

CESifo Bulletin

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OUTSOURCING GOES GLOBAL

Globalisation opens wide, alluring vistas that force companies to rethink their organisational strategies: Global outsourcing? Or setting up foreign subsidiaries? **Gene Grossman** will devote his CES stay in June to expanding his research into this field. *(page 3)*

ON THE WING

The advent of the airplane changed our life: it shrank the globe. Deregulation, in turn, made it affordable, but it also congested the airports. **Jan Brueckner** will explore at CES the economics of airport congestion pricing. *(page 5)*

HEALTH & ECONOMIC POLICY CONFERENCE

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MUNICH SEMINARS

How to adjust to macroeconomic shocks in the EMU is one of the questions addressed at the **2002 Summer Semester Munich Seminars**. Check out this semester's programme. *(page 3)*

TAX POLICIES

Tax reforms are a desirable but tricky undertaking: Will they have the desired effect? What will their economic impact be? **Dale W. Jorgenson** will pursue research on this during his stay at CES. *(page 3)*

TIME SERIES MODEL

Financial time series have proven their worth as tools for analysis. **Ching-Fan Chung** will further at CES his refinement for a new time series model. *(page 3)*

WORLD ECONOMIC CLIMATE

At long last, the index brightens up a bit —albeit not everywhere. The **Ifo News** section summarizes the latest findings. *(page 4)*

TAXES AND ENTREPRENEURSHIP

The tax structure can stimulate entrepreneurial spirit —or stifle it. It pays to find out. **Roger Gordon** will explore at CES which features provide effective incentives to become self-employed. *(page 5)*

THE INDUSTRIAL REVOLUTION REVISITED

Why only some countries escaped the Malthusian constraints into a regime of constant economic growth. is one of **Gregory Clark's** research topics at CES. *(page 6)*

FINANCIAL TIME SERIES

Chung

Ching-Fan Chung, from the Institute of Economics, Academia Sinica, in Taipei, Taiwan, will visit CES in May 2002. Among his main areas of interest is the analysis of financial time series, a powerful tool that has been applied with great success to numerous financial and macroeconomic studies in the last ten years.

During his visit to CES, he intends to complete a research project about a new time series model that allows for high-order Markov regime switching. Thanks to this research, Economists have gained more diversified views about how and why many financial and macroeconomic time series have evolved during the past fifty years. Mr. Chung expects to build a new model that



Ching-Fan Chung

provides more flexibility without incurring too much computation costs.

He is also going to teach a short course on Financial Time Series Analysis.

Trained as an econometrician, Mr. Chung obtained a Ph.D. from the University of Wisconsin-Madison in 1987 and has published in prestigious Econometrics journals such as *Econometrica*, *Econometric Theory*, and in the *Journal of Econometrics*. He is also affiliated with National Chengchi University in Taiwan and Xi'an Jiao-Tung University in China.

His recent research focuses on econometric modeling and empirical analysis of financial data. He also works on a panel study of families in Taiwan.

SB

HEALTH AND ECONOMIC POLICY CONFERENCE

On **1 June 2002** is the deadline for submission of papers for this CESifo conference on issues of health policy, to be held on 27-28 June 2003.

Intended to give an overview of current research in Health Economics, the conference will address such issues as the role of health in the persistence of poverty traps, the effect of public policy on health, forecasting supply and demand for health, demographic outcomes in an ageing population and their policy implications for OECD countries.

The conference papers will be published in the CESifo Seminar Series with MIT Press subject to a refereeing process.

The scientific organisers are **Robert Fogel** (Chicago) and **John Komlos** (Munich).

Further info at

www.cesifo.de/pls/ifo_app/CESifoSwitch?setPage=hep03-hp.htm

OUTSOURCING GOES GLOBAL

Grossman

Spurred by the opening of the world economy in the past couple of decades, outsourcing has turned increasingly global. This development both offers opportunities and poses new challenges to companies in terms of how they organise, and whether and where they outsource. Professor **Gene Grossman**, of Princeton University, will devote part of his upcoming stay at CES, scheduled for June this year, to delve into the determinants of the organization of firms in an open world economy. He is one of the leading researchers in the field of international trade theory and policy and well known for his work on the determinants of international competitiveness in dynamic, research-intensive industries.



Gene Grossman

In a recent paper, *Outsourcing in a Global Economy*, Professor Grossman and Elhanan Helpman studied the determinants of the extent of international versus domestic outsourcing. They considered changes in communication and design technologies, as well as in the legal and contracting environment in the developing countries, as possible explanations for the rapid growth of global outsourcing in recent years. Now they are seeking to understand not only firms'

decisions about where to outsource, but also their choice of whether to outsource or to establish foreign subsidiaries. Their modeling emphasizes the advantages of outsourcing that come from specialization and increasing returns to scale, and the disadvantages that arise from the difficulties of locating partners with suitable expertise, the impossibility of monitoring perfectly the efforts of a partner firm, and the impossibility of writing complete contracts to relationship specific investments.

Grossman is the Jacob Viner Professor of International Economics at Princeton University and the Director of Princeton's International Economics Section. He received a Ph.D. from the Massachusetts Institute of Technology in 1980, the same year that he joined the Princeton faculty. He is a Fellow of the Econometric Society and of the American Academy of Arts and Sciences, and previously received prestigious fellowships from the Alfred P. Sloan Foundation and the John Simon Guggenheim Memorial Foundation. He recently completed terms on the Executive Committees of the American Economic Association and the International Economic Association.

KT

TAXES AND MUCH MORE

Jorgenson

What is the economic impact of tax policies? Will a tax reform have the desired effects and, if so, will there be some undesired side effects as well? Weighty questions for politicians and their advisors, undoubtedly, but momentous for the public at large.

Dale W. Jorgenson tackles these issues in his latest book (together with Kun-Young Yun) on *Lifting the Burden: Tax Reform, the Cost of Capital and U.S. Economic Growth*, issues which he will



Dale W. Jorgenson

further pursue during his forthcoming stay at CES in June. The cost-of-capital approach provides an intellectual impetus for proposing reforms of capital income taxation in the United States and around the world.

Two avenues for tax reform result from this approach: One would retain the income tax base of the existing U.S. tax system, but would equalize tax burdens on all forms of assets as well as average and marginal tax rates on labor income. The other would substitute consumption for income as a tax base, while equating average and marginal tax rates on labor income.

Jorgenson received his Ph.D. from Harvard University, where he returned after some years in Berkeley and at various other universities. With econometrics as his primary field of interest, Jorgenson has worked on an impressive variety of topics ranging from energy, the environment, economic growth in China, investment in human capital, international comparisons of economic growth to, of course, tax reform and U.S. economic growth.

SÜ

HANS-MÖLLER SEMINARS

Summer Semester 2002

Tuesdays, 5 pm

Venue: Library of the Seminar for International Economic Relations, CES, Ludwigstr. 28/II, Munich

Organised jointly by CES and the Faculty of Economics of Ludwig Maximilians University, the Faculty of Economic and Organisational Sciences of the Bundeswehr University and the Technical University of Munich.

7 May 2002

Fiona Scott Morton
Yale University

Love or Money? The Effect of Owner Motivations in the California Wine Industry

14 May 2002

John Kagel
Ohio State University

Experimental Labor Markets and Gift Exchange

28 May 2002

Bennett McCallum
Carnegie Mellon University

Consistent Expectations, Rational Expectations, Indeterminacy, and Learnability

4 June 2002

Dale Jorgensen
Harvard University

Lifting the Burden: Tax Reform, the Cost of Capital, and U.S. Economic Growth

11 June 2002

Don Fullerton
Harvard University

Tax and Subsidy Combinations for the Control of Car Pollution

18 June 2002

Lutz Arnold
Universität Regensburg

Does the Choice Between Wage Inequality and Unemployment Affect Growth?

25 June 2002

Georg Nöldeke
Universität Bonn

To be announced

2 July 2002

Roger Gordon
University of California San Diego

Taxes and Entrepreneurial Activity: Theory and Evidence for the U.S.

9 July 2002

Kenneth Kletzer
University of California Santa Cruz

The renegotiation and currency denomination of sovereign debt

16 July 2002

Dalia Marin
Universität München

Power Inside the Firm and the Market: A General Equilibrium Approach

MUNICH SEMINARS

Summer Semester 2002

22.04.2002

Ignazio Angeloni
European Central Bank

Policy Devolution in the European Union: Theory and Evidence

29.04.2002

Lars Calmfors
University of Stockholm

The Adjustment to Macroeconomic Shocks in the EMU

06.05.2002

Wilhelm Simson
E.ON AG

Menschen als Gestalter der Globalisierung

10.06.2002

Jean Pisani-Ferry
Conseil d'Analyse Économique, Paris

Das Thema wird kurz vor dem Vortrag auf www.cesifo.de bekannt gegeben

01.07.2002

Jon Danielsson
London School of Economics and Social Science

On the Feasibility of Risk-Based Regulation

08.07.2002

Fiorella K. Padoa Schioppa
Istituto di Studi e Analisi Economica, Rome

Italy's Growth Prospects

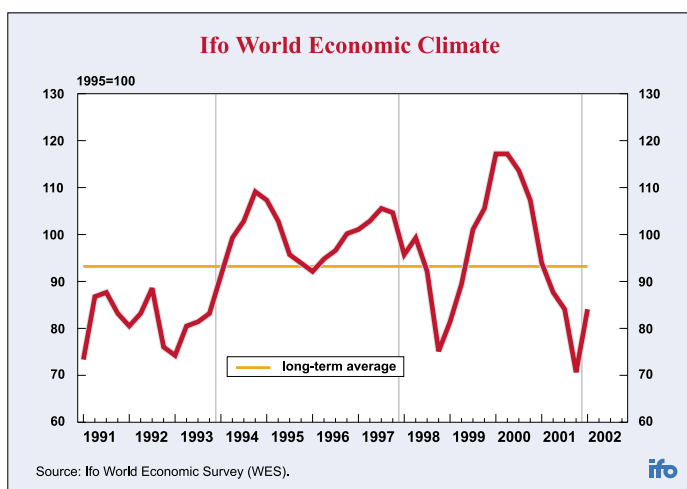
IFO NEWS

IFO WORLD ECONOMIC CLIMATE BRIGHTENS

In January 2002 the Ifo Institute conducted its 75th **World Economic Survey (WES)**. According to the response of 890 experts in 80 countries, the world economic climate improved somewhat and is now at the same level as in July 2001, i.e. before the terrorist attacks in New York and Washington (84.1 after 70.7 in October 2001, 84.1 in July 2001 and 117.2 at the peak in this cycle in April 2000; 1995=100). For this to be a clear sign of the onset of worldwide recovery, three consecutive, positive survey results are usually necessary. At this stage it cannot be ruled out that an initial improvement of the indicator will be followed by a renewed setback – as in the early 1990s – before a longer-lasting recovery phase starts. Thus, the next two surveys in April and July will be crucial for predicting the timing and the strength of the recovery.

U.S.A.: Increasing Signs of Recovery

In the United States the current economic situation is already perking up, though the signs are still weak.



Upswing?: World Economic Survey January 2002

However, optimism regarding economic developments in the next six months has increased sharply. New data support our view that the U.S. economy will pull out first from the cyclical trough. The assessment of the current situation in

most Western European economies deteriorated further. Germany again received the lowest marks for the current situation, closely followed by Austria, Belgium and Portugal. But the outlook for the next half-year improved markedly for Western Europe as a whole and especially for Finland and Germany. Below the European average were economic expectations for the United Kingdom, Ireland and Spain, while expectations for France and Italy hovered around the average. The assessments of the current economic situation in Eastern Europe remained almost unchanged, close to the "satisfactory" level. The expectations for the next six months show growing optimism.

The signs of economic recovery in the G7 area – particularly in the United States – are showing spill-over effects in Latin America. Brazil, the largest economy in this area, appears to have left the doldrums. The assessment of the current economic situation has emerged from negative territory and expectations for the coming two quarters improved even more, largely due to better export prospects. The economic climate is also relatively positive in Chile. By far the most negative assessments concerning the current economic situation came from Argentina, hit by a currency and banking crisis, followed by Uruguay, Paraguay and Bolivia.

Although the assessment of the current economic situation is low for Asia as a whole, the assessment for Japan is poorest, albeit bottoming out. Capital expenditures and private consumption are both rated near the bottom. Expectations for the performance of the overall economy by the end of the next six months deteriorated slightly compared to the last survey, but expected capital expenditures

improved, albeit to a level which is still dismal and the lowest of all Asian economies. The yen is considered at about the right level against the US dollar and pound Sterling, but overvalued against the euro. Not surprisingly, insufficient demand is held to be the most important problem facing Japan, closely followed by unemployment.

The assessment of the current economic situation of ASEAN and East Asian NICs has deteriorated further. The situation is again considered worst for Taiwan, followed by Hong Kong and the Philippines. The economic situation of South Korea, Malaysia and Thailand is considered to have improved, their ratings edging toward the middle of the scale. Expectations for the economic situation by the end of the next half-year have improved sharply, however, giving hope for a cyclical turnaround, especially in Taiwan and the Philippines.

Euro is still Regarded as Undervalued

The euro was still seen as undervalued against practically all currencies, though again somewhat less strongly than in the previous surveys. Conversely, the US dollar and the British pound continue to appear overvalued according to the majority of experts polled. After marked devaluations in recent months, the Japanese yen is now close to an appropriate level according to the majority of the WES experts. Unemployment and insufficient demand maintain their top position amongst economic problems.

IFO ANNUAL MEETING 2002

On 25 June 2002, the Ifo Institute will hold its 53rd Annual Meeting. Hans-Werner Sinn, President of the Ifo Institute, will give a presentation on the current and expected economic developments on the international and the German levels. The highlight will be the address by Werner Müller, Federal Minister for Economic Affairs. In the afternoon session members of the Ifo staff will present a review of work during the past year.

HS

TAXES AND ENTREPRENEURSHIP

Gordon

Roger Gordon, from the University of California at San Diego, will be visiting CES during the first two weeks of July. While in Munich, he will be presenting a joint paper with Julianne Cullen, from the University of Michigan, on the effects of taxes on entrepreneurial



Roger Gordon

activity. This paper first develops the potential effects of the tax structure on the incentives an individual faces to become self-employed and to pursue more risky ventures. It then uses U.S. data to see how large these tax effects have been in practice.

Another project with Joel Slemrod and Laura Kalambokidis that he will be finishing up while in Munich and then presenting at a CES conference in Venice, following his visit to Munich, compares various methods for measuring the marginal effective tax rate on investment, to see how robust these measures are to the many complicated aspects of both the tax law and behavioral responses.

While in Munich, he will also continue work on the appropriate tax treatment of the financial sector, building on a recent paper he has prepared with Alan Auerbach. Existing models of the tax structure have largely ignored the presence of money and the role of the financial sector, leading to continuing debate about how to extend past results on tax policy to the financial sector.

If time allows, he plans to continue work with Wei Li on the role that the financial sector plays in the structure of the tax system, as well as to start work on a project with Clemens Fuest and Bernd Huber dealing with the potential role of tax subsidies to debt finance to address adverse selection problems in the credit market.

DOES AIRPORT CONGESTION CALL FOR TRADITIONAL RECIPES?

Brueckner

The saga of American Airlines / British Airways failed merger brought into sharp relief the pivotal nature of airport landing slots: highly coveted, they are ultimately a measure of increasing airport congestion and their allotment can make or break open-skies treaties and even shoot down airline mergers. **Jan K. Brueckner**, a leading scholar in the area of urban and public economics, will devote part of his upcoming stay at CES in July to research on airport congestion pricing.



Jan Brueckner

His recent paper *Airport Congestion When Carriers Have Market Power* shows that the standard theory of congestion pricing does not apply to airports. The reason is that, unlike the road users depicted in the standard congestion model, airlines are not atomistic. Since much of the traffic at any given airport is often controlled by just a few carriers, airlines internalize a portion of the congestion they create, with each carrier taking account of the congestion it imposes on itself (impacts on operating costs and passenger time costs

are both considered). As a result, congestion tolls are reduced relative to the atomistic case, with the toll equal to the uninternalized portion of congestion caused by an extra flight. At a monopoly airport, where congestion is fully internalized, no toll is needed.

At CES, Brueckner will extend the model generating these results so that it better captures network effects. In particular, the analysis will recognize that

passengers at a congested hub airport are a mixture of local passengers (who are subject to the hub airline's market power) and connecting passengers (who benefit from competition through other hubs). The goal is to appraise the effects of these different degrees of market power on the internalization of congestion at the hub airport.

Brueckner, IBE Distinguished Professor of Economics, has published over eighty papers on urban economics, public economics, housing finance, and the economics of the airline industry.

MK

FACULTY NEWS

- Prof. **Stephan Klasen**, Ph.D., accepted an appointment at the faculty to head the Department for Empirical Economic Research that he previously headed in an acting capacity.
- Prof. **Jan-Egbert Sturm** accepted a call (C3, limited) to the faculty starting WS 2001/2002. Prof. Sturm is assigned to CES.
- Prof. **Andreas Haufler**, Department of Economic Policy (formerly Haffner), assumed his duties on 1 April 2002.
- Prof. **Viktor Steiner** accepted a C4 position at the Free University of Berlin.
- Prof. **Monika Schnitzer**, Department of Comparative Economic Research, was appointed member of the Scientific Advisory Council of the Federal Ministry of Economics and Technology.
- Prof. **Klaus Schmidt**, Department of Economic Theory, received the Gossen Prize

of the Verein für Socialpolitik.

- Dr. **Ariane Breittfelder** began work as Assistant to the Dean on 1 April 2002.
- In a new study by the Centrum für Hochschulentwicklung ranking German universities, the **Economics Faculty of the LMU** was the only faculty that ranked in the top in both categories (in "Research", along with Kiel and Mannheim, and in "Good Supervision, Fast Completion" along with Bayreuth, Konstanz, Regensburg, Trier and Tübingen).
- The **DFG** fully approved the application of the faculty for the establishment and funding of a graduate research training programme on "Markets, Institutions and the Scope of Government" at the Institut für Volkswirtschaftslehre starting on 1 October 2002.
- The **Munich Graduate School of Economics (MGSE)** will also be launched on 1 October 2002. The MGSE will be responsible for doctoral candidates.

The **7th Summer Ball** of the Economics Faculty will take place on 14 June 2002 at the lake-side restaurant "Undosa" in Starnberg, organised by the faculty's Alumni Club. It is sponsored this year by the Munich branch of **MLP Financial Services**.

THE GREAT ESCAPE: A NEW HISTORY OF THE INDUSTRIAL REVOLUTION

Clark

The economic history of the world is simple. It composes two regimes. Before about 1800, in the long Malthusian era, material living standards depended solely on fertility and mortality. Slow technological advance resulted only in population increases. Since 1800, the rate of technological advance in successful economies has been fast enough to liberate living standards from the Malthusian constraints, and to allow a twelvefold gain in living standards: but only for a favored group of economies. The great problem of economic history is first why this break between the old and the new worlds took place in England in the Industrial



Gregory Clark

Revolution of 1770, and second why only some countries escaped into the regime of constant economic growth? These problems have long fascinated historians. But in recent years economic theorists such as Robert Lucas, Nancy Stokey and Edward Prescott have turned their attention to this issue, so that there has been a recent spate of theoretical models of "the great escape". **Gregory Clark**, a scholar of quantitative economic history, will devote part of his upcoming stay at CES in July to research on these topics.

In his recent paper *The Meaning of the Industrial Revolution*, he proposes, through a detailed estimation of the real income of England from 1260 to 1869, and of the sources of income growth, to show that the problem has been insoluble because we have misdated the Industrial Revolution. There was nothing special about the events of 1770 in England. 1770 was just the latest of a series of episodic growth spurts that had occurred in England and elsewhere in Europe since at least the Middle Ages. England itself had significant economic growth in the 17th century. That is why no one can find the significant cause of the events of 1770. Nothing unusual happened. The seeming dramatic industrialization of the British economy in these years was instead the result of the unusual demographic experience of England compared to the rest of Europe, in conjunction with the expansion of the British Empire in the

early 19th century. This population growth combined with rapid productivity growth in small parts of the English economy spurred fast-paced structural change and urbanization. But similar events had occurred on a smaller scale in Europe in the years before. The true break between the old and new worlds came only in the late 19th century.

At CES Clark will be mainly working on a review article that appraises modern theories of the Industrial Revolution in the light of the significant advances in our knowledge of the facts of the Industrial Revolution within the last decade.

Clark is Professor of Economics at the University of California at Davis, where he has been faculty member since 1990. He received his B.A. from Cambridge University and his Ph.D. from Harvard University.

UH

CES visitor in June



Don Fullerton

University of Texas

His recent research includes the distributional effects of social security. In environmental economics, he works on household disposal of garbage and recycling, policies for green design, the effects of the Superfund clean-up program, vehicle emission control policies, and other second-best policies where direct environmental taxes are not feasible.

He received a BA degree from Cornell in 1974 and a PhD in Economics from Berkeley in 1978. He now holds the Addison Baker Duncan Centennial Professorship of Economics at the University of Texas.

THE QUEST FOR PPP

Binder

Recent empirical work on the purchasing power parity (PPP) hypothesis using long time series or panel data based unit root tests has yielded mixed evidence as to whether real exchange rates conform to the PPP hypothesis at least in the long run. Conceptual limitations of unit root tests add to the difficulties of drawing policy conclusions from this line of work. **Michael Binder**, Assistant Professor at the University of Maryland, will pursue this question while visiting CES in June.



In a joint project with M. Hashem Pesaran (U. of Cambridge) and Sunil Sharma (IMF) on the cross-country dynamics of nominal and real exchange rates, they are developing a new methodological framework for the analysis of PPP and its interdependence with countries' macroeconomic environments. This framework involves estimation of the long-run relations between prices, exchange rates, and control variables reflecting countries' macroeconomic environments within a heterogeneous panel vector autoregression. Using this framework, the aim is to provide a characterization of how the long-run equilibrium relations involving countries' prices and exchange rates as well as the speed of adjustment toward these long-run relations depend on such factors as a country's exchange rate and fiscal policies, its record of price stability, standard of living, current account balance, and openness toward international trade.

Beside the above project, Binder's current research focuses on the investigation of the effects of social interactions, uncertainty, and aggregation on macroeconomic outcomes, as well as the investigation of econometric and computational tools for rational expectations and dynamic panel data models. Recent papers and ongoing work specifically address issues in consumption and saving, in economic growth, and in asset pricing and exchange rate behavior. Suited to these issues, he will give a lecture course on Dynamic Panel Data Models and Cross-Country Studies in Macroeconomics.

UH

RESEARCH SEMINARS

Summer Semester 2002
Monday 3:15 p.m. CES, Schackstr. 4

15.4.02

Stefanie Kleimeier (Universiteit Maastricht)

European Financial Integration: Evidence on the Emergence of a Single Eurozone Retail Banking Market

22.04.02

Norman Braun (LMU, Munich)
Illicit Drug Consumption: Theories and Evidence

29.04.02

Angela Birk (HWWA Hamburg)
Technical Progress and Long-Term Unemployment in an Open Growth-Matching Model

06.05.02

Ralph Leonhardt (LMU, Munich)
Sovereign Risk, Spillover and Ownership Distribution in Foreign Direct Investment – A Conditional Tobit Approach

13.05.02

Sunil Kanwar (University of Delhi)
Does Intellectual Property Protection Spur Technological Change?

27.05.02

Silke Übelmesser (CES, Munich)
On the Optimal Timing of Implicit Social Security Taxes over the Life Cycle

03.06.02

Larry Blume (Cornell University)
Stigma and Social Control

10.06.02

Martin Steininger (Technische Universität München)

Info at www.vwl.uni-muenchen.de/ls_rady/seminar.html

17.06.02

Martin Dufwenberg (Univ. Stockholm)
Promises and Partnerships

24.06.02

Frank Smets (European Central Bank)
Monetary Policy in an Estimated SDGE Model of the Euro Area

01.07.02

Andreas Roider (Universität Bonn)
Asset Ownership and Contractability of Interaction

08.07.02

Sonia Bhalotra (University of Bristol)
Parent Altruism

15.07.02

Ulrich Doraszewski (Stanford University)
Info at www.vwl.uni-

ADVANTAGES OF SHOPPING ONLINE

Scott Morton

Internet-shopping is good for your wallet. And not just if you're after books or CD's. Professor **Fiona Scott Morton**'s recent research has found that if you're in the United States, you will pay lower



Fiona Scott Morton

prices for an automobile if you search for and contact a dealer through the Internet. In particular, she and her co-authors found that racial minorities pay higher prices for cars on average in offline transactions, but do not face discrimination when they shop online.

Her work on the effect of consumer search over the Internet on negotiated prices found that users of the Internet car service are disproportionately consumers who would have paid above average prices in the traditional channel; early adopters are those with the most to gain from using the technology.

While at CES in May, she will be working on how inventory levels at the dealership affect the price a consumer pays for her car. The dealer negotiates individually with the consumer and will use his own supply of the car as well as an assessment of the consumer's willingness to pay to set price. The relative importance of these effects is unknown; the latter will be reduced or eliminated by the Internet, but the former will not. In addition, Professor Scott Morton is interested in optimal pricing to consumers who exhibit standard "behavioral" traits and plans to work on a project in that area while in Munich.

Fiona Scott Morton is an Associate Professor of Economics at the Yale School of Management. She received her Ph.D. from the Massachusetts Institute of Technology and is currently a Faculty Research Fellow in the NBER Industrial Organization Program.

CK

JOINING THE EMU?

Calmfors

Could national fiscal policy be substituted for monetary policy as a national stabilisation policy tool in the EMU? This is one of the main questions **Lars Calmfors**, profes-



Lars Calmfors

sor of Stockholm University, will delve into while visiting CES in April and May. One of the most influential economists in this field, he chaired the Economic Council of Sweden in 1993-2001 and was councillor of the Swedish Government Commission on the EMU, which recommended Sweden not to join in the first round. In 2000-02 he has been a member of the the Swedish Government Commission on Stabilisation Policy in the EMU analysing the requirements on fiscal policy in the case of Swedish membership in the EMU. We are very proud that Lars Calmfors will take part in the **European Economic Advisory Group** at CESifo.

Another project Calmfors will work on is the effect of the EMU on wage setting. One key issue is whether the loss of monetary policy as a national policy tool to counter asymmetric shocks in the EMU will lead to more nominal wage flexibility. His project examines how the incentives to use contingency clauses, such as wage indexation, and the length of wage contracts is likely to be affected. The main conclusion is that the EMU creates incentives to use such contingency clauses and to shorten wage contracts, but that the effects are likely to be limited. A second key issue concerns the effects of a common monetary policy on the equilibrium rate of unemployment. It has been claimed that the strategic interaction between monetary policy and wage setting in a country outside the EMU is likely to provide incentives for more wage restraint than is the case with EMU membership. The basis for these claims will be examined in a model with explicit micro foundations, but which at the same time captures relevant aspects of trade union behaviour.

UH

RICHARD ARNOTT: ROADS AND MAGNETISM

Roads have always played a major role in **Richard Arnott's** life: the road from his native London to Boston, by way of Canada; his road from would-be nuclear physicist to renowned economist, and the congested roads of our world, the use of which he would like to rationalize.



Bit by bit, he unravels to us the roads traveled from childhood to this spacious, sun-bathed office at CES in Munich.

"We emigrated to Canada in 1960, when I was 11 years old," he begins. After the British boarding-school regimentation, it was like being born again: "Canada became my favorite country." Studies, however, brought him later to the U.S.

"As a child I thought I'd be a doctor, like my parents and other relatives". But in high-school in Canada, he decided he wanted to be a nuclear physicist, so he headed for MIT. Differential equations put him off, though. "And I had a problem with magnetism, too," he adds.

So, on to theoretical chemistry. That didn't quite work out either.

He felt somehow attracted to architecture. As he did not consider himself "very artistic," he steered towards computer architecture: that could be it. His teacher was no less than the guru of atoms-to-bytes, **Nicholas Negroponti**. While at it, he took courses on city planning, transportation, and civil engineering.

He wanted Literature as a minor, but he decided instead to follow "a sort of interest" for Economics—and found that he was good at it.

He then decided to take a year off, "to improve the world", studying development. He went to Canada, then to Yale. And, almost by accident, he found an inspiring professor: Nobel-Prize winner

Joseph Stieglitz. He spent a month at Oxford with the laureate, and once, 10 hours on the phone with him working on his thesis.

He hasn't given up trying to improve the world. He now devotes much study to rationalising the use of roads and streets. "European cities were founded before the advent of the car, but have adapted better to it", he muses. Fittingly, in Munich he has devoted a month ("beats a holiday") to refining economic models for road pricing, staggered working hours, and the economics of bicycling, while writing a book on Transportation Economics with Ronnie Schöb. He also dictated some well-attended seminars on the subject.

Meanwhile, dusk has engulfed the city: listening to him, three hours have gone by unnoticed. Not bad for someone who has a problem with magnetism.

JS

RENEGOTIATING SOVEREIGN DEBT

The renegotiation of sovereign debts has been a protracted and costly process for many countries. **Kenneth Kletzer**, Professor of Economics at the University of California, Santa Cruz, will devote part of his forthcoming stay at CES to this subject.



Recently, proposals have been made for reforming the framework of international financial capital markets to reduce the income losses suffered by residents of crisis countries. These include the adoption of collective action clauses in sovereign bond contracts and the establishment of an international tribunal to restructure emerging market country debts. Kletzer's project investigates how this change might affect the social costs of renegotiation and the terms on which initial loans to developing countries are made, among other aspects.

BENNETT MCCALLUM: THAT MISGUIDED STRAND

One small but prominent strand of the recent literature in monetary economics is misguided, according to Carnegie Mellon University's **Bennett McCallum**, who will be visiting CES in May. It is the strand featuring rational expectations "indeterminacies" that occur under various conditions pertaining to policy-rule design. McCallum emphasises that the aberrations in question reflect multiple (real) solutions of the "bubble" or "sunspot" type, not purely nominal indeterminacies of the type discussed in the classic monetary writings of Lange, Gurley and Shaw, Johnson, and especially Patinkin. He argues that there are several reasons to believe that the multiple-solution indeterminacies represent mathematical curiosities that are of no relevance for actual policymaking. One reason is that the solutions involving problematic results are not E-stable or adaptively learnable, as explained in the extensive theoretical contributions of Evans and Honkapohja. By contrast, the minimum-state-variable solution exists, is unique, is learnable, and is perfectly well-behaved in the analytical settings under discussion. Applications of this analysis pertain to the "fiscal theory of price level determination," as well as warnings against monetary rules based on expected future inflation rates and suggestions of liquidity traps generated by global indeterminacy under Taylor rules.



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