

CESifo Bulletin

Volume 12, No. 1 • January 2002



ISPE Conference	UTMS Auctions	IFO News	Research Seminars	Venice 2002
Preparation is underway for the second stage of this two-part conference	The lessons to be learned from radio spectrum auctions	The economic mood darkens in Germany, according to the latest Ifo survey	From bank relationships to young people's decision to leave home	It is that time of the year again: economic policy discussions in a superb setting

NON-LINEAR PRICING

Sophisticated contracting and non-linear pricing schemes are commonly used by a large array of institutions in order to better meet their objectives when dealing with agents that have private information.

Non-linear pricing problems (or more generally, contract design problems) in the presence of self-selection and private information have received much attention by economists over the past two decades. Unfortunately, much less is



Lars Stole, CES guest in February-March

known about the design of optimal non-linear pricing in competitive settings.

Lars A. Stole will visit CESifo in late February and early March, 2002, to explore competition in these richer and more realistic settings. While at CES, Professor Stole will also lecture on the closely related topic of price discrimination in competitive environments. The three lectures on price discrimination will be based on a forthcoming chapter in the *Handbook of Industrial Organisation* which Professor Stole will also be finalising while in Munich.

When one airline is designing its price-segmenting menu of ticket prices and associated ticket qualities, it must take into account the presence of other competitors who also offer competing

schedules of prices. How does this strategic effect impact the firm's output and average price? The presence of competition introduces numerous difficulties in our understanding of non-linear pricing and our intuitions about competition in simple pricing environments cannot easily be applied to the more complex non-linear pricing setting. This is particularly unfortunate because competition is present in most interesting non-linear pricing environments.

Professor Stole's current research program focuses on three distinct areas: (i) bargaining within organisations, (ii) social exchange, and (iii) the impact of

(continued on page 2)

CONFERENCE ON THE EU COMMISSION REPORT ON COMPANY TAXATION IN EUROPE

This October, the EU Commission released an important report on Company Taxation in Europe. That long-awaited document formed the core of a conference jointly set up by CESifo and Belgian FUCaM's Arpege, held in Mons, Belgium, on 7-8 December. In addition to the conference's key focus on this report, the discussions were actually much broader, with empirical and theoretical contributions on the relationship between taxation and FDI as well as the costs of capital and investment, effective tax rates and tax designs. A selection of

(continued on page 2)

CORPORATE GOVERNANCE IN GERMANY

Jeremy Edwards, a well-known CES guest, will visit us again in February 2002. Currently a Reader in Economics at Cambridge University's Faculty of



Jeremy Edwards, CES guest in February

Economics and Politics, where he got his B.A., he is engaged in the field of applied economics, pursuing his long-standing interest in public economics, corporate finance and corporate governance. He is

(continued on page 2)

MUNICH SEMINARS WINTER SEMESTER 2001/2002

14.01.2002

Francesco Giavazzi

IGIER, University of Bocconi

Macroeconomic effects of regulation and deregulation in goods and labor markets

28.01.2002

Guy Kirsch

University of Fribourg, Switzerland

Die Osterweiterung der EU – Integration oder Desintegration?

18.02.2002

Karl Homann

Ludwig Maximilians University, Munich

To be announced

22.04.2002

Ignazio Angeloni

European Central Bank

Policy Devolution in the European Union: Theory and Evidence

*(continued from page 1)***NON-LINEAR...**

competition on contracts (including non-linear pricing, price discrimination, and regulation).

For example, a government agency may wish to procure a specialised product from a single producer, but the producer alone knows the marginal cost of the output. In this case, the government may wish to offer a schedule of prices and purchased quantities (i.e., a non-linear pricing scheme) while letting the producer decide how much to supply. By careful design, the government can reduce its expected price of procurement. Similarly, firms with monopoly markets often offer menus of prices and corresponding qualities, allowing the consumer to choose which features to add to the base product. In these settings, the consumers know their valuation of the product's quality, but the firm does not. By carefully designing the menus of prices, a firm can increase its expected profit per consumer.

Professor Stole received his PhD from the Massachusetts Institute of Technology in 1991; prior to that he studied at Yale University, the London School of Economics, Harvard Law School, and the University of Illinois in Champaign-Urbana. He also served as an editor for the RAND Journal of Economics from 1997 to 2001. He currently holds the David W. Johnson Professor of Economics Chair at the University of Chicago Graduate School of Business where he has served on the faculty since 1991.

JS

*(continued from page 1)***CORPORATE GOVERNANCE...**

now working on the theoretical aspects of taxation and international trade, and on aspects of the German corporate governance system, the subject matter for his forthcoming stay at CES.

The research on German corporate governance is part of a new project with **Wolfgang Eggert** of the University of Konstanz and **Alfons Weichenrieder** of CESifo and the University of Vienna. This project will build on earlier work presented in the CESifo Working Paper 193 (1999) on *Ownership Concentration and Share Valuation: Evidence from Germany*, co-authored by Alfons Weichenrieder, and in Edwards and Nibler

(2000), *Corporate Governance in Germany: The Role of Banks and Ownership Concentration*, ECONOMIC POLICY 15. A particular aim of this project is to establish robust empirical conclusions about various aspects of German corporate governance by assembling a panel dataset. The questions to be addressed include whether concentrated ownership of listed companies in Germany has a positive or negative overall effect on minority shareholders, and how managerial compensation affects the performance of German companies.

Edwards received his D.Phil. in Economics from Oxford University. Since 1979 he has taught at the Faculty of Economics and Politics at Cambridge University.

MK

Eggert**MANAGERIAL COMPENSATION AND COMPANY PERFORMANCE**

Wolfgang Eggert will visit CES in February. Currently at the Economic Policy Research Unit at the University of Copenhagen, he concentrates on issues of international taxation, political economy of market integration, fiscal federalism, and the German tax reform.



Wolfgang Eggert, CES visitor in February

Eggert's most recent work deals with the role of international agreements to limit harmful tax competition for mobile tax bases between governments within an economic union or federation. In particular, this work emphasises that measures of tax co-ordination cannot be anything else than equilibrium strategies of the players. The existence of an equilibrium selection problem therefore is the logical prerequisite for policy co-ordination in situations where countries perceive a pressure on public spending caused by the

international mobility of tax bases, but cannot refer to any outside enforcement agency. Results -rather surprisingly- indicate that governments often can coordinate on the efficient equilibrium in the presence of perfect markets. In contrast, the scope for international tax agreements may be limited when governments are forced to use fiscal policy to counteract (domestic) market imperfections. However, when market imperfections are a primary cause for a prisoner's dilemma problem in international taxation, then an interesting aspect for further research on optimal fiscal policy is to identify cases where relevant market imperfections are supported as an equilibrium outcome.

During his stay in Munich, Eggert plans to pursue research jointly with **Alfons J. Weichenrieder** (Vienna and Munich) and **Jeremy S. Edwards** (Cambridge), focusing on the characteristics of corporations that may fruitfully help to explain the relation between company performance and the structure of compensation of the board. This is an important issue for both empirical and theoretical research, since it can be expected that the structure of the board's compensation alters the attitude towards profitable but risky investments.

*(continued from page 1)***COMPANY TAXATION ...**

contributing papers will be published in a future issue of *Ifo Studien*.

The presentations were supplemented by a round table discussion with **Matthias Mors**, **Sjibren Cnossen**, **Peter Birch Sørensen**, **Silvias Giannini**, and **Frans Vanistendael**. It became clear that the fundamental question when judging the EU Commission's report is whether one sees tax competition as a harmful or a harmless phenomenon. For the EU Commission, tax competition *per se* is nothing negative, especially as so far no race to the bottom in the effective tax rates can be observed. This position, however, was not shared by everybody. For those who consider tax competition as a threat to the corporate tax systems, full harmonisation is the long-term goal with a step by step approach starting, for example, with a harmonisation of the tax base and leading to a harmonisation of tax rates.

For further information see our web site: www.cesifo.de/orcl/dbssi/past_conf2.htm#cci01

SÜ

Pischke**TRAINING HUMAN CAPITAL**

Why are markets for vocational training organised in such different fashion in different countries? The German apprenticeship system involves large efforts by business companies, which spend their own resources on the training. In the US, on the other hand,



Jörn-Steffen Pischke, CES guest April

most vocational preparation takes place in schools and is paid for by the students through fees.

Jörn-Steffen Pischke, currently a Reader at the London School of Economics, will visit the CES in April 2002 to delve deeper into these and other issues related to labour economics and human capital, his main areas of interest.

In a series of papers with Daron Acemoglu, Pischke tries to explain these differences by differences in the structure of the labour markets in these countries. Their research predicts that firms should be more willing to pay for the training of their workers in a labour market in which job mobility is low and union wage setting is important, as in Germany. One implication of this research is that firms and apprentices should share the returns of training.

During his stay at CES, Pischke plans to investigate what the payoffs of apprenticeship training are for workers. This is of high interest because the German apprenticeship system is often seen as a model institution, not just in terms of producing a skilled workforce, but also in terms of the results it delivers for the apprentices. However, much of the observed difference in earnings between apprentices and school leavers without

further qualification could just be due to the selection by training firms, who pick the most qualified school leavers.

Pischke received his Ph.D. from Princeton University and worked for two years at the Center for European Economic Research (ZEW) in Mannheim, before spending seven years as an assistant professor at MIT. He is also a co-editor of the *European Economic Review*.

SB

CESIFO CONFERENCE SPECTRUM AUCTIONS AND COMPETITION IN TELECOMMUNICATIONS

In most European countries, the past few years have seen several public auctions of radio spectrum licences -known as UTMS licences- by national governments. Judging that the time was ripe for discussing the lessons that can be learned from these auctions, CESifo organised a conference, held in Munich in November 2001, intended to shed light on questions regarding auction behaviour and auction design, linking both aspects to regulatory issues and problems of competition policy.

Theoretically, auctions represent a very efficient way to allocate scarce resources. However, when the resource in question is a bit of the electromagnetic spectrum, implementation can be tricky indeed. This was clearly in evidence at the presentations and in the lively discussions on the benefits and problems of increased competition in telecommunications. How can competition be strengthened? How does the actual allocation of spectrum influence future interactions amongst winning bidders, regulators and consumers? Are the efficiency gains obtained through a flexible auction design outweighed by the risk of a concentrated market structure? These were some of the main issues brought up for discussion.

There are no clear-cut answers. But the discussions clearly spelled out the need for carrying out substantial research on these issues, bringing together leading experts in auction theory and telecom regulation.

For further information, check this page of our web site:

www.cesifo.de/orcl/dbssi/past_conf2.htm#umts01.

CONGRATULATIONS!

We are delighted that our network members are being recognised for their contributions to the field of economics. Our first congratulations go to **Domenico Siniscalco** of the Fondazione Mattei, Milan, who has taken over the position of Director General of the Italian Ministry of the Economy. Secondly, let us congratulate **Christian Gollier**, University of Toulouse and a CESifo Area Co-ordinator, who is co-winner of the Paul A. Samuelson Award for his book *The Economics of Risk and Time* (MIT Press).

CES visitor in February - March

Richard Arnott

Research Interests:

Public Finance, Urban Economics, Theory of Contracts and Insurance, Nonconvexities and Transactions Costs

RESEARCH SEMINARS

Winter Semester 2001-2002

Mondays, 3:15 pm, CES Seminar Room, Schackstr. 4, Munich

14.01.02

Armin Falk, Ludwig Maximilians University:

Contractual Incompleteness and the Nature of Market Interactions

21.01.02

Hermann Gartner, Ludwig Maximilians University, Munich:

Household Formation and Employment in Germany: Determinants of Young Peoples' Decision to Leave Home

28.01.01

Felix Münnich, London School of Economics:

To be announced

04.02.02

Elena Carletti, University of Mannheim:

The Structure of Bank Relationships, Endogenous Monitoring and Loan Rates

Ifo NEWS

ECONOMIC SURVEY INTERNATIONAL: WORLD ECONOMIC CLIMATE FALLS TO ALL-TIME LOW

According to the latest Ifo survey of 833 economists at multinational corporations in 79 countries (7th ESI of October 2001), the World Economic Climate index fell sharply to 70.7 (October 2000: 84.1; 1995=100), marking the lowest level since the introduction of this survey in Spring 1981. Inflation expectations receded almost everywhere, whereas lack of demand is currently considered the most important economic problem. Bright spots in this gloomy picture are expectations pointing to economic recovery in the course of the next six months, particularly in the United States, Norway and Germany, as well as most Eastern European and CIS countries. ESI experts increasingly expect short-term interest rates to decline further in the next six months.

Western Europe: Hopes for a cyclical bottoming-out are postponed

In most European countries assessments of the current situation deteriorated further and -with the exception of Finland, the Netherlands, Ireland, Spain,

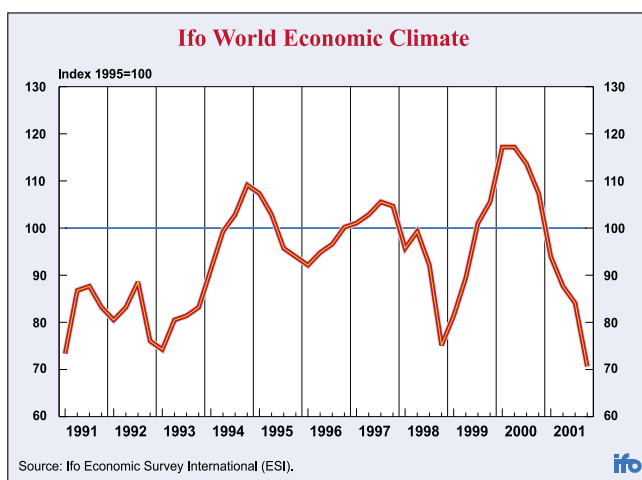
rated lowest in Germany and Portugal. It remained above average in Norway and Greece.

The United States: Sharp slowdown but positive expectations

The current economic situation cooled off sharply, reaching only 2.2 on a 9-point scale, which is significantly lower than in Western Europe (4.3) and the world average (3.5). Expectations for the next six months remain positive, however, despite some deterioration (5.8 compared to 6.7). This constellation of data supports the view that the US economy will pull out first from the cyclical trough. A positive signal is the improved outlook for capital expenditures which were hit particularly hard in the recent downswing. Growth of private consumption, in contrast, is expected to slow further in the next six months.

Asia: Economic Climate deteriorates sharply

Expectations of economic developments in the next six months deteriorated significantly; assessments of the current situation remained unsatisfactory but did not worsen further. In China the current business situation was assessed as somewhat more favourable whereas expectations trended down. In India the current situation is showing signs of improvement and expectations, while deteriorating, have not entered negative territory as is the case in most other countries in the region. Similarly, low assessments of the current situation, similar to those during the Asian crisis, are reported in Taiwan, the Philippines, Singapore and Japan.



Roller-Coaster: ESI October 2001

Greece, and Switzerland - are below the "satisfactory" threshold. Expectations for the next six months also deteriorated almost everywhere after having shown signs of improvement in the previous two surveys. The current situation was

RECENTLY COMPLETED PROJECTS

Effect of Pension Reform on the Actual Age of Retirement

From 1969 to 1995, in Germany the average actual age of retirement fell from

65.2 to 60.5 years for men and from 62.3 to 58.4 years for women. During the same period of time the remaining life expectancy of a 55 year-old man rose from 19.14 to 21.83; for women it was significantly higher. While this development may be welcomed by the individual, it causes high costs for the pay-as-you-go retirement fund: pensioners are receiving pensions for an ever longer period of time, but these pensions must be financed by contributors who are working for an ever shorter period of time. The Ifo Institute compared the pension reform effective 2002 with alternative reform proposals. The findings showed that the pension reform 2002 distorts the actual age of retirement more strongly in the long term than the reform proposed by Minister Riester in the summer of 2000, which contained a compensation factor for the calculation of the initial pension payment. This means that the pension reform now passed will make early retirement even more attractive than the rejected reform proposal of 2000. The Ifo calculations have shown in particular that none of the reforms makes real progress in reducing the incentives for early retirement. A non-distorting pension system ought to contain actuarially equivalent additions to or reductions from the pension in order to balance the losses from additional contributions and the sacrifice of pension payments when retiring later. Such a reform ought to start with a retirement entry-age factor.

(R. Fenge, "Early Retirement: Incentives of current pension reform proposals", *ifo Schnelldienst* 23/2001, 17-22, in German).

West German Industry Will Invest Less in 2002

According to the results of the Ifo Investment Survey, to which more than 1800 west German industrial firms responded in September and October 2001, the manufacturing industry spent 3% more on plant and equipment in 2001 (EUR 47.5 billion) than in 2000. Based on the spring survey, a 6% increase had been expected. Strikingly, big companies in particular raised their capital spending

by the amount planned originally, while the SMEs invested less than planned in the spring. Consequently, the consumer goods manufacturing industry, which is dominated by SMEs, reduced investment whereas it was raised in other branches.

In view of the present economic uncertainty, the willingness to invest of manufacturing firms has declined widely. The poor sales outlook, falling capacity utilization, and the wage demands of the unions have reduced profit expectations and hence clouded the investment climate. Nonetheless, in autumn 2001 35% of the firms surveyed still planned to raise capital spending in 2002, 29% planned reductions, and the remainder wanted to invest as much as in 2001. If the qualitative answers are quantified with the help of the rates of change re-reported by the firms, the west German manufacturing industry may be expected to spend around 2% less on plant and equipment than in 2001. (Since a part of the responses were submitted before 11th September, a bigger reduction of investment spending may not be precluded. This is also supported by a telephone survey conducted by the Ifo Institute in November 2001).

(A. Weichselberger, "West German Manufacturing in 2002: Planned Investment to Decline by 2%", *ifo Schnelldienst* 24/2000, 52-57, in German)

HS

Garretsen

GEOGRAPHICAL ECONOMICS

Harry Garretsen, professor of economics at the University of Nijmegen in the Netherlands, will visit CES in January.

With a Ph.D. in economics from the University of Groningen and a stint at the Dutch central bank, he has oriented his research towards the effects of capital



Harry Garretsen, University of Nijmegen

market imperfections on growth and investment and the transmission of monetary and fiscal policy in the EMU.

Starting with work by Paul Krugman in the early 1990s, mainstream economics has witnessed the rise of the so-called *new economic geography* approach, which aims at developing a sound theoretical foundation for the analysis of the

location of economic activity. Garretsen, together with his colleague **Steven Brakman** from the University of Groningen, prefer the label *geographical economics* instead of *new economic geography*, so as to emphasise that this branch of economics strives primarily to put some geography into economic trade and growth models.

It is in this field, specifically on the importance of location for trade and growth, that Garretsen -together with Brakman- will focus his research during his stay at CES, working on the empirical and policy relevance of geographical economics.

As regards empirical relevance, the main question is whether and how to test for the impact of agglomeration forces on regional wages and employment (see also their CESifo Working Paper No. 395); policy relevance, in turn, deals for instance with the way in which policy competition across the EU may become less likely when agglomeration forces are taken into account.

Harry Garretsen, together with Brakman and Charles van Marrewijk, has published extensively on the subject. Their latest work is *An Introduction to Geographical Economics* (2001, Cambridge University Press).

CK

Widgrén

DECISION MAKING IN THE EU

Mika Widgrén, Professor of International Economics at Turku School of Economics and Business Administration, Finland, will visit CES in February this year.

Widgrén's primary research interests converge on institutions of economic integration and their design, and on the power relations among the actors in these institutions. He has published extensively on decision making in the European Union in academic journals, but also in policy-oriented outlets. A recent example of the latter is *Nice Try: Should the Treaty of Nice be Ratified?*, a

joint publication with Richard Baldwin, Erik Berglöf and Francesco Giavazzi.

The results of the Nice summit limited themselves mainly to voting rules in the Council of Ministers, leaving more fundamental interinstitutional considerations for the future.

Widgrén wants to address some of these future considerations while at CES, focusing on the design of inter-body relationships in EU decision making and on strategic aspects of the power of these bodies' actors. In addition, he will delve into Eastern enlargement of the EU, as it

will exert a significant impact on EU legislating institutions and on decision making at the European Central Bank. These topics, analysed both theoretically and empirically, will form Widgrén's research agenda while at CES, and incidentally are also the issues that will form the basis of the EU's next intergovernmental conference, planned for 2004.

Widgrén got his Ph.D. in 1995 from the University of Helsinki, where he also teaches. Additionally, he is Associate Research Fellow at the Research Institute of the Finnish Economy in Helsinki.

FW

Announcing

CESifo International Spring Conference
Prospects for the European Economy
March 21 - 22, 2002
Kardinal Wendel Haus, Munich

ISPE CONFERENCE: SERVING THE MARKET ECONOMY

Preparations are underway for the second stage of the CESifo-hosted conference on *Labour Market Institutions and Public Regulation*, while participants digest the issued raised and ideas exchanged during the conference's first stage, held at the CESifo Conference Centre in Munich on 26 - 27 October 2001. The conference is a joint initiative of CESifo and the International Seminar in Public Economics (ISPE).

At the first stage, the speakers were invited to present and discuss the draft of their respective papers. The conference focused on which fiscal arrangements, labour market institutions and public regulations best serve a modern market economy. A reduction in the amount of labour market regulation may be common advice for policy makers, but these regulations may nevertheless prove beneficial in protecting workers from excessive shocks and economic uncertainty, thus counteracting market failures and serving equity objectives.

The papers submitted tried to give answers to such questions as what the impact of employment protection legislation on economic growth might be, what determines the optimal level of unemployment insurance, how an economy might lose its scope for redistribution in globalised markets, or how subsidisation of education might serve as a second-best means for redistribution.

A second strand of papers tried to evaluate the success and drawbacks of existing labour market programmes and reforms in different European countries such as Sweden, Austria, Spain or Italy. The findings of the papers were quite mixed, but generally speaking they questioned the usefulness of large-scale programmes to reduce unemployment effectively.

The final versions of the papers will be presented at the second conference, to be held on 3 - 4 June 2002 in Cadenabbia, Italy. If you are interested in this conference, please contact the CESifo office for more information.

Flâm

LEARNING EQUILIBRIUM PLAY

Sjur Didrik Flâm is a mathematician by training and an economist by choice. It was therefore natural that he would orient his main area of research towards mathematical economics. Historically, his focus has been on game theory, finance, and insurance. More recently, his work has concentrated on understanding ways in which equilibrium can be learned,



Sjur Didrik Flâm CES visitor in February

approached, and reached. Complementing this research will be the purpose of his visit to CES in February, 2002. He joins us from Norway, where he is a professor of economics at the University of Bergen.

Non-co-operative game theory provides social science with concepts and focal points, but not quite to satisfaction. Questions arise when theory offers several solutions, some of which are unstable, and each of which is declared a Nash equilibrium. Further discontent stems from silence about how (if at all) equilibria can be reached. To mitigate such defects, and inspire or restore faith in equilibrium, one must come up with appropriate models of repeated play. These models should ideally produce Nash outcomes in the long run and help to discard non-credible behaviour. For the sake of realism, such models should be fairly decentralised and tolerate parties who hold moderate competence and information. They also ought to accept that not much computation or communication goes on during play. If Nash equilibrium becomes asymptotically stable all the same, then that configuration ultimately portrays players as skilled and enlightened. In other words: agents may in the end appear cleverer than they actually are.

The literature already offers several studies of strategic interaction over time.

Some notable examples include fictitious play, Bayesian learning, minimising conditional regret, and on-going testing of hypotheses. Common to these studies is the prime position –and almost exclusive attention– given to finite-strategy games, as well as to best responses, or variants of such behaviour, at every stage.

Prof. Flâm's purpose is to complement these studies in accommodating agents who contend with marginal improvement at each round of play. In doing so, he will continue a tradition that goes back to Rosen (1965). Some novelty comes broadly as follows: Each player is likely to regard his marginal payoff with one prime concern in mind, namely Does that item indicate prospects for improved outcome? If indeed it does, he naturally goes on to enquire whether his most recent –or actually contemplated– move complies with the said marginal incentive. If not –if the planned direction or speed of strategy change does not quite fit– there is room and reason for distorting it by appropriate acceleration.

RJ

Ahsan

RISK AND THE CHOICE OF THE TAX BASE

Since the days of his doctoral dissertation, the theme of risk and taxation has been **Syed Ahsan's** big passion and a key focus of his research. A professor at Concordia University in Montreal, Ahsan plans to work on the Nordic dual income tax –which is increasingly gaining endorsement for possible adoption in the greater EU– during his upcoming visit to CES in April-May, 2002. The range of issues spans from (a) simple efficiency aspects (of the level playing field in the treatment of corporate capital and personal capital tied up in closely held organisations), (b) to the differential role of human capital risks vs. that in physical capital, and finally, (c) to one of optimality.

During Ahsan's first visit to the University of Munich in 1989, he was working on the tax base issue. By then **David Bradford** and others had completed a major research project proposing the adoption of consumption as the desirable tax base to replace the income base. They had shown that the two alternative modes

of implementing the consumption base, namely the cash-flow tax and the "pre-payment" tax (essentially wage taxation), were indeed equivalent. In view of the simplicity of the second method, it was argued that actual implementation would be easier with the latter. While the US Treasury declined to



Syed Ahsan will be visiting us in April-May

embrace the consumption tax *per se*, researchers have continued the debate.

Ahsan's focus in this area has been to develop a better understanding of the changes that may be called for in interpreting the possible equivalence of the two modes of implementing the consumption base in light of capital risks. In a series of papers (most recently together with Peter Tsigaris), Ahsan has shown that efficient risk allocation across generations via the cash-flow method leads to a Pareto superior outcome vis-à-vis the pre-payment (i.e., wage) tax. The policy perspective also dictates that the former be adopted via registered pension plans (e.g., RRSPs in Canada or the IRAs in the U.S.).

SÜ

Askildsen

HEALTHY LABOUR

Jan Erik Askildsen, associate professor at the Department of Economics, University of Bergen, Norway, will visit CES during April 2002.

Since 1998, Askildsen has been the research director for the Program for Health Economics in Bergen, an undertaking aimed at establishing a more permanent centre for research in health economics in Norway. Askildsen has endeavoured to address a significant problem within Norway's public health

care sector, namely the shortage of skilled nurses, by being involved in empirical studies of this problem using a quite unique Norwegian panel data set.

While at CES, Askildsen will further pursue his primary fields of interest: health economics and labour economics, with emphasis on labour market issues of relevance for health personnel in general and nurses in particular. He will also continue his research on the study of sickness-related absenteeism and on the role of works councils. The latter project is in co-operation with **Uwe Jirjahn** at University of Hanover and **Stephen Smith**, of George Washington University. Workplace investment in health and safety, in pollution abatement, and in training may be less than optimal due to



Askildsen will visit CES in April 2002

public-good aspects and problems of credibility and communication between employees and company management or owners. Works councils may be a vehicle for better decision-making both among the group of workers, and for bargaining between workers and management regarding work conditions and work environment.

Askildsen *et al.* are making use of four waves of a panel study of manufacturing establishments in the German state of Lower Saxony to investigate investment in relevant workplace public goods, and whether works councils contribute to more or less investment in training, and in health- and safety-related measures.

Askildsen attained his Ph.D. at the Norwegian School of Economics and Business Administration. His current projects involve the study of nurses' labour supply, sickness absenteeism, company-related health insurance and the role of works councils.

TE

Vartiainen

GAMES ARE A SERIOUS BUSINESS

Hannu Vartiainen, Research Director of the Yrjö Jahnsson Foundation, will visit CES in March 2002.

Vartiainen's domain of interest lies in economic theory. He has contributed to game theory, implementation theory and bargaining theory. For example, he has derived the complete characterisation of social choice rules that can be implemented in a subgame perfect Nash equilibrium. One corollary of the characterisation is that practically any bargaining solution can be implemented by some game form.

On the more applied side, Vartiainen is interested in auction design. His main result concerns the design of auction mechanisms when the rules of the mechanisms can be redesigned in the middle of the game. To analyse the problem, a non-cooperative solution is refined by entertaining the vNM stable set. This simplifies the problem greatly, and a generalisation of the famous Coase conjecture can thus be easily established. With



Vartiainen brings economic theory and games together

Klaus Kultti (University of Helsinki), Vartiainen demonstrates that the approach can fruitfully be used to analyse more general bargaining situations.

While at CES, Vartiainen plans to conduct new research on optimal auction design with the possibility of resale. This problem is not only theoretically intriguing but also highly relevant in view of the current wave of privatisations. During his stay in Munich, he will also teach a course on Social Choice and Implementation Theory.

UH

HOW SWISSAIR COULD HAVE BEEN SAVED

As Swissair went into a tailspin last September, few expected it to actually crash-land, as it eventually did. Then, the view set in that, given the prevailing conditions, its fate was all but inevitable. **Oliver Hart**



(above), who gave a lecture series that touched on the matter, begs to differ. Swissair, had the proper bankruptcy framework been in place, could have been saved.

Hart's brilliant lectures were part of the highlight of this year's academic life at CES. In the footsteps of **Avinash Dixit**, **Anthony Atkinson**, **Jean Tirole**, **Paul Krugman**, **Rudiger Dornbusch**, **Guido Tabellini**, and **Peter Diamond**, **Oliver Hart** was awarded as eighth Distinguished CES Fellow.

In his three lectures entitled *Firms and Markets*, Oliver Hart presented a lively outline of his and others' work on business company theory. Since Coase's seminal work on this topic, economists have come up with three main reasons why markets may not work well and why firms can sometimes do better. They are: the existence of relationship-specific investments, the difficulty of writing good contracts, and the fact that people cannot be trusted for calling for intervention rights.

As Oliver Hart made clear, the main ideas can be applied to many examples. One of them is bankruptcy reform, since the ideas concerning incomplete contracts or intervention rights can be easily used to understand how a firm should finance itself, whether it should borrow or issue shares, and what should happen if it cannot pay back its debt.

Let's assume you are an entrepreneur and you need capital for a new project. One way you can get it is to issue shares to outside investors. Of course, the

investors may be worried about simply giving you the money with the hope that one day you will pay it back. They want some protection. One way to get protection is to acquire voting control. And if the investors have the majority of votes, they can replace you if they think you are not performing well.

But this is only one side. On the other hand, giving voting control away may decrease your incentive to innovate. Also, you may worry that if things start to go wrong the investors will kill the project. One way to solve this trade-off is to finance your project with debt. If you as the entrepreneur repay the loan, you retain control of the project. And if not, you will lose control and the financier can terminate the project and have it liquidated. This strategy encourages the



Grounded: Truly inevitable?

entrepreneur to make repayments, since otherwise he loses control, and to protect the investor.

Things become more complicated if there are many creditors and lenders. If each one has the right to liquidate part of the project, then the problem is that there may be a race to be the first, and it is more likely that a potentially valuable project may thus be dismantled. That is, while it may be in the collective interest of all creditors that the project continues, individual action may not lead to this.

There is an obvious solution to this problem. Instead of allowing each creditor to liquidate part of the project, carry out an automatic debt-equity swap whereby the former creditors become the new

owners of the project. Now, the new owners will collectively decide on the project, and if it is worth more alive than liquidated, they will refrain from terminating it.

From the viewpoint of Oliver Hart, it is a pity that Switzerland does not currently have such a bankruptcy proposal for airlines. He believes that many of the recent problems Swissair faced are the result of creditors' collective actions, in particular, the fact that senior creditors like UBS or Credit Suisse had no real interest in saving the airline, since they can be repaid through asset liquidation. Thus, Swissair probably would not have been closed down if a debt-equity swap had been performed.

This is but a brief outline of the very interesting and stimulating lecture series by Oliver Hart. As in previous years, the lecture series will be published in the CES/MIT Press Munich Lectures Series. If you do not want to wait until publishing date, visit our website www.cesifo.de and click on CES Internet Lectures to watch the lectures in full length.

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