
Soundbite

The HIDDEN COST of HEALTHY LIFESTYLES

When the NHS was created in 1948, Aneurin Bevan believed that healthcare spending would fall as the population became healthier.

In the years since, infectious diseases have been virtually eradicated, diets have improved, smoking rates have plummeted, and life expectancy has risen from 68 years to 81 years. And yet healthcare spending has manifestly not fallen.

The NHS budget, which represented less than three per cent of GDP in the early 1950s, exceeds seven per cent of our (much larger) GDP today.

The belief that the NHS's financial problems would be alleviated if people led healthier lifestyles continues to be widely held. When policies to clamp down on bad habits are proposed, campaigners cite the cost of smoking, drinking and obesity as their justification.

When government preventative health budgets are cut, those who work in the sector claim that it is a 'false economy' that will cost the government more in the long run by creating more illness.

None of this makes sense to economists who understand that healthier lifestyles not only increase healthcare costs but also put a strain on other government departments by raising demand for pensions and social care.

As Jane Hall explains in the *Oxford Handbook of Health Economics*, most preventive medicine, if successful, adds to government spending in the long run. 'Although it is frequently argued (but not by economists) that prevention will save expenditure on future treatment,' she writes, 'the current body of evidence demonstrates that it is more likely to generate additional health care costs.'

Economic studies have found that 80 per cent of preventive health initiatives increase overall healthcare expenditure. In financial terms, a stitch in time does not save nine.

CHRISTOPHER SNOWDON INVESTIGATES

The reason is simple. A large proportion of a person's healthcare costs are spent in the last year of life. These end-of-life costs cannot be prevented, only delayed, and are much the same regardless of the age at death.

The years of life gained by lifestyle changes and medical technology tend to come when the person is retired and is a net recipient from the welfare system.

The person who would have lived to the age of 68 when the NHS was founded now lives an extra thirteen years. This means an extra thirteen years of healthcare provision, pension payments and other benefits – all at a time when the person is paying no income tax.

When campaigners talk about the costs of smoking, drinking and obesity, they ignore the costs of old age that taxpayers would have to meet if nobody smoked, drank or gained weight. Most studies have shown smoking to be cost-saving overall and the same may also be true of obesity.

All told, only a fraction of the £24 billion paid in alcohol and tobacco duty each year is needed to pay for public services related to drinking, smoking and obesity. The rest of it is essentially a subsidy paid by those who drink and smoke to those who do not.

Whilst it would be repugnant for the government to actively encourage unhealthy living to save itself money, those who believe that taxes would be lower if unhealthy habits were stamped out are mistaken.

There is a case for spending government money on preventative health care and there is a case for taxing alcohol and tobacco consumption.

However, the case for both these policies cannot be made from the perspective of saving government money in the long run. As far as externalities arising from eating, drinking and smoking are concerned, they may exist, but they do not relate to costs imposed on taxpayers.

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HELL
TOUPEE?

RAZEEN SALLY CONTEMPLATES THE NEW GLOBAL ORDER IN THE AGE OF TRUMP

Donald Trump's election is perhaps the biggest political shock worldwide since the fall of the Berlin Wall.

It raises huge questions about the future of the seventy-year-old US-led global order. Will it collapse into a 1920s/30s scenario of global disorder – power conflicts, economic de-globalisation and depression?

Instead of a highly premature doomsday scenario, here are four preliminary observations.

- Firstly, we should all be worried by Mr Trump's terrible character and judgement. Ordinarily, this would disqualify him from the highest public office in the world.
- Secondly, his election brings some good news. Now is the best chance in perhaps a generation to inject a strong dose of economic liberalism into US domestic policy – on tax reform, deregulation, the environment, energy, education, health care and labour markets. Mr Trump has picked many good people for high office. They could work productively with a Republican Congress to bring economic liberalism back to America.
- But thirdly the Age of Trump brings very worrying news on international politics and economics. Most alarming is his isolationism on geopolitics and globalisation.
- And fourthly, bundling the last three factors together is a recipe for wildly contradictory signals – economic liberalism at home and isolationism abroad – and heightened policy unpredictability and volatility.

That is bad for global order.

Now let's look at the two most vexing issues, geopolitics and globalisation.

Since 1945, US leadership has provided essential public goods for a stable and open global order. But US leadership has been declining since the beginning of this millennium. Concurrently, the world has become more multi-polar, especially with China's spectacular economic ascent.

So what comes next with President Trump? Will he head towards disengagement or re-engagement with the world? It is too early to tell.

But some who predict continued, even accelerated, US decline and disengagement say the world will remain stable and open. They argue that others will pick up where the USA leaves off and that international cooperation will be more equally shared.

But, I doubt that very much. Europe, with the European Union at its core, is ever-more divided and weak. India, Brazil and Russia will remain sub-regional and at best regional powers.

That leaves China as the sole contender for pan-regional and international leadership. But it is weaker than most outsiders think. China's conspicuous lack of an open society is its Achilles heel. That limits its ability to lead abroad.

This all leaves no alternative, for the foreseeable future, to US leadership for a stable and open global order.

The risk of accelerated US withdrawal from global leadership is real. It must not happen – for the sake of the world. It is up to decision-makers and opinion-formers, inside and outside the USA, to prevent a Trump presidency from heading in this direction.

What about the Trump trade agenda? This goes in exactly the opposite direction to emerging economic liberalism at home.

Mr Trump's message is economic nationalism abroad – loud and clear. He has announced the US's withdrawal from the Trans-Pacific Partnership, wants to renegotiate NAFTA, has threatened high tariffs against China and says he will ignore the World Trade Organization.

A protectionist turn in US trade policy is likely. And other countries will follow the US lead, starting with the EU and China.

If this happens, it will only accelerate trends since the global financial crisis. Protectionism will affect bigger chunks of international trade and disrupt global value chains. There will be a bigger world trade slowdown. That will drive world GDP growth even lower, in the West and the Rest.

Containing this new protectionism is imperative. That requires effective lobbying inside and outside the USA. And, not least, it demands effective communication of sensible ideas on trade●

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QUALIFIED SUCCESS?

GABRIEL HELLER SAHLGREN EXAMINES THE COMPETITION BETWEEN EDUCATIONAL QUALIFICATIONS

In the last couple of years, the qualifications system in England, Wales and Northern Ireland – all of which allow schools to choose between multiple providers – have faced criticism from politicians and in the media.

Many argue that qualification and assessment choice introduces perverse incentives for exam boards to decrease standards and inflate grades in a 'race to the bottom'.

To address these concerns, some support abolishing independent exam boards in favour of a single government board.

Others have suggested a franchising model under which boards would compete for politicians' business to deliver qualifications and examinations on a fixed-term contractual basis only.

From an economic perspective, whether or not a service should be outsourced depends on who can deliver it most efficiently.

This, in turn, depends on so-called external 'transaction costs' – the costs of monitoring to ensure that the service is provided in accordance with the buyer's expectations.

If the total price for purchasing the service externally, including the transaction costs, is lower than in-house production costs, it makes more sense to go for outsourcing.

A key aspect of this is the level of 'contract incompleteness'. Many quality aspects of complex public services are difficult to measure, which makes it difficult to hold external providers to account. If this is the case, outsourcing could in fact lead to lower quality.

In practice, however, most public services do not warrant government provision on this basis. This includes qualifications and assessment where there are few non-measurable elements involved, considerable scope for innovation, and strong reputational mechanisms to ensure that boards do not cut corners. Nationalising exam boards would just raise costs and decrease innovation.

But should the government or schools choose the exam board? In the franchising alternative, government would pick winners via a tendering process, in contrast to the current user-choice model where schools do the choosing.

The case for choice rests on the assumption that it improves matching between pupils and the qualifications offered, while also generating stronger competitive pressures among exam boards.

Yet, in some situations, choice may not generate the desired outcomes. For example, the impact of competition on quality depends on how schools weight quality vis-à-vis price. If they are very sensitive to price, exam boards may focus on competing along this margin – which could potentially decrease quality.

Still, there is no evidence that the existing model has produced a race to the bottom. Given the strict regulatory framework in place, this is not surprising.

Certainly, the equivalency framework and the way school league tables are constructed have incentivised schools to choose what they perceive to be easier subjects – a problem that would remain if choice between exam boards were abolished.

At the same time, there is little evidence of excessive price competition in the current system either; rather, independent exam boards have invested heavily in technology to increase the effectiveness of the overall system.

Rather than abolishing the qualifications market, it would therefore be preferable to improve it.

Instead of seeking strict comparability, the accreditation framework could focus on specified minimum standards.

Boards could then compete by providing higher, but not lower, standards in national and alternative qualifications.

With such a focus, it would also be possible to lower the regulatory barriers to new providers, which would provide stronger incentives among existing providers to compete and innovate.

It would then be useful to reform league tables to avoid perverse incentives. For example, outcomes could be published separately for different qualifications.

The goal should be to improve the market – not to abolish it●

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SHOCK and ORE

ROMESH VAITILINGAM REVEALS THE 'UNSEEN' EFFECTS OF INDUSTRIAL POLICY

There has been much discussion over the last year about whether the government should support the steel industry in the UK.

Professor Bruce Blonigen of the University of Oregon recently published a paper in the *Economic Journal* called *When Industrial Policy Harms Performance: Evidence from the World Steel Industry*.

It suggests that before we use industrial policy to support a country's steel sector we should consider the second round effects – such policies can have damaging effects on the export competitiveness of downstream manufacturing sectors that make use of steel.

Throughout history, governments have used industrial policies to guide the development of key sectors in their economies and to spur economic development.

These policies can vary substantially. They include subsidising production, limiting import competition and promoting export sales.

Blonigen's cross-country analysis indicates that sectors in which steel is a major input, such as fabricated metals and machinery, suffer particularly badly.

He also finds that export subsidies and government ownership are the industrial policies that have the most harmful effects on downstream export competitiveness – and the effects are most evident in less developed countries.

So, why do such policies exist? The first explanation for the existence of harmful industrial policies is that governments are not seeking to improve the welfare of their country, but have other objectives in mind, such as responding to political lobbies.

The other possibility is that policy makers simply do not understand the effects of such policies. This is especially so given that a layering of industrial policies often accumulates over time, leading to the presence of multiple policies at cross-purposes with each other.

Recent efforts by the South African government to target industrial policies at its lagging manufacturing sector illustrate these concerns.

The government found that a prior policy programme targeted at its steel sector, which is a source of key inputs to many manufacturing sectors, had led to uncompetitive steel prices and hurt downstream manufacturing sectors.

Rather than eliminate the industrial policies in their steel sector, the government layered additional policies in the steel-using sectors in the hope of restoring the health of these downstream sectors.

Is this South African example typical? Evidence is scant to non-existent on the net effects of industrial policies on economic growth and development.

While there are many studies of the effects of specific industrial policies, particularly import tariffs, the difficulty of collecting information on the wide variety of industrial policies in a consistent fashion has hindered systematic analysis.

Using a new hand-collected database of industrial policies used in the steel sector in major steel-producing countries, the author of this new study is able to overcome a number of these data difficulties and provide estimates of the effects of industrial policy in one of the sectors most often targeted by governments for industrial policies.

Because steel is a primary input in so many manufactured goods, the research focuses on how industrial policies in a country's steel sector affect the export competitiveness of downstream manufacturing sectors that use steel.

The research finds:

- The use of industrial policy is harmful to downstream sectors. A one standard deviation increase in steel industrial policy usage leads to an immediate 1.2 per cent decline in export competitiveness for the average downstream manufacturing sector.
- This effect is five times as high (or roughly 6 per cent) for major steel-using downstream sectors, such as fabricated metals and machinery.
- The long-run effect of increased industrial policy usage for the average downstream sector is a decline in their exports by more than 15 per cent.
- These industrial policy effects on downstream export performance seem more obvious in less developed countries. However, there are significant effects of steel industry intervention on downstream competitiveness in a few developed countries as well.
- Export subsidies and government ownership of the industry have the most harmful effects on downstream export competitiveness.

Overall, policies to support the steel industry may or may not help that particular industry. However, they certainly seem to adversely affect other sectors of the economy●

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