



# Bulletin

Volume 12 No. 4  
October 2002

## DISTINGUISHED CES FELLOW 2002

**Nicholas Stern**, Chief Economist of The World Bank, is this year's Distinguished CES Fellow. He will hold the Munich Lectures in Economics in November. *(page 3)*

## SUBDUED PROSPECTS

Read what the joint forecast by the six leading German economic research institutes has to say on the state of the world economy and the German economy in the Ifo News section. *(pages 4-5)*

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**FACULTY NEWS**  
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## DEVELOPING A WORK ETHIC

Altruistic parents may be bad for your future economic prospects. This is the –rather counter-intuitive– conclusion **Sten Nyberg's** research has led him to. Early development of a work ethic is the right way forward, he has found. *(page 6)*

## THE RIGHT PRICE

One of the trickiest questions for any firm is what prices to commit to when lacking precise knowledge of demand for a given product. **Martin Peitz** has done quite a bit of research on the matter, and will pursue it further at CES. *(page 7)*

## KEEP IT CONSTANT

Many an economics minister would kill for it: constant GDP growth. But the reality tells a different story, with GDP growth subject to maddening fluctuations. **Klaus Wälde's** research throws some light on this and provides an interesting tool for policy formulation. *(page 7)*

## A DISTINCTION FOR A CESIFO NETWORK MEMBER

**Angar Sandmo** has been awarded the Prize for Outstanding Research by the Norwegian Research Council. *(page 7)*

## INVESTMENT: HOW TO ATTRACT IT...

Which tools are best for a country to convert itself into a magnet for Foreign Direct Investment? **Trond E. Olsen's** research aims to clarify the effects of one such tool, tax policy. *(page 8)*

## ...AND HOW TO UNDERSTAND ITS FRICTIONS

Investment decisions are affected by real and financial frictions which the neoclassical theory does not explain satisfactorily. **Plutarchos Sakellaris** intends to conduct empirical work at CES to weigh the relative importance of such factors. *(page 8)*

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**THE 2003 CESIFO INTERNATIONAL  
SPRING CONFERENCE**  
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## FEATURED RESEARCHERS

Sten Nyberg (p. 6)  
Trond E. Olsen (p. 8)  
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### THE 2003 CESIFO INTERNATIONAL SPRING CONFERENCE

This annual event, to be held on 20-21 March 2003 at the Kardinal Wendel Haus in Munich, will focus on the *Prospects for the European Economy*, offering macroeconomic forecasts as well as industry analyses. The conference is aimed at business and banking representatives, as well as the public at large.

The first section will be devoted to examining the outlook for the world economy, with special emphasis on the United States, followed by an analysis of the state of the European economy and a

forecast on its prospects. The second section will start with a close look at the economies of China and the Asian NIEs, leading then to a presentation on the state of the financial markets, the reasons for their retrenchment and the likelihood of their prompt recovery. Discussion of these issues will be further pursued over dinner at the end of this first day.

On Friday morning the focus will be on the major branches of European industry. In the first section, representatives of well-known companies will discuss developments in the chemical and steel

industries. In the second section, the electronics, engineering and automobile industries will be analysed. This second day concludes with a hot buffet lunch.



Check out our website, [www.cesifo.de](http://www.cesifo.de), for a registration form, map, and a selection of hotels in the vicinity of the conference venue.

### HANS-MÖLLER SEMINARS

#### Winter 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.

15 October 2002

**Itzhak Zilcha**

Tel Aviv University

*The Effect of Better Information on Growth and Welfare*

22 October 2002

**Karl Morasch**

Universität der Bundeswehr München

*Electronic Coordination in Oligopolistic Markets: Impact on Transport Costs and Product Differentiation*

29 October 2002

**Sten Nyberg**

Stockholm School of Economics

*Raising Children to Work Hard: Altruism, Work Norms and Social Insurance*

5 November 2002

**Jiahua Che**

University of Illinois

*Running Dinosaur: A Political Economy Model of Subsidies vs. Soft Budget Constraints*

13 November 2002

**Don Denis Gromb**

LBS

*Entrepreneurship in Equilibrium*

19 November 2002

**Nicholas Stern**

World Bank

*CES Distinguished Fellow 2002 Prize Award (Alte Aula)*

26 November 2002

**Klaus Wälde**

Universität Dresden

*Endogenous technology shocks, short-run fluctuations and long-run growth*

3 December 2002

**David Martimort**

University of Toulouse

*Info at [http://www.vwl.uni-muenchen.de/ls\\_marin/hmoeller.html](http://www.vwl.uni-muenchen.de/ls_marin/hmoeller.html)*

11 December 2002

**Philippe Aghion**

Harvard University and UCL

*Time and topic to be announced at [http://www.vwl.uni-muenchen.de/ls\\_marin/hmoeller.html](http://www.vwl.uni-muenchen.de/ls_marin/hmoeller.html)*

17 December 2002

**Alberto Alesina**

Harvard University and Bocconi

*Info at [http://www.vwl.uni-muenchen.de/ls\\_marin/hmoeller.html](http://www.vwl.uni-muenchen.de/ls_marin/hmoeller.html)*

7 January 2003

**Ray Rees**

Universität München

*Info at [http://www.vwl.uni-muenchen.de/ls\\_marin/hmoeller.html](http://www.vwl.uni-muenchen.de/ls_marin/hmoeller.html)*

14 January 2003

**Martin Peitz**

Universität Mannheim

*Monopoly Pricing under Demand Uncertainty: Final Sales versus Introductory Offers*

21 January 2003

**Gilles Saint-Paul**

University of Toulouse

*Info at [http://www.vwl.uni-muenchen.de/ls\\_marin/hmoeller.html](http://www.vwl.uni-muenchen.de/ls_marin/hmoeller.html)*

28 January 2003

**Jon Danielsson**

LSE

*Anatomy of an Emerging Market Crash: A Market Microstructure Analysis of the Turkish Repo Crisis*

4 February 2003

**Gianmarco Ottaviano**

University of Bologna

*Info at [http://www.vwl.uni-muenchen.de/ls\\_marin/hmoeller.html](http://www.vwl.uni-muenchen.de/ls_marin/hmoeller.html)*

### MUNICH LECTURES IN ECONOMICS

2002

Every year, the Council of the Center for Economic Studies nominates an outstanding international economist as the year's **Distinguished CES Fellow**. The award is presented in November, when the laureate gives the **Munich Lectures in Economics**, sharing a recent economics research topic with a broad audience.

This year's laureate is the renowned economist **Nicholas Stern**, Chief Economist of the World Bank and Senior Vice President for Development Economics (*see biographical sketch on the right column*).

Stern has made fundamental contributions in several areas of economics: economic theory; public economics and taxation; economic development and growth; tax reform in developing countries; the nature of the rural economy; public policy and the role of the state, *inter alia*. Alongside his academic work, he has always shown a deep interest in the process of development and in policy-making. He spent eight months doing fieldwork in a village in northern India and has kept in touch with the village for nearly 30 years. He has served on committees of OXFAM, ODA, and the UN; he has been Chief Economist of the European Bank for Reconstruction and Development, and is currently Chief Economist of the World Bank.

From this unique perspective and experience, Stern will present his vision for a strategy for development in this year's Munich Lectures in Economics, which he entitled ***Dynamic Development: Innovation and Inclusion***.

Drawing his inspiration from Schumpeter, Hirschman, and Sen, he views development as intertwined dynamic processes of growth and inclusion. He argues that development is built on two pillars: creating a climate that facilitates investment and growth, and empowering poor people to participate in that growth. What is cru-

cial to recognize is that both pillars embody processes.

The theoretical and empirical discussion in the lectures focuses particularly on the investment climate and strategies for empowerment and inclusion. The investment climate is the policy, institutional, and behavioural environment that influences the returns and risks associated with investment. Empowerment and inclusion refer to the ability of poor people to shape their own lives and participate in the economy and society.

In the context of the strategic pillars and the goals of poverty reduction and social inclusion, the lectures provide a rich and subtle treatment of mechanisms that encourage innovation and entrepreneurship, learning, and change in institutions and behaviour of economic agents, all factors that lie at the heart of the development transformation.



Nicholas Stern,  
Distinguished CES Fellow  
2002

#### LECTURE SCHEDULE

Tuesday, November 19<sup>th</sup>, 6 pm, Grosse Aula, University of Munich (*First Lecture and Prize Award*)

Wednesday, November 20<sup>th</sup>, 6 pm, CES seminar room, Schackstrasse 4 (*Second Lecture*), and

Thursday, November 21<sup>st</sup>, 9.15 am, CES seminar room, Schackstrasse 4 (*Last Lecture*)

*The Lectures are supported by SwissRe Germany AG, the Ifo Institute and CESifo, and organized jointly with MIT Press and the Alumni Club of the Economics Department of Ludwig-Maximilians-Universität.*

### DISTINGUISHED CES FELLOW

Stern

**Nicholas Stern** graduated with a B.A. in Mathematics from Cambridge University and then went on to Oxford to do the D.Phil. in Economics. He briefly held a Research Fellowship at The Queen's College before being elected to a University Lecturership and Tutorial Fellowship at St. Catherine's College in Oxford.

After a decade at Oxford, he moved to the University of Warwick as Professor of Economics and founded the Development Economics Research Centre there, becoming its first Director. In 1987 he was appointed the Sir John Hicks Professor of Economics at the London School of Economics (LSE), and Chairman of the Suntory-Toyota Centre for Economics and Related Disciplines at the LSE.

From 1994 to late 1999 he served as Chief Economist of the European Bank for Reconstruction and Development, where he was also Special Counsellor to the President. At the beginning of 2000 he returned to the LSE as School Professor of Economics. In July 2000 Stern became Chief Economist of the World Bank and Senior Vice President, for Development Economics.

During his academic career he has held a number of positions as visiting professor or visiting scholar — including the Massachusetts Institute of Technology, the Ecole Polytechnique in Paris, the Indian Statistical Institute in Bangalore and Delhi, and the People's University of China in Beijing, where he is an Honorary Professor. He has also served extensively as an economic advisor to businesses, governments and international institutions.

Stern's research achievements have been recognized through receipt of the highest academic honours. He was elected to a Fellowship of the Econometric Society in 1978 (and is currently a Member of Council), to a Fellowship of the British Academy in July 1993, and to a Foreign Honorary Membership of the American Academy of Arts and Sciences in 1998.

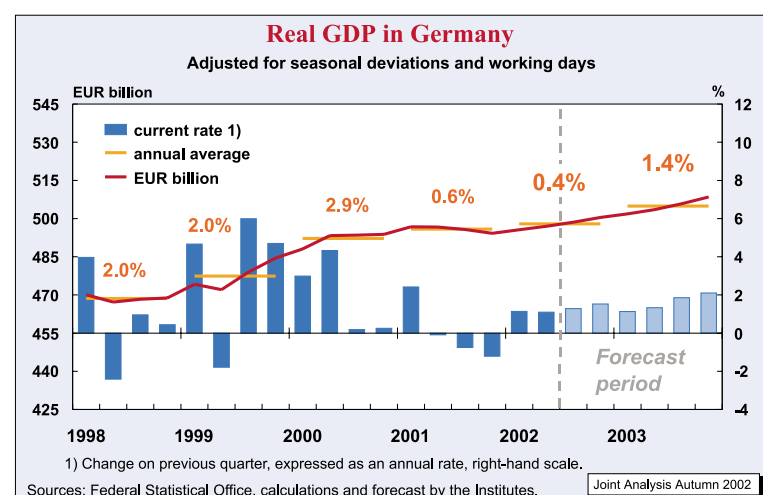
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# Ifo NEWS

## PRESENTATION OF THE INSTITUTE'S NEW JOINT FORECAST

On 22 October, the six German economic research institutes—including the Ifo Institute—presented their forecast on *The State of the World Economy and the German Economy in Autumn 2002*. Against the background of a fragile world economy, suffering from the Iraq crisis and the sharp decline of equity prices, the short-term prospects for Germany remain subdued. Although the economy has improved somewhat after last year's mild recession, the upswing is late in coming and expected to be weak.

Given the slow pace of the expansion, the ECB will maintain its expansionary stance way into next year. Short-term interest rates will be raised slightly toward the end of 2003 as the euro-area economy firms. Wage agreements, which this year were excessive, will be more modest again next year. Fiscal policy will be markedly restrictive in 2003, as the budget calls for intensive consolidation.



*Subdued prospects: A fairly slow climb*

Government spending will be cut by 6 billion and taxes will be raised by 6.5 billion in addition to an increase in social insurance contributions.

In the light of this, the German economy is expected to recover slowly in the course of next year. Exports will be boosted by a reviving world economy and diminishing effects of the euro appreciation. Furthermore, expectations of

consumers and investors will brighten as soon as stock prices stabilise and the tight situation in the Middle East eases. At this point the expansionary monetary policy will become more effective again, although counteracted by the very restrictive fiscal policy.

On average, German GDP is expected to increase by 0.4% in 2002 and by 1.4% in 2003. The labour market is unlikely to improve significantly; unemployment will still be rising in 2003. The government budget will deteriorate markedly this year; at 2.3%, the deficit/GDP ratio will exceed the upper bound of the Maastricht criteria. Next year, however, the ratio will drop to 1.9% again as the consolidation efforts bear fruit.

The institutes emphasised that economic policy must focus on improving the conditions for growth and employment. Fiscal policy must concentrate on budget consolidation, but realised by a reduction of government expenditure. For the sake of credibility, the government must specify which benefits will be modified and which subsidies will be cut. Furthermore, public investment must not be reduced. On the contrary, the budget needs to be restructured in favour of investment in human and physical capital. Finally, the institutes criticised the increases of taxes and social insurance contributions laid down in the coalition agreements as being anything but conducive to growth.

## Ifo and Deutsche Welle Sign Co-operation Agreement

Deutsche Welle and the Ifo Institute agreed to co-operate in the area of economic reporting. The co-operation will

focus on the international presentation of the Ifo Institute's *World Economic Survey*, a world-wide poll of experts who report on the state of the economy in their countries of residence and their expectations regarding these countries' economic prospects. Deutsche Welle TV will broadcast regularly the results of the World Economic Survey in its economic and business news. The Ifo Institute will provide the data and their interpretation in German and English. Co-operation in other areas is planned.

## Co-operation Agreement Between Ifo and IAB

Another co-operation agreement signed this year concerned that between the Ifo Institute and the Institute for Employment Research (IAB), the research institution of the Federal Employment Services. The aim of the agreement is the promotion of scientific work on topics of common interest and improved provision of scientific information to the public and the business community by scientific dialogue, by co-operation in data collection, the development of procedures, and in research as well as by the exchange of research findings.

## Research Directors at Ifo

Several research directors support the work of individual departments. They include: **Prof. Rainer Fehn**, Structural and Industrial Analyses; **Prof. Gerhard Illing**, CESifo Economic Studies; **Prof. Marcel Thum**, Ifo Dresden Branch, and **Prof. Jan Egbert Sturm**, Economic Forecasting.

## Research Professors at Ifo

In order to intensify the co-operation with universities, the Ifo Institute has also appointed several research professors. Whereas research directors, as members of the Ifo staff, are directly involved in the Institute's activities, research professors remain at their institutions and are involved in specific Ifo research projects.

Research professors are:

**Prof. Kai A. Konrad**, Social Science Research Center (Wissenschaftszentrum)

Berlin; **Prof. Dietmar Wellisch**, University of Magdeburg; **Prof. Christian Keuschnigg**, University of St. Gallen; **Prof. Helmut Seitz**, University of Frankfurt/Oder, and **Prof. Michael Rauscher**, University of Rostock.

## Visiting Researchers

As the first researcher in residence, **Rick van der Ploeg** occupied an office in the main building and the new guest apartment during September 2002. Until 1998 Rick taught at Tilburg, Florence and Amsterdam. From 1994 he was a member of the Dutch parliament and he worked for four years as State Secretary for Education, Culture and Science. After many years in politics, he utilised his stay in Munich to take up his research activities again.

From December 2002 to February 2003, **Prof. Jong-Hwan Ko** will join the Dept. of International Institutional Comparison as visiting researcher. Prof. Ko is a member of the faculty of International and Area Studies at the Pukyong National University, Korea.

## Ifo Business Survey of IT

According to the **Ifo Business Survey of IT** firms for the second quarter 2002, the business situation deteriorated further. Only 18% of the firms assessed their business activity as favourable, 53% as satisfactory, and 29% even rated it bad. In addition, the firms are increasingly pessimistic about the outlook. Accordingly, the Business Climate has worsened again. Total employment in the German software industry declined by almost 2% in the second quarter (first quarter: -1%). Worries about poor order stocks are rapidly increasing: 60% of the firms complained about a lack of orders. Other factors like a lack of skilled employees (6%) or financing problems (8%) were mentioned much less frequently.

## Ifo Business Survey of Leasing

According to the latest survey results, the Business Climate in Leasing deteriorated again. As the smoothed data are

pointing upward, however, the worst may be over. The recovery is likely to proceed slowly, the Business Climate is still a far way from the level reached a year ago. Whereas the present business situation deteriorated further, the favourable assessments were still (though just) in the majority. Twenty percent of the firms assessed their present situation as favourable, 68% as satisfactory, but 12% as bad. Fewer firms than in the first quarter are optimistic

about the future. For 2002 as a whole, a positive growth rate of leasing investment is unlikely, stagnation is probable. The weak investment activity is reflected in employment: hirings and firings balanced. The small leasing firms managed to hold on to their personnel, whereas the larger ones had to lay off people. The business outlook is such that employment is expected to stagnate in the third quarter as well.

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## RESEARCH SEMINARS

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

14 October 02 <b>Holger Strulik</b> (Universität Hamburg) <i>Child Mortality, Child Labour, and Economic Development</i>	2 December 02 <b>Dorothea Kübler</b> (Humboldt Universität, Berlin) <i>Limited Depth of Reasoning and Failure of Cascade Formation in the Laboratory</i>
21 October 02 <b>Jürgen Ledl</b> (Ludwig-Maximilians-Universität, München) <i>Formal Education and On-the-Job Training – a Comparison</i>	9 December 02 <b>Michael von Hohenau</b> (Ludwig-Maximilians-Universität, München) <i>EU Enlargement and Monetary Policy</i>
28 October 02 <b>Matthias Blonski</b> (Universität Mannheim) <i>Prisoners' other Dilemma</i>	16 December 02 <b>Deszö Szalay</b> (Universität Mannheim) <i>Info at <a href="http://www.vwl.uni-muenchen.de/ls_rady/seminar.html">www.vwl.uni-muenchen.de/ls_rady/seminar.html</a></i>
4 November 02 <b>Joao Cocco</b> (London Business School) <i>Household Risk Management and Optimal Mortgage Choice</i>	13 December 03 <b>Gregor Gehauf</b> (Ludwig-Maximilians-Universität, München) <i>Transfer Pricing Strategies of Multinational Companies in International Partnerships</i>
11 November 02 <b>Karl Schlag</b> (European University Institute, Florence) <i>Selecting Simple Rules for Repeated Decision Making using Minimax Regret and Worst Case Priors</i>	20 December 02 <b>Mathias Hoffmann</b> (Universität Dortmund) <i>Financial Integration, Specialisation and Trade: more or less Business Cycle Symmetry?</i>
18 November 02 <b>Ingrid Stein</b> (Universität der Bundeswehr, München) <i>Info at <a href="http://www.vwl.uni-muenchen.de/ls_rady/seminar.html">www.vwl.uni-muenchen.de/ls_rady/seminar.html</a></i>	27 December 03 <b>Alexander Protsenko</b> (Ludwig-Maximilians-Universität, München) <i>Cross Border Employment Effects of Horizontal and Vertical FDI: Empirical Evidence from German FDI in Eastern Europe</i>
25 November 02 <b>Christian Ewerhart</b> (Universität Mannheim) <i>Info at <a href="http://www.vwl.uni-muenchen.de/ls_rady/seminar.html">www.vwl.uni-muenchen.de/ls_rady/seminar.html</a></i>	03 December 03 <b>Sven Stöwhase</b> (Ludwig-Maximilians-Universität, München) <i>Profit Shifting Opportunities and the</i>

## CALL FOR PAPERS

## PUBLIC FINANCE AND FINANCIAL MARKETS

59TH CONGRESS OF THE INTERNATIONAL INSTITUTE OF PUBLIC FINANCE

The 59th Congress of the International Institute of Public Finance (IIPF) will be held in Prague during August 25-28, 2003. Prospective contributors are invited to submit papers or abstracts of papers before **January 31, 2003**. Both practitioners and academics are encouraged to participate.

The role of the government in financial markets is extensive and complex. In some financial sectors, e.g. "social insurance," the role of the government is dominant, even though private markets often coexist. In other sectors, e.g. for consumer and business loans, governments normally limit their intervention to regulatory oversight, though tax distortions/incentives can be large. Yet the same qualitative problems, e.g. with adverse selection, exist in all of these markets. Interjurisdictional externalities can also be important, as seen in recent financial crises and in the role of tax havens. To what degree have government policies affected the amount of private savings, their allocation among alternative real investments (domestic and foreign), and the resulting allocation of risk? To what degree do they help overcome liquidity constraints, adverse selection problems, externalities, or time-inconsistent preferences?

While the main theme of this conference will be positive and normative studies of the role of government in financial markets, contributed papers on any topic in the field of public economics will be considered.

To submit a complete paper or an extended abstracts please go to the following web page:

<http://www.econometricsociety.org/conference/IIPF59>

You will first need to register as a new user, and can then submit a paper. Those who would be interested simply in serving as discussants or session chairs should also go to this web site and register as a new user. Only pdf files will be considered. (Please *embed all fonts* to make sure that your pdf file will be readable across systems.) The papers will be selected by a Scientific Committee consisting of Julian Alworth, Alan Auerbach, David

de-Meza, Jaroslava Durcakova, Roger Gordon, Bojka Hamernikova, Harry Huizinga, James Poterba, Assaf Razin, Hirofumi Shibata, Joel Slemrod, Hans-Werner Sinn and Alfons Weichenrieder. Authors will be notified about acceptance or rejection of papers by **April 15, 2003**.

Authors of accepted papers are expected to join the IIPF; payment of the modest annual membership fee prior to the Congress will ensure a reduced registration fee. Membership also carries with it a subscription to the journal *International Tax and Public Finance*. See the IIPF website [www.iipf.net](http://www.iipf.net) for further information.

Selected papers will be published in a special issue of the journal *International Tax and Public Finance*. To be considered for publication, papers should be available for review before the Congress. Given space constraints, only short papers can be considered.

AW

## FACULTY NEWS

- Prof. Dr. **Monika Schnitzer** and Prof. Dr. **Klaus Schmidt** received an invitation to work at the University of Zurich, but both ultimately decided to decline the invitation.
- Prof. **Sven Rady**, Ph.D., has received an invitation to work at the University of Frankfurt/ Main.
- Prof. **Stephan Klasen**, Ph.D., has received an invitation for a C4 professorship in economics, with a focus on development economics and empirical economic research, at the University of Göttingen. Furthermore, he has been invited to head the Ibero-America Institute for Economics research at the same University.
- Prof. Dr. **Klaus Schmidt** has been elected dean and Prof. Dr. **Gerhard Illing** deputy dean until 30.09.04, while **Monika Schnitzer** has been elected dean of studies until 30.09.2006.

## FORMATION OF WORK NORMS

Nyberg



If children can count on financial support from their parents in the event they should prove unsuccessful in the labor market, their effort incentives will be reduced. Economic incentives, e.g. making bequests contingent on success, may not be credible if parents are truly altruistic. Non-economic incentives, such as a work ethic, work better in this respect. Work norms and their formation, therefore, constitute a field worth studying in depth.

That is one line of research which **Sten Nyberg**, Associate Professor of Economics at Stockholm University and member of the Market Court in Sweden, has pursued for the past several years. His other areas of interest concern social norms in economics, the political economy of income redistribution and industrial organization.

Together with Assar Lindbeck and Jörgen Weibull, Nyberg has studied work norms in relation to transfer and income insurance systems in the welfare state. One issue has been to examine what budget balanced tax-transfer policies emerge as political equilibria in a majority voting context, when the strength of the welfare stigma declines in the number of transfer recipients. The most recent paper on the subject highlighted the possibility that adjustments of norms to changes in benefit dependency exhibit inertia, which may give short-run incentives for providing more generous benefits than what is sustainable in the long-run.

In a joint paper with Lindbeck (*CESifo Working Paper No. 498*), Nyberg also studies the formation of work norms. This work explores altruistic parents' interest in influencing the work norms of their children and how that is influenced by the generosity of social insurance benefits.

During his stay at CES, in November and December this year, Nyberg will continue this line of research. He will also work on two related projects, one involving evolutionary formation of work norms and the other on norms to limit effort.

JS

## PRICING IN THE DARK

Peitz

Can a firm safely commit to prices and quantities at a point where it lacks precise knowledge of demand? This is not a trivial question for the business well-being of any company. **Martin Peitz**, who will visit CES in January 2003, has delved extensively into this matter, and will continue exploring it while at CES, in particular as it relates to the telecommunications market.

Pricing strategies, explains Peitz, include introductory offers, in which a limited quantity is initially offered at a discount,

and final sales, in which in a final period a good is offered at a lower price. In a simple world Peitz and Nocke show that while introductory offers may dominate uniform pricing, it is never optimal if the monopolist can use final sales. The results allow to explain certain business practices for ticket pricing such as "community rush tickets", "day seats", or standby tickets. During his stay at the CES Peitz will present this work in a research seminar at the University of Munich.

Another of Peitz's main research themes has been the theoretical analysis of telecommunications markets, in particular the analysis of recently liberalized telecommunications markets in which the incumbent enjoys advantages over entrants. He formulates recommendations for regulatory policy based on theoretical insights. At CES he will give a short course on "competition in telecommunications" where he presents some research by himself and other researchers in this very active field.

Another theme of Peitz' research has been the analysis of mechanisms to transmit information in imperfectly competitive market environments, asserting that market behavior of more than one informed market player can give valuable information to uninformed market participants. Important to sustain such an information transmission mechanism is the threat or potential reaction by some market players which in effect sustains the signal sent by other players. Peitz (and coauthors) have successfully applied this novel mechanism to intermediation in goods markets, exclusionary practices and comparative advertising. Important conclusions for competition policy emerge: business practices which in a world without informational problems may be deemed anti-competitive can help to solve the problem of asymmetric information and, therefore, may have to be seen in a different light. During his stay at CES Peitz plans to extend the analysis to other environments.

Peitz is Heisenberg Fellow of the Deutsche Forschungsgemeinschaft. He completed his doctorate at the University of Bonn within the European Doctoral Program.

## AWARD FOR CESIFO NETWORK MEMBER

**Angar Sandmo**, member of both the Ifo and the CES Scientific Councils and long-time CESifo Research Network member, has just been awarded the **Prize for Outstanding Research** by the Norwegian Research Council.

## MUNICH SEMINARS

4 November 2002

**Prof. Wolfgang Franz**

President and Scientific Director, Zentrum für Europäische Wirtschaftsforschung  
*Economic Policy Challenges for the New Federal Government*

18 November 2002

**Kurt F. Viermetz**

Chairman of the Board, Hypovereinsbank  
*Die Konsequenzen der jüngsten Bilanzskandale auf beiden Seiten des Atlantiks*

02 December 2002

**Dr. Ferdinand Graf von Ballestrem**

Member of the Board of MAN AG  
Info at [www.CESifo.de/MunichSeminars](http://www.CESifo.de/MunichSeminars)

13 January 2003

**Prof. Dr. Wolfgang Fikentscher**

Department of Law, LMU Munich  
*Culture, Justice and Commerce: An Anthropological Approach to Markets*

17 February 2003

**Prof. Dr. Manfred J.M. Neumann**

Institute for International Economics  
*Probleme der Geldpolitik der Europäischen Zentralbank*

## MACROECONOMIC REGULARITIES

Wälde



Klaus Wälde

Why are GDP growth rates not constant? This is one of the big questions in economics and many economists devote much time to finding an answer. It is also a recurring theme in public policy discussions.

**Klaus Wälde**, Professor of Economics at the University of Dresden, will visit CES in November and December 2002 to continue research on this field, particularly on fluctuations and growth.

The dominating schools view sources for fluctuations as lying outside the economy – technology (and other) shocks disturb some balanced growth path or steady state. In recent years, economists like B. Bental and D. Peled, K. Matsuyama or K. Wälde argued that R&D can be a source of economic fluctuations. The fundamental difference of this approach lies in the endogenous nature of R&D – economic fluctuations are the natural endogenous outcome of a growing economy.

All approaches in the literature are characterized by periods of high growth and low innovation, followed by periods of low growth and high innovation. In recent empirical work, Wälde has shown this to be contradicted by data. Innovative activity is high in periods of high growth and low in periods of low growth. Work in progress studies under which conditions endogenous fluctuations can be reconciled with procyclical innovation.

Policy implications of this line of research cannot be underestimated: it provides a tool for understanding the impact of policy on the cyclical behavior of GDP, investment and employment, as exogenous sources for fluctuations cannot be influenced through policy measures, but endogenous fluctuations can. More information on his research is available at <http://www.waelde.com>.

Klaus Wälde obtained his Ph.D. from the University of Kiel in 1994 and worked for the World Bank.

JS

## MULTINATIONALS AND INTERNATIONAL TAX COMPETITION

Olsen

With increased international mobility of capital and other productive resources, governments have adopted policies to attract favorable investments from firms to their national economies. Investments in advanced technology appear especially attractive.



Trond E. Olsen

Such investments are most often controlled by multinational enterprises (MNE's), and individual governments have incentives to offer favorable conditions for local investments.

Foreign direct investments have been increasing, and empirical research shows that effective tax rates are important for the localization decisions of multinationals. Tax policy, broadly defined, can thus be an effective instrument for national governments. The broad definition includes not only statutory corporate tax rates, but also other measures that influence effective tax rates, e.g. depreciation rates, tax holidays, subsidized land and the like.

How does this kind of international competition affect multinationals' profits and investment allocations? **Trond E. Olsen**, professor of Finance and Management Science at the Norwegian School of Economics and Business Administration will devote part of his stay at CES to research on this topic.

In their dealings with technologically advanced firms governments are likely to be constrained by information asymmetries; a firm is likely to be better informed about its technology and operating profits than are the national governments that it relates to. A recent strand of research has examined implications of international tax competition in the presence of asymmetric information.

This research has, among other things, pointed out that international tax competition may be harmful for an MNE; the firm can be worse off if a number of host countries engage in tax competition rather than tax cooperation. This finding is surprising, and at odds with results in the literature on tax competition under symmetric information, where it is typically found that tax competition causes source taxes to fall and investments to rise, and is thus beneficial for firms. Professor Olsen's research in this area aims to clarify and further analyse this issue.

## INVESTMENT FRICTIONS

Sakellaris

Investment is an important component of aggregate activity and much effort has been spent on trying to understand it. The workhorse of modern investment research has been Tobin's Q theory and the neoclassical theory of investment with convex adjustment costs. In this framework, the market value of capital is an important determinant of a firm's capital investment decision.

The initial empirical results of this research have been largely disappointing. Briefly, the estimates of investment responsiveness to fundamentals have been very low whereas output terms (such as profits or cash flows) have been very significant contrary to theoretical implications. This has continuously set a challenge on empirical work.

This is a challenge that **Plutarchos Sakellaris**, of the Athens University of Economics and Business and the University of Maryland, is glad to tackle.



Plutarchos Sakellaris

At CES he intends to conduct empirical work to weigh the relative importance of non-linearities and financial constraints (real vs. financial frictions) in determining firm investment in German manufacturing. The novelty of the approach relative to past ones is to build a structural estimation framework that encompasses both sorts of friction.

The research of the last fifteen years has provided two breakthroughs. In reverse chronological order, one emphasized the importance of nonlinearities and the other, that of financing constraints.

The literature on non-linearities argues that the apparent failures of neoclassical theory are a result of misspecification of the costs that are relevant in the capital adjustment decision. In particular, irreversibilities and fixed costs to investment may lead firms to experience episodes of zero investment as well as episodes of large investment in response to similarly small movements in fundamentals. This is in sharp contrast to convex adjustment costs which, at least in their usual quadratic implementation, imply proportional responses. This provides an explanation for the low estimated responsiveness in the data.

The observation that firms rely mainly on internal sources of funds to finance investment is the starting point for the financing constraints literature. This is interpreted as evidence of a divergence between the costs of internal and external funds leading to excess sensitivity of firms' investment to their cash flows. This strand leads to a rejection of the neoclassical theory and stresses the role of firms' balance sheet.

Both strands have a strong message for those wishing to understand aggregate investment: microeconomic heterogeneity may be very important in determining macro behavior. The sources of this heterogeneity are real in the former strand whereas they are financial in the latter.

Sakellaris received his BA from Brandeis University and his Ph.D. from Yale University. He also served in the staff of the Federal Reserve Board.