

iea

Economic Affairs

Student & Teacher Supplement

Public Goods and Club Goods – Does the State Need to Provide Libraries?

James B. Stanfield

One topic that is covered in all A-level syllabuses is that of 'public goods'. Although it is sometimes pointed out 'government failure' means that it does not necessarily follow that public goods should be provided or financed by the state, the arguments and subtleties are not always well brought out in A-level (or, indeed, even in undergraduate) textbooks.

Currently, the financing of libraries is controversial in the public policy arena and this is a useful example to illustrate the points. It is often argued that libraries are a public good which should be publically provided. However, the initial growth and development of libraries in the UK suggests that this is not the case.

Public goods are said to have two distinct characteristics – they are non-excludable (no one can be effectively excluded from using the good) and non-rivalrous (consumption by one person does not reduce availability for others). National defence has both of these characteristics and is therefore often referred to as a pure public good. However, with reference to libraries, while they are non-rivalrous (one member's use does not reduce another member's use – at least until congestion occurs), they are not non-excludable because subscription fees can be used to exclude those who are not prepared to pay. Libraries are therefore similar to swimming pools and golf courses which are defined as 'club goods' – private goods with some public good qualities.

During the 18th century, the increase in secular literature and the high cost of books encouraged the spread of lending libraries. Commercial subscription libraries began when booksellers began renting out extra copies of books and by 1790 there were already over 600 private rental and lending libraries, with a clientele of 50,000 readers. It was at one of these libraries that David Ricardo was first introduced to economics. Following the growth of gentlemen-only libraries, the late 18th century also witnessed the growth of subscription libraries for tradesmen which were designed principally for the use and instruction of the working classes.

In 1842, Charles Edward Mudie (1818–90) started to lend books from his stationery shop in Southampton Row, London, and by the end of the century he would be referred to as 'the King of the librarians' and credited with revolutionising book reading across the UK. At Mudie's Select Library, a subscriber could borrow an unlimited number of books (one at a time) for one guinea a year, and have his order sent to his door within a 20-mile radius of London. Branches soon opened in Birmingham and Manchester.

Mudie increased his influence by advertising his 'Constant Succession of the Best New Books, Exchangeable at Pleasure' and by buying books from publishers in bulk. Mudie also generated income from rebinding his books and selling them. This allowed him to turn over his stock continually and keep it

up to date. Between 1853 and 1862, 960,000 books were added to the library, and in 1864 Mudie's Select Library was converted into a limited company. By the end of the century, Mudie's Select Library consisted of an estimated 7.5 million books.

While Mudie's success also sealed the fate of many smaller commercial libraries operating at the time, some competitors did exist. For example, in 1858 William Henry Smith started lending books from its railway bookstalls, a service which lasted until 1961. At W. H. Smith's, Class B books could be borrowed for 2d for five days and Class A books cost 1d a day. Books could be borrowed from a railway bookstall, before the borrower got onto the train, and then exchanged at the final destination. In 1898 Jessie Boot also opened the Boot's Book Lovers' Library which charged borrowers 2d per book, and by 1938 they had one million subscribers who were borrowing 35 million books a year. Books were strategically positioned in stores to encourage subscribers to purchase other Boot's products. This initiative lasted until 1966.

The 1920s also witnessed the rapid growth of pay-as-you-read two-penny libraries which made use of cheap reprints and second hand books and were often operated as a sideline to another business. By the late 1930s there were an estimated 6,000–7,000 of such libraries across the UK. The decline of Mudie's Select Library finally occurred in 1937, when it could no longer compete with the growth of free government libraries and the increasing affordability of both new and second hand books. Mudie's landmark headquarters in New Oxford Street was subsequently destroyed in a bombing raid in 1942, leaving no trace of this ground-breaking company.

There were also many philanthropic libraries – including the one at which Engels and Marx used to meet in Manchester. But the key message is this – library provision is a club good and not a public good. This distinction is crucial in economics because understanding it can lead to entirely different policy conclusions.

James Stanfield is based at the University of Newcastle upon Tyne (j.stanfield@ncl.ac.uk).



No Case for Plan B – Lessons for the Great Recession From the Great Depression

Kent Matthews

Introduction

The slow pace of recovery of the UK economy and the avalanche of bad news coming out of the euro-zone economies have once again increased the calls for a 'Plan B' in government policy. Suggestions for Plan B usually mean a slowing down in deficit reduction and the use of fiscal policy to offset weak household spending and corporate investment. The Obama administration opted for a \$787 billion fiscal stimulus package of which \$499 billion was a government spending increase which came into effect in 2009–10. A more modest fiscal package in the euro-zone came to €174.1 billion over 2009 and 2010 of which €61.9 billion was an increase in government spending (Cwik and Wieland, 2011).

This has reignited the old debate about the effectiveness of fiscal policy and focused attention on the inter-war years to provide lessons for current economic policy. If Plan B could be implemented without loss of credibility of the long-term objective of reducing the public sector deficit and stabilising the government debt-income ratio, then clearly it is worth considering.

There are three issues we should consider. Firstly, how effective is fiscal policy? Secondly, what led to recovery in the 1930s? Thirdly, would recovery in the 1930s have been hastened with fiscal expansion?

This article argues that Plan B is not a viable option in the current economic situation. Empirical evidence also suggests that a Keynesian-style fiscal policy would not have worked in the inter-war period.

Lessons from the past

The inter-war years throw up both similarities and differences which make the exercise of learning from history an imprecise one. Britain exited the gold standard in September 1931; similarly, there was a 25 per cent depreciation of sterling between mid-2007 and end-2008. Another similarity is the period of low interest rates in the recovery period of the 1930s. While Bank rate fell to a constant 2 per cent from 1933 till 1939, Treasury Bill rates were around 1/2–3/4 per cent and long-dated gilts between 2 1/2–3 1/2 per cent. Government debt after World War I was around 175 per cent of GDP over the whole period – well above current levels but something that was a cause for concern and a constraint in fiscal policy, in terms of maintaining credibility with foreign investors, just as current debt levels are.

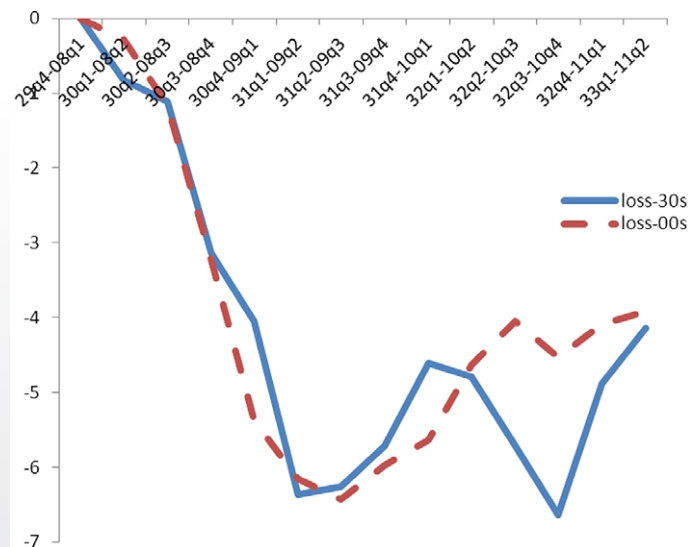
In other respects there are differences between the two periods. The most obvious is the level of inflation. Inflation was negative 3–3.5 per cent in the 1921–33 period and positive 1.3 per cent in 1934–38, compared with today's rate of around five per cent. The public sector deficit was another striking difference. Although there were instances when public sector borrowing came in higher than expected (particularly in the recession period of 1929–31 – see Middleton, 2010), by and large the period was one of fiscal

orthodoxy. Table 1 provides some summary statistics of the period.

However, one striking similarity is the way the economy behaved in the aftermath of the downturn in the world economy and the exiting from the gold standard. Taking 1929 quarter 4 (1929(4) means 1929, quarter 4 and so on) and 2008 quarter 1 as starting points, Figure 1 shows the output loss relative to the base point from 1929(4) to 1933(1) and 2008(1) to 2011(2). What is particularly striking for the current recession is the depth of output loss relative to its peak and the closeness of the match with the Great Depression of the inter-war years. This pattern is not matched by any other recession since World War II. In other words, in terms of total output



Figure 1: Recession and recovery 1929(4)–1933(1) and 2008(1)–2011(2)

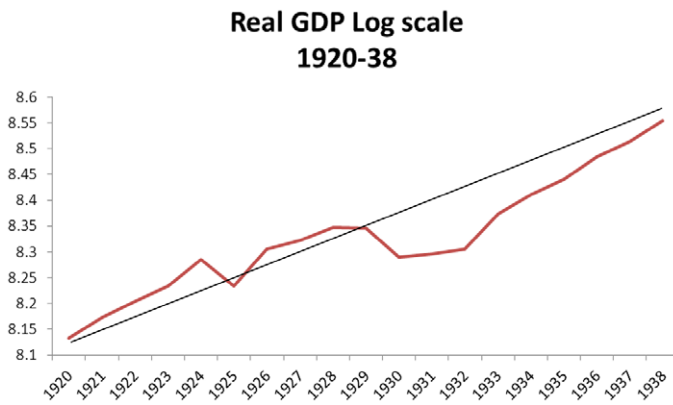


Source: Hayes and Turner (2007) and National Statistics.

Table 1: Summary statistics 1921–38

Years	Public sector deficit/GDP%	Annual Inflation%	Bank Rate %	Treasury Bill Rate %	Yield on 2 1/2% Consols
1921–29	0.5	-3.7	4.6	3.9	4.6
1930–33	1.1	-2.9	3.8	2.0	4.0
1934–38	0.9	1.3	2.0	0.6	3.2

Source: Feinstein (1972), Capie and Collins (1983).

Figure 2: Real GDP 1938 prices

Source: Feinstein (1972).

loss, the picture today looks very much like the picture at exactly the same stage of the Great Depression.

However, Figure 2 is especially interesting in the current circumstances. It shows that, by 1938, the UK had nearly returned to trend output (shown by the straight line). In other words, the position of the UK economy in 1938 was almost as if the Great Depression had never happened. We certainly cannot be confident that the same will happen in the current recession. What policies were followed in the Great Depression that made the recovery from 1934 so healthy?

The Keynesian multiplier

The neo-classical revolution has ensured that the simple Keynesian multiplier that appeared in (and still does appear in some) A-level textbooks is no longer accepted by more than a few populist economists who have turned to journalism. Once we consider how the government finances its borrowing, consider the reaction of businesses and households to unsustainable levels of debt, and consider the supply side of the economy, the short-run multiplier is less than unity (even without having to invoke a strict neo-classical interpretation of rational expectations). For example, simulations of a typical New Keynesian model for the euro-area by Cwik and Wieland (2011) reveal short-run multipliers of 0.5. As such, they caution against the use of discretionary fiscal policy to fight the recession. It should be noted that the long-run multipliers may be even less and that the multipliers for economies on floating exchange rates would be less still (see below). The claims, for example, of Obama's former economic adviser Christina Romer that there is a fiscal multiplier of 1.6 have been shown to be built on extremely naïve assumptions.

In their pamphlet, *Can Lloyd George Do It?*, Keynes and Henderson argued that a £100m-a-year fiscal boost for three years would have reduced unemployment by 500,000. Up-to-date modelling of this proposal has brought this conclusion into question. Even where strong Keynesian assumptions are used, this level of increase in government spending would only have led to an increase in employment of 300,000. More realistic new-classical models of the economy, which take into account the supply side, would suggest no or minimal impact from a fiscal expansion.

Indeed, the fact that the recovery continued from 1934, through 1936 (when Keynes published *General Theory*) to 1938 when the economy was close to capacity, suggests that, without any use of discretionary fiscal policy, the economy recovered far better than we expect the UK economy to recover today. Today, of course, we have had a fiscal stimulus and have been running budget deficits between 10 per cent and 15 per cent of national income. How did the economy do so well between 1933 and 1938?

As noted, it certainly was not a fiscal expansion that led to recovery. Government borrowing was at a fraction of today's levels: fiscal expansion was rejected; the Treasury view prevailed. The public sector deficit averaged 1.1% of GDP during the recession period of 1930/33 – small by current standards but viewed widely as damaging to confidence at the time (Middleton, 2010). The position of Britain in the world economy, the use of sterling as a global vehicle currency, and her heavy indebtedness weighed heavily on the thinking of the policy makers.

The key to recovery was tight fiscal policy and appropriate monetary policy for the conditions. The budget of 10 September 1931 was the turning point in fiscal policy (Middleton, 1985), involving a rise in taxes (including a rise in the standard rate of tax), expenditure cut-backs and raiding of the contingency reserves. Following the unpopular May Report of 31st July that called for wage cuts to the armed services and cuts to unemployment insurance, the emergency budget was a response. Nine days later Britain left the gold standard and the rules of monetary policy changed. It was, in fact, the change in monetary policy that led Britain out of depression.

Conclusion

If the drop in trend output is temporary in the current recession – as it was in the Great Depression of the 1930s – then the Bank of England is vindicated in its looser monetary policy. Fiscal austerity is the appropriate complement to loose monetary policy in the current circumstances. Expansionary fiscal policy would have had limited impact in the 1930s. The policy response in the Great Depression was not a mistake as naïve-Keynesians have argued – the problem was that a looser monetary policy was too delayed.

Running high budget deficits would not have a beneficial long-run impact in the 1930s; the policy has also not had any beneficial impact today. Further expansion of budget deficits would not improve matters either. Although government debt was higher in the 1930s than it is today, government borrowing and spending was much lower. A rise in government borrowing and debt at the current time – especially given the sovereign debt crisis elsewhere in the world – would affect expectations and confidence quite apart from any crowding out effect. This is borne out by recent research by Ilzetzki *et al.* (2010) which concludes that economies that are highly indebted have fiscal multipliers close to zero; economies on floating exchange rates have fiscal multipliers of zero; and open economies have lower fiscal multipliers. The UK is an indebted, open economy with a floating exchange rate: we are in the very worst position to benefit from a fiscal expansion. The lesson from the 1930s is that the appropriate course of action is loose monetary policy, fiscal austerity and supply side reform. The need for loose monetary policy is probably the most questionable aspect of the three policy prescriptions. The appropriate monetary policy stance depends on a number of factors too complex to go into in this short article. However, it is worth ending by noting that it is possible that the financial crash and regulatory response has reduced Britain's productive capacity, in which case loose monetary policy will just lead to inflation. But, when it comes to deficit reduction, those who call for 'Plan B' should be told that there is no credible alternative.

Kent Matthews is Head of Economics Section and Sir Julian Hodge Professor of Banking and Finance at Cardiff Business School (matthewsk@cardiff.ac.uk).

References

- Capie, F. H. and M. Collins (1983) *The Inter-war British Economy: A Statistical Abstract*, Manchester: Manchester University Press.
- Cwik, T. and V. Wieland (2011) 'Keynesian Government Spending Multipliers and Spillovers in the Euro Area', *Economic Policy*, July 495–536.
- Feinstein, C. H. (1972) *National Income, Expenditure and Output of the United Kingdom 1855–1965*, Cambridge: Cambridge University Press.
- Hayes, P. and P. Turner (2007) 'Estimates of Quarterly GDP for the Interwar UK Economy', *Applied Economics Letters*, 14, 8, 569–572.
- Ilzetzki, E., E. G. Mendoza and C. A. Végh (2010), *How Big (Small?) are Fiscal Multipliers?*, NBER Working Paper 16479, NBER, MA, USA.
- Middleton, R. (1985) *Towards the Managed Economy: Keynes, the Treasury and the Fiscal Policy Debate of the 1930s*, London: Methuen.
- Middleton, R. (2010) 'British Monetary and Fiscal Policy in the 1930s', *Oxford Review of Economic Policy*, 26, 3, 414–441.

OFFA's Demands Could Lead to Leading Universities Opting-Out of State Funding

J. R. Shackleton

When 'top-up' fees were first introduced in England and Wales in 2006–7, MPs were afraid that they would deter some potential students from applying to university. Each higher education institution was therefore required to spend 20–25% of the additional fee income to encourage wider participation in higher education. More than 100 'access agreements' were approved by the Office of Fair Access (OFFA), a small organisation set up for this purpose and run on a part-time basis by Sir Martin Harris. None were rejected.

In fact, over the last few years participation in higher education has continued to rise. Things have moved on, however. The coalition has cut direct funding via the Higher Education Funding Council sharply – in some subjects it has virtually disappeared – and annual fees have been raised to a maximum of £9,000.

The government was surprised that so many universities raised their fee to the upper limit: universities acting suspiciously like a cartel. This has created problems. Firstly, because fees are largely funded by loans from the state, extra short-term government spending will be incurred. Secondly, the bigger fee increases and changes to the terms of student loans have revived fears that some potential students will be deterred from seeking university places.

So OFFA has been given a new regulatory remit, more staff and more powers. Universities charging more than £6,000 must submit detailed annual plans with proposed expenditure, targets, milestones and monitoring requirements. Universities will be spending around £700 million a year to satisfy OFFA.

Student bursaries (reduced fees and some living expenses) were previously a key element of most widening participation strategies, but a 2010 OFFA report found them to be ineffective. They are now downplayed, and OFFA favours 'outreach'. In the case of institutions with strong local recruitment it is easy to see what this might mean – school visits, open days, mentoring arrangements, and so forth. But how does somewhere like the University of Exeter, which recruits nationwide, begin to attract a new demographic?

Historically a good university education has been a key route by which hardworking individuals from modest homes progressed to a better standard of life than their parents. However, promoting inter-generational social mobility is not the only function of universities – scholarship, research, the transmission of culture and employability are also important.

Moreover inter-generational mobility depends on many factors, including the size of generational cohorts, geographical mobility (including immigration), the state of the business cycle and the pattern of labour demand. It is also influenced by the standard of primary and secondary education. Individual universities have very limited powers.

Furthermore, disadvantage is not easy to define: low-income postcodes, quality of school attended, parental income and

education are indicators which could give different signals. Any measure adopted will probably be 'gamed' by institutions (targets being set to mislead the regulator), not to mention by candidates and their families (who may move house or school to maximise their chances, or misrepresent income or previous education in order to gain an easier rise in the admissions process).

If universities do not game the system, the temptation will be to take short cuts to pacify OFFA, by letting students into university who are ill-prepared for higher education and may not take proper advantage of it.

Top universities could, however, head in another direction and become completely independent of state funding. They could charge higher average fees than the £9,000 currently on offer and develop their own means of attracting the best students. These would include all those prepared for serious high-level study and willing to work hard – including, but not specifically, those from disadvantaged backgrounds. A needs-based system of grants and bursaries, as in leading US institutions, would be likely to develop.

Most students at top institutions have far better employment prospects than the average for the sector as a whole. They could take out loans which their universities could negotiate with financial institutions rather than the government. The present state-designed loan system involves heavy government spending upfront. But it also involves students with good job prospects effectively subsidising others who will never repay their loans. The involvement of universities in developing schemes in partnership with banks would also remove the moral hazard involved in current student funding arrangements, where universities turning out difficult-to-employ graduates suffer no significant penalties.

Freeing universities from the fees 'cap' would also encourage more realistic pricing. There is currently excessive cross-subsidisation of courses and subjects as a result of most degrees being priced at £9,000 a year. Removal of this constraint could encourage greater competition within and between institutions – and greater student value for money.

It would be difficult for the 'first mover'. No individual institution wants to take the risk of being the first institution to give up state funding thus finding itself isolated. But the time may be coming when our leading institutions will increasingly see the benefits of independence from OFFA and the other regulators of higher education.

J. R. Shackleton is Professor of Economics at the University of Buckingham (len.shackleton@buckingham.ac.uk).

