors which use PCSOs primarily to tackle crime or anti-social behaviour hotspots, the flexibility of the PCSO role is a great asset – they can work as 'extra eyes and ears' in almost any setting, and can provide a conspicuous presence that frees up police for more discrete or targeted action. At a more local level, the high-visibility but low-power role of a PCSO is well suited to the 'grass-roots' nature of community policing – having PCSOs at local events, for example, enables police to maintain a public profile (and gain insights from PCSOs' reports) while focusing their own time on serious crime and disorder issues. Nor are PCSOs valued only for PR purposes; in some areas, they are tasked with doing follow-up interviews after burglaries or similar incidents, interviews which they have time to conduct with everyone on a street, and thereby not identify specific households as 'grasses'.

PCSOs probably do raise the profile of the police. I think they improve the image and the responsiveness of the police.

Area manager, Blackburn

In such contexts – where residents see support officers as being 'at one remove' from police and so are more prepared to engage with them – PCSOs' limited powers have proved beneficial. In other situations, however, PCSOs felt that their status and effectiveness were undermined by the limits on their powers. Many PCSOs expressed real frustration at not being able to do much more than request people to abide by the law; indeed one recounted how he had physically detained someone, despite not having that power, 'because I could not in good conscience let him go'. The support officers noted that young people are particularly aware of the limits and so tend not to accord PCSOs even the (minimal) respect that police receive – as exemplified by the taunts of 'plastic police' which I heard directed at them in some areas. Nevertheless, whilst the PCSOs hoped that their powers would be extended, most saw clear advantages in being something different to the police. For those who were itinerant – working across wide areas – one key advantage was not having the extensive paperwork that accompanies mainstream policing. For those working in specific neighbourhoods, the main benefit was the opportunity to engage more closely with the residents than police are typically able. PCSOs deployed to tackle hotspots were less prone to antagonism, but could not build a rapport with the public.

They're alright. They were involved a lot with the garden project so we got to know them from that. They know all the kids, they talk to them – some are alright with the kids, some are not so good, just depends on the PCSO. The kids were cocky at first but they're better now they know the PCSOs can get them arrested.

Resident, Leeds

The Home Office is conducting consultation on the standardisation of CSO powers⁴, in order to develop a set of minimum powers for PCSOs across the forces. The question of which powers are most important is one for further research, but our study's preliminary investigation suggests that the current limitations of the role are not as significant as the slang for them – 'plastic police', 'mobile scarecrows' – would suggest. There is a clear trade-off between the disdain and the rapport that can follow from their limited powers. There is a particular problem for PCSOs in dealing with young people, who are the most dismissive of PCSOs' powers. But on the evidence of this study it appears that the balance is mostly positive, even in relation to teenagers.

‘Young people definitely don’t see PCSOs as fully-fledged police – which can be a bonus as young people will talk to them, although they still bandy about that call of them being ‘plastic’.’



PCSOs have added to the yellow jacket cohort on the street, as also are police, wardens, some council staff and others. These are seen as having a positive and deterrent effect upon youth, and are an attempt to return authority figures to the community.

Community safety worker, Hackney

Young people **definitely** don’t see PCSOs as fully-fledged police – which can be a bonus as young people will talk to them, although they still bandy about that call of them being ‘plastic’. They did have stones thrown but that’s not such an issue now because they recognise the kids.

Police sergeant, Blackburn

... the introduction of PCSOs is interesting because it makes the individual [resident] partly work to make the resolution of the situation themselves – rather than with police, giving the police complete control to resolve situations. ...with PCSOs, people don’t expect them to resolve the issue ... so PCSOs can be a good tool to help encourage people to stand and fight – to solve the problem.

Community activist, Nottingham

[See Appendices on page 28 for references]

Although the research was conducted only months, sometimes weeks, after PCSOs came into post, their particular contribution was already apparent. The relative lack of authority inherent to the role appears to be mostly an advantage in the context of neighbourhood policing. Furthermore, its flexibility makes the PCSO role especially suitable for developing local links, facilitating local police relations and thereby reinforcing community safety. Local police and PCSOs both observed that the flexibility of the PCSO role particularly suits the ‘grass-roots’ nature of community policing. Thus the initial evidence from this study is that, whilst the policing of city centres and hotspots will also benefit from the additional resource of PCSOs, the support officers offer greater potential as local intermediaries.



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Appendices

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Footnotes

¹See Buchanan and Tullock (1962), and Mueller (1989) for a general survey of the Public Choice literature.

²See Alesina and Rodrik (1994) and Persson and Tabellini (1994) as examples of this approach.

³The Veronese (2004) paper about the effects of the transition from a parliamentary to a presidential system in Italian municipalities is perhaps the best example of the LSE atPE way of analysing grand institutional comparisons, i.e. without relying on cross country variation. In fact, this paper analyses a panel of Italian municipalities, in order to gauge the effects of the electoral reform on the personal characteristics of elected politicians, like the education level and the profession.

⁴*Ideaе clarae et distinctae*, in the latin of Descartes. The *ceteris paribus* approach has an illustrious father in Descartes.

A flexible force, or just 'plastic police'? Initial observations on Police Community Support Officers

¹See Part 1 of Schedule 4 of the Police Reform Act 2002: www.hmso.gov.uk/acts/acts2002/20020030.htm

²Additional provisions were made through the Serious and Organised Crime and Police Act, but these did not come into effect until 1 July 2005 – after most of this research was conducted – and so these are not included in this review.

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