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Discussion Papers

No. 204.

An empirical analysis of monetary policy choices in the pre-EMU period

by *Ray Barrell, Dawn Holland and Kateřina Imřdkovř*

This paper argues that the choice of exchange rate regime in the process of accession to the European Union and EMU can affect the growth rate of the economy in the medium term. It goes on to discuss the effects of exchange rate choice, and of the timing of transition to EMU on the core accession countries.

No. 205.

The role of efficiency as an explanation of international income differences

by *Richard Kneller and Philip Andrew Stevens*

Why are some countries richer than others? If, as some recent work has suggested, the answer lies not in differences in physical and human capital accumulation but in differences in productivity, this merely shifts the question to: why are some countries more productive than others? This paper investigates differences in productive efficiency as an explanation of international income difference using stochastic frontier analysis. We find that human capital and geography are important in explaining differences in productive inefficiency in a panel of 82 countries over the period 1960-87. We also investigate the effects of government policy, as measured by its fiscal stance, on a subset of OECD countries over a shorter period. We find that increases in the budget surplus are associated with lower levels of productive efficiency in the economy as a whole.

No. 206.

Non-linear modelling of household consumption: an examination of a closed-form life-cycle model

by *Rebecca Riley and Martin Weale*

We use successive datasets from the U.K. Family Expenditure Survey to estimate a closed form consumption function for households facing uncertain future income. The closed form is derived from a model of absolute risk aversion modified to reflect differences in consumers' circumstances (quasi-relative risk aversion). Proper adjustment is made for demographic effects. Plausible estimates for the intertemporal substitution parameter are found. However an encompassing test shows that a naive Keynesian model has some residual explanatory power.

No. 207.

Evaluating currency crises: the case of the European Monetary System

by *Kostas Mouratidis and Nicola Spagnolo*

In this paper we examine the nature of currency crises. We ascertain whether the currency crises of the European Monetary System (EMS) were based either on bad fundamentals, or on self-fulfilling market expectations driven by external uncertainty, or a combination of both. In particular, we extend previous work of Jeane and Masson (2000) regarding evaluation of currency crisis. To this end we contribute to the existing literature proposing the use of three different Markov regime-switching models. Our empirical results suggest that the currency crises of the EMS were not due only to market expectations driven by external uncertainty, or 'sunspots', but also to fundamental variables that help explain the behaviour of market expectations.

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The *Review* is the quarterly publication of the National Institute of Economic and Social Research – one of Britain's oldest and most prestigious independent research organisations. The Institute's objective is to promote, through quantitative research, a deeper understanding of the interaction of economic and social forces that affect people's lives so that they may be improved. It has no political affiliation, and receives no core funding from government. Its research programme is organised under the headings of Economic Modelling and Analysis; Productivity; Education and Training and the International Economy.

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