

No. 175  
January 2001

niesr

National Institute Economic Review

1 / 2001

# National Institute of Economic and Social Research

## Discussion Papers

No. 172.

The importance of long-run structure for impulse response analysis in VAR models

by *James Mitchell*

Structural VAR models have been used to trace out the dynamic effect on variables of economic shocks. In attributing economic meaning to the shock identifying restrictions have to be imposed on the contemporaneous relations in the VAR model. Researchers choose between alternative sets of identifying restrictions on the basis of whether the observed effect of the identified shock is consistent with priors, but traditionally impulse response analysis remains confined to VAR models estimated in levels of the variables. The paper shows that how we identify the long run has implications for the way we identify impulse response functions, finding that we should consider the long-run structure of the VAR model in addition to the set of identifying restrictions imposed on the contemporaneous relations.

No. 173.

Pay settlements in Britain

by *John Forth and Neil Millward*

Data from the 1998 Workplace Employee Relations Survey are analysed to investigate the processes and outcomes of pay setting for the largest occupational group in a representative sample of all but the smallest British workplaces. The effects of inflation, changes in labour demand and supply, comparability and upskilling are all examined. Trade unions appear to modify the process of pay-setting more than the outcome: if anything, bargained settlements are somewhat smaller than non-bargained ones.

No. 174.

Openness, growth and development: trade and investment issues for developing economies

by *Nigel Pain*

Many developing economies have become disenchanted with the operations of the World Trade Organisation and the global trading system in general, thus reducing the enthusiasm of many governments for participating in further rounds of multilateral trade and investment talks. Yet liberalisation is far from complete, suggesting that it may be worth pursuing reforms to the rules governing the multilateral trading system. The paper assesses the evidence on whether the interests of developing countries will be enhanced through greater international openness and draws out some of the implications for the issues confronting them in any future round of negotiations.

No. 175.

Inward investment and technical progress in the United Kingdom manufacturing sector

by *Florence Hubert and Nigel Pain*

The paper investigates the impact of inward investment by foreign-owned companies on technical progress, and hence labour productivity, in the UK manufacturing sector. Using an industry-level panel data set we find that foreign-owned firms have a positive effect on the level of technical efficiency in domestic firms. There is evidence of significant intra-industry and inter-industry spillovers from inward investment. Inward investment appears to be a much more important source of technical progress than foreign trade and its impact appears to vary according to the nationality of the investing firm.

No. 176.

Evaluating macroeconomic models of the business cycle

by *Andrew P. Blake and Garry Young*

Many different models can be used to analyse the behaviour of the economy over the cycle. While various diagnostic tools are available to discriminate between them, these are rarely conclusive. Poor models survive alongside good ones. The paper develops the use of stochastic simulation techniques as a diagnostic device to assess the overall properties of models. The stochastic properties of the National Institute model are outlined, showing the extent to which it matches the business cycle moments of the UK economy and the persistence of the economic cycle, comparing its properties with those of theory-based Real Business Cycle models and data-based VAR models. It shows how structural models are needed to quantify the effect of appropriate choice of policy rules on the business cycle.

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0027-9501(200101)175;1-B

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In 2001 National Institute Economic Review [ISSN: 0027-9501] is published in January, April, July and October by SAGE Publications (London, Thousand Oaks, CA and New Delhi).

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### Aims and Scope

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 Economics, Modelling and Analysis; Productivity; Education and Training and the International Economy.

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Printed by Direct Image, London.  
ISSN: 0027-9501