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## Why do we write research papers?

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As economists, we speculate continually about others' motivation. What about our own: why do we write research papers? There are obvious answers: because we enjoy it, and because we are paid to do it. But there is more.

Every paper is a ticket in a lottery. The prize is immortality -- of a kind. It is a lottery because none of us knows exactly how good our next paper will be.

The odds are poor. There are maybe 500 journals of economics, mostly publishing in English. If each published 40 papers a year, that would make a total of 20,000 published papers. Most will never be noticed.

Over a period of time, a minority will attract attention and significant numbers of citations, and will find their way into reading lists for a few years. A handful will be widely influential and will eventually be cited hundreds of times; they will work their way into textbooks. In the course of a decade, a few rare items may appear that will still be remembered over generations.

The authors of this work will find their names forever linked with ideas and concepts: Bayesian updating, the Edgeworth box, Pigovian taxes, the Coase theorem, Nash equilibrium, the Balassa effect. That is as close to immortality as a scholar can get.

This also suggests an answer to a question that is sometimes raised: does research not get into the way of teaching? Today, it is true, a student who interrupts our thoughts with an unanticipated knock on the door may occasionally be received with less than calm good manners.

That is a fact, although a regrettable one: to remain polite and welcoming under pressure gives a truer picture of the person than the same when everything is going smoothly.

But tomorrow the same students will have the chance to learn what we found today. The day after, if our research is any good, it may inspire them to follow us into the profession.

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## Technical analysis: an obstinate passion

Technical analysis – which predicts future asset price movements on the basis of their past movements – is widely used in the foreign exchange markets. In a forthcoming survey, **Lukas Menkhoff** and **Mark P. Taylor** try to find a rationale for a practice that has long perplexed academic researchers but which can prove to be profitable.

For many professional financial economists, the widespread and continuing use of technical analysis – or, as it sometimes called, "chartist analysis" – in the foreign exchange market is somewhat puzzling. These techniques eschew scrutiny of economic fundamentals, relying only on information about past exchange rate movements. According to even the weakest notion of market efficiency, such data should already be embedded in the current exchange rate.

The widespread use of technical analysis by foreign exchange professionals was first brought to the attention of academic researchers during the 1980s. But it has been during the last 15 years or so – beginning with joint research by Mark P. Taylor and Helen Allen (1990, 1992) – that a number of studies have reported the results of surveys of foreign exchange market participants in the major trading centres concerning the use of technical analysis.

all professionals in the market rely on the tool at least to a small degree.

Another view relates the profitability of technical analysis to foreign exchange interventions by the monetary authorities. But recent evidence suggests that by driving the exchange rate away from the level consistent with the fundamentals, it is the other way round: the influence of technical analysis may in fact generate a rationale for official intervention.

A third position – namely that technical analysis is simply an instrument in the processing and assimilation of market information – can also reconcile the importance of market order flows and technical analysis to some degree. The main problem with this position, however, is that it does not explain the reason behind such market phenomena as sluggish adjustment to news and traders' preferences for round figures when placing orders.

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Technical analysis can best be seen as an instrument for informing traders about "market sentiment"

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Technical trading strategies should be constantly evaluated as potential tools in the search for excess returns

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These studies suggest both that technical analysis is in widespread use among foreign exchange professionals and that significant profits can be and are being made using these techniques. How can this be explained?

One argument is that the use of technical analysis is an indication of behaviour that is not fully rational. This view is difficult to reconcile with the fact that virtually

Overall, therefore, perhaps the most satisfying explanation for the continued use of technical analysis seems to be a fourth position, whereby technical analysis is seen as an instrument for informing traders about non-fundamental determinants of prices – what might be collectively described as "market sentiment."

These forces are more important in the shorter run. So for a full understanding of exchange rate dynamics,

professionals need a combination of several tools encompassing both technical and fundamental analysis.

What is perhaps most striking from our reading of the research literature is that technical analysis remains a passionate obsession of many foreign exchange market professionals. It is clearly an intrinsic part of this market.

For academic researchers, this means that it must be understood and integrated into economic reasoning at both the macroeconomic and the microstructural levels. For market practitioners, it means that technical trading strategies should be constantly evaluated as potentially important tools in the search for excess returns.

#### *Publication Details*

"The Obstinate Passion of Foreign Exchange Professionals: Technical Analysis," by Lukas Menkhoff and Mark P. Taylor, is forthcoming in the *Journal of Economic Literature*, December 2007.

#### *The Authors*

Lukas Menkhoff is professor of economics at the University of Hannover. Mark P. Taylor is professor of macroeconomics and international finance at the University of Warwick, and a research fellow of the Centre for Economic Policy Research. He is also a managing director of Barclays Global Investors, where he works on international active asset allocation strategies.

#### *Further reading*

- » Allen, Helen, and Mark P. Taylor. 1990. "Charts, Noise and Fundamentals in the London Foreign Exchange Market." *Economic Journal* 100 (supplement): 49-59.
- » Taylor, Mark P., and Helen Allen. 1992. "The Use of Technical Analysis in the Foreign Exchange Market." *Journal of International Money and Finance* 11: 304-14.

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## Managerial incentives to improve productivity

Does performance pay for managers boost a firm's productivity? And if so, what is it that managers focus on to achieve an increase in their workers' total output? In an effort to answer these questions, **Iwan Barankay** and his colleagues have been running some field experiments at a large UK fruit farm.

The last two decades have seen a surge in the popularity of performance pay for individuals in executive and managerial positions – from chief executives down to middle and lower management. But until now, there has not been much evidence on how managerial performance pay affects a firm's productivity and the performance of individual workers in lower tiers of the firm's hierarchy.

In research with Oriana Bandiera and Imran Rasul, I have been seeking to shed light on these issues by running a series of experiments in conjunction with a UK-based firm. In field experiments like ours, one aspect of the firm – typically its employee contracts – is changed in a randomised way that allows a causal interpretation of the effects.

The series of experiments we engineered were designed to understand how individuals respond to changes in the monetary incentives offered to them, and whether this response depends on the type of people they work with or their broader social network in the workplace.

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### Managerial incentives increase workers' average productivity but also the dispersion of worker productivity

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The firm we studied is a leading producer of soft fruit. In this firm, managerial staff belong to two classes: the first consists of a single general manager and the second comprises 10 field managers. The bottom tier of the firm hierarchy consists of workers whose task is to pick fruit, a physically strenuous task for which workers are of varied ability.

Managers are responsible for field logistics, most importantly to assign workers to rows of fruit within the field and to monitor workers. The general manager's task is to decide which workers are selected to pick fruit each day and which are assigned to non-picking tasks. He also decides the allocation of workers and managers to fields.

Our experiment involved changing the incentive scheme for both the field managers and the general manager. For the first two months, they were paid a

fixed wage. They continued to receive this for a second period of two months, but in addition they could earn a performance bonus based on the average productivity of the workers they managed.

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### With the incentive of performance pay, managers target their efforts towards more able workers

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We found that the introduction of performance pay for managers increased worker productivity by 20%. But it also increased the dispersion of worker productivity: the increase in productivity was the greatest for the most able workers, while low ability workers were less likely to be selected to pick fruit. This suggests that managers target their efforts towards more able workers when they have the incentive of performance pay.

This research has important implications for the organisation of firms, highlighting as it does the interplay between the provision of managerial incentives and earnings inequality among lower-tier workers. For example, managers may show favouritism towards some employees, which can be bad for overall firm performance. Such favouritism can be mitigated if managerial incentives are correctly structured.

#### *Publication Details*

"Incentives for Managers and Inequality Among Workers: Evidence from a Firm-Level Experiment" by Oriana Bandiera, Iwan Barankay, and Imran Rasul, is published in the May 2007 issue of the *Quarterly Journal of Economics*.

#### *The Authors*

Oriana Bandiera is associate professor of economics at the London School of Economics. Iwan Barankay is associate professor of economics at the University of Warwick and a research fellow of the Institute for the Study of Labor (IZA) in Bonn. Imran Rasul is associate professor of economics at University College London. All three authors are research affiliates of the Centre for Economic Policy Research.

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## The road to a command economy

A newly found verbatim transcript of a Politburo meeting in January 1927 reveals the Bolsheviks on the brink of abandoning market incentives – and Stalin persuading his comrades that this was the only option for the future of the Soviet Union. **Mark Harrison** recounts the story of a debate that would have far-reaching consequences.

Thirty-one verbatim transcripts of meetings of the Politburo, the highest decision-making body of the Soviet communist party, held between 1923 and 1938, were found recently in the Russian archives. These formerly secret documents show a narrow circle of top leaders of the Soviet Union locked in debate about the key political and economic issues of the time.

My research focuses on a particular discussion held in January 1927 about progress towards cutting the retail prices of industrial commodities – an apparently dry, technical subject that in practice laid bare the underlying tensions in Bolshevik economic policy.

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By 1927, the Bolsheviks were moving to the view that if market incentives did not work, force would do instead

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The Soviet economy, poor and largely agrarian, was now ruled by a narrow political elite (though not yet a personal dictatorship), which was committed to state-led modernisation. The policy of cutting industrial retail prices was intended to harmonise the interests of urban and rural consumers with those of the state, and keep peasant farmers motivated to supply food – in return for cheap industrial goods – on a scale sufficient to meet the needs of state-led industrialisation.

This policy was difficult to implement because it ran counter to the requirements of market equilibrium. Industry could not supply enough consumer goods to meet market demand at lower prices, so shortages were developing. The implied squeeze on industry's trading costs and profits also generated widespread resistance. The Bolshevik leaders faced a choice between allowing the market to return to equilibrium and imposing the desired prices and quantities by force. The verbatim minutes of their discussion, available for the first time, show us how they perceived this choice before they made it.

To some extent, this is a story of unintended consequences. The Bolsheviks had thought that price cuts would harmonise the interests of the regime and the peasantry. This had worked in 1922/23, but by 1927 the context had changed. As a result, the policy was actually driving the peasants and the regime apart because it was destroying the urban-rural market equilibrium.

At the same time, in so far as they were becoming aware of the unintended consequences, the Bolsheviks did not really care – that is, if their measures were driving the market out of balance, then so much the worse for the market. If market incentives did not work, force would do instead. This was a step on the road to the command economy and the criminalisation of self-interested market behaviour.

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The Soviet Union was on the way to making self-interested market behaviour a criminal offence

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Two years later Stalin launched the Soviet economic and political system into forced-march industrialisation, the five-year plans, and the mass collectivisation of peasant farming. The lives of a hundred million people were turned upside down; a significant proportion of them were tragically curtailed by famine and terror. Stalin himself gathered up the personal power of an absolute ruler.

The transcript shows Stalin clearly leading the others down this road and, with calculated brutality of expression, educating his comrades in the vision and language that would make this seem the only possible path to survival of the regime. In my account of the meeting, I propose the analogy of a classroom. I call Stalin "the teacher" – and that is not a chance expression.

### *Publication Details*

"Prices in the Politburo, 1927: Market Equilibrium versus the Use of Force" by Mark Harrison is a chapter in *The Lost Transcripts of the Politburo* edited by Paul R Gregory and Norman Naimark, forthcoming from Yale University Press.

### *The Author*

Mark Harrison is professor of economics at the University of Warwick, senior fellow of the Centre for Russian and East European Studies at the University of Birmingham, and distinguished visiting fellow of the Hoover Institution at Stanford University.

### *Further Reading*

Paul Gregory describes the Politburo transcripts in "Watching Stalin Win," published in 2007 in issue no. 4 of *The Hoover Digest*.

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## The University of Warwick Economics Research Institute

The ERI is an integral part of the Department of Economics at the University of Warwick. Its members include the academic and research staff and research students of the Department of Economics; visitors attached to the Department of Economics; and scholars from other institutions who are associated with programmes of research administered within the Institute.

The Director of ERI is Professor Mark Harrison. You can contact Mark at [mark.harrison@warwick.ac.uk](mailto:mark.harrison@warwick.ac.uk).

The aims of ERI are to promote directly and indirectly research in economics and interdisciplinary research that has an economic aspect; to facilitate the funding and organisation of collaborative research projects involving the participation of members of the Department of Economics; and to support scholarly

activities such as conferences and research networks that extend beyond the routine scholarly life of the Department of Economics.

The Bulletin of the ERI appears once a term. Each issue features summaries of published or forthcoming research by ERI members. The Bulletin's editor is Romesh Vaitilingam. You can contact Romesh at [romesh@compuserve.com](mailto:romesh@compuserve.com).

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