

CESifo Bulletin

Volume 20 No. 1
January 2010

Ifo News

(p. 4-5)

Munich Seminars

(p. 7)

Hans Möller & Research Seminars

(p. 3)

Featured Researchers

Stefan Ambec (p. 2)

Sven Feldmann (p. 3)

Marcel Fratzscher (p. 6)

Beat Hintermann (p. 3)

Marko Koethenbueger (p. 8)

Michael Lechner (p. 7)

Etienne Lehmann (p. 7)

Gerd Muehlheusser (p. 6)

Douglas R. Nelson (p. 8)

Helmut Rainer (p. 5)

Andreas Roider (p. 6)

Sensational Discovery

Germany's Nature and Biodiversity Conservation Union has unearthed a startling fact: by studying **dinosaurs** closely, valuable insights regarding the best ways to fight global warming can be gained. (page 2)

Lobbying and Corruption Economics

One, the other, or both are a sort of national sport in some countries. Lobbying and corruption exert major economic effects. **Sven Feldmann** is studying them from an economics perspective. (page 3)

The Human Side of Economic Policymaking

Many policies look fantastic on paper and in theory. But, ultimately, if the citizens affected are unhappy with them because of employment or fairness concerns, for instance, they would need to be rethought, as **Douglas R. Nelson** points out. (page 8)

Doing Sports to Improve Employment Chances

Now, that is good news: a sporty nature is not only good for your body, but for your chances in the employment market as well, as **Michael Lechner**'s research shows. (page 7)

2.8 Trillion Loss

No, we are not talking about the financial and economic crises. This figure refers to the amount of growth Germany is predicted to forgo up to 2090 due to the poor quality of its **education**. And it is 2.8 trillion *euros*, mind you. (page 5)

Studying Shock Waves

The financial crisis spread violently from one country to the next. Which transmission channels play a role and how these shock waves affect economic and financial stability is a focus of **Marcel Fratzscher**'s research. (page 6)

Carbonic Bubbles

That carbon dioxide produces bubbles in your fizzy drink is well known. That it can also do so in emissions trading markets is a new insight. **Beat Hintermann** explains it. (page 3)

Designing Optimal Taxation

It is not easy to design redistributive taxation that achieves an optimum tradeoff between the gains of an increase in marginal tax rate and the efficiency loss of a too-low wage level. **Etienne Lehmann** is working on that. (page 7)

Sensational Discovery! The Link Between Dinosaurs and Climate Change

Who would have thought it: dinosaurs, a species long considered to be extinct, may hold the clue to combating climate change. To be precise, it is not the entire species but just one representative of those fossil giants that appears to have survived, undetected, to this day.



The discovery of this special dinosaur was made by Germany's Nature Conservation Society (known by its German moniker NABU). The fact that the dinosaur in question has been making noises about the most effective way to combat climate change gave it away, attracting NABU's attention. It promptly declared it "Dinosaur of the Year 2009".

The secret dinosaur had been living and acting under the guise of a well-known German economist, Hans-Werner Sinn, managing to capture the presidency of a prestigious think-tank and hogging the position of economics oracle of the nation.

Some quarters have expressed a *Schadenfreude*-type of glee at the dinosaur's exposure, given that the formidable beast had been busy punching holes in the renewable-energy balloon some hoist as the holy grail for solving the climate conundrum.

What attracted the ire of NABU were the dinosaur's six theses on climate change, which appear to put in doubt the effectiveness of some of the measures propounded by Germany to stop global warming. The six ungreen theses are:

Human action is behind global warming.

Well, this one actually coincides with NABU's own position and did not raise hackles among the conservationists.

Germany spends lots of money on green electricity, but still achieves little in terms of climate protection. This one was anathema to NABU's ears. On close inspection, however, when viewed in a European or global context, the thesis appears to be right: an unintended consequence of the European emissions trading system is that, in the end, Germany's many measures to push green electricity only serve to subsidise the non-green electricity generated by other EU countries.

Giving the fuel tank priority over the food plate creates poverty and unrest in the world. Well, you cannot eat bioethanol or biodiesel, and your own food goes up in price when those fuels are produced. Hunger and strife in several countries have been the result – and with a questionable carbon balance to boot.

Germany is on the wrong track in terms of nuclear energy. If renewables are not up to par yet, why decommission carbon-free power plants in good working order? No other country in the world is doing that.

European climate policies have accelerated climate change instead of curbing it. Reducing demand for fossil fuels in one corner of the world does not reduce global consumption if fossil fuel producers do not reduce their supply as a result: they will just sell their stuff elsewhere. Worse, if they fear that green policies will become increasingly greener over time, exerting downward pressure on fossil fuel prices, they will feel compelled to speed up fossil carbon extraction and, with it, global warming. This is the so-called Green Paradox, a term introduced by our dinosaur.

And, finally, *only a worldwide emissions trading system, coupled with a source tax on the resource owners' capital gains, could persuade fossil fuel suppliers to postpone resource extraction, thereby slowing down climate change.* In addition, if deforestation is halted and afforestation efforts stepped up, mankind would have a fair chance of winning the battle against carbon dioxide that threatens to make our planet unlivable.

So, it appears, the dinotheses are not wide of the mark, actually, if you analyse them in a less local context and go for the global, or at least European, perspective.

But, on reflection, what is so bad about being a dinosaur, anyway? They ruled the earth for more than 160 million years, and to wipe them out it took an asteroid impact that nearly destroyed the entire planet. *Homo sapiens*, by contrast, has been around for a mere 200 thousand years. And it is managing to destroy the planet all by itself.

Going with the Flow

Access to the flow of rivers running across borders is often a bone of contention for the countries involved. With changes in water flow likely to result from climate change, the issue is bound to become somewhat more acrimonious in years to come. This is one focus of **Stefan Ambec's** research, who will further examine the issue, together with Ariel Dinar, during his stay at CES.

A further project he will be working on, in collaboration with Lars Ehlers, analyses the fairness properties and the acceptability of

the polluter-pays principle in a general model of production and consumption with negative externalities.

Stefan Ambec is a micro-economist with research interests in environmental economics, industrial organisation and development economics. He is INRA Senior Researcher at the Toulouse School of Economics, member of LERNA, a research center in environmental and natural resource economics. He holds a PhD in Economics from the University of Montreal. He was previ-

ously a postdoc researcher at Laval University in Quebec City, TMR research fellow at the University of Salerno and INRA researcher at the University of Grenoble for six years before joining Toulouse. He is now director of the Master Programme in Environmental Economics from the University of Toulouse, where he teaches Environmental Economics and Water Management.



Lobbying and Corruption Economics

Feldmann

Lobbying and corruption play undeniably significant roles, questionable the one and despicable the other, in many modern economies. It pays then to understand the economics of these two phenomena.



This is what **Sven Feldmann** is working on. When it comes to lobbying and corruption, he is particularly interested in the way dispersed information is transmitted to decision makers—whether within firms or from private parties to government entities. A crucial aspect of information transmission is whether or not the information is verifiable by the receiver, and whether side-payments are possible to induce truthful revelation of information.

In the context of public decision-making such models of information transmission help understand the nature and extent of biases caused by information obtained from interested parties such as lobby groups, biased committees, or external experts.

During his stay at CES, Mr Feldmann explored the role of delegation in obtaining decentralised information. In most economic models of delegation the agent to whom authority is delegated enjoys an informational advantage over the principal. The benefit of delegation then lies in harnessing the agent's information at the

expense of possibly distorting the decision away from the principal's most preferred alternative. In his work, Mr Feldmann endogenises the agent's information and explores the benefit of constraining a decision *ex ante* in order to improve the agent's ability to elicit information from private parties.

An example of *ex ante* constraints on decisions occurs in the prosecution of white-collar crime: by granting immunity to key witnesses the prosecution commits not to use the information against the informant in order to improve the witness's incentive to reveal what he knows. Mr Feldmann demonstrates that delegation can serve a similar purpose of constraining a decision-maker so as to allow private parties to provide information that they otherwise would be unwilling to share.

Sven Feldmann is an associate professor at Melbourne Business School. His research interests are in political economy, applied game theory and the economics organisations and institutions. He obtained his PhD at Harvard University and prior to joining MBS, taught at the University of Chicago and at the Kellogg School of Management. He has been a Hoover National Fellow and a visiting professor at the Stanford Graduate School of Business.

Carbonic Bubbles

Hintermann

Asset bubbles do not occur only in real estate or securities markets. Atmosphere pollution permits are also susceptible to the malaise, as **Beat Hintermann's** research suggests. While at CESifo in February, he will pursue his examination of asset price bubbles applied to the first phase of the European Allowance Trading System (ETS), the EU's carbon cap-and-trade scheme. The price of one allowance hit nearly 30 euros early on, only to slump to around 12 euros for quite a while later on, hinting at a bubbly behaviour in the early days. Mr Hintermann will apply a bubble test devised by Phillips et al to this carbon market.



A related project will see him shedding some light on why firms participate voluntarily in carbon markets, examining the incentives behind emissions allowance purchases and abatement measures. His goal is to derive a theoretical model and obtain firm data from the US via a letter survey.

And while he is into abatement, he will also explore the effect of learning about stochastic abatement costs on optimal tax. If private costs of abatement to consumers (such as replacing car commuting with public transportation) are not fully known before they embark in such an action, consumers may choose to under-abate. The goal of this project is to derive the optimal Pigouvian tax that takes learning into account, under different assumptions.

Beat Hintermann is a postdoctoral researcher at the Centre for Energy Policy and Economics (CEPE), ETH Zurich. He obtained his PhD in Agricultural and Resource Economics from the University of Maryland in 2008. Before that, he was a consultant for the World Bank and a research associate with Radioactive Waste Management Associates, New York. His research interests range from environmental economics through the valuation of non-market goods to development economics and price bubbles.

Hans-Möller Seminars

Seminar for International Economic Relations
Library, Ludwigstr. 28/II, Tue. 4:30 - 6:00 pm

2 February 2010*

Martin Peitz

University of Mannheim

9 February 2010*

Thomas Crossley

University of Cambridge

* The subject for these seminars will be posted at www.hans-moeller-seminar.vwl.unimuenchen.de

Research Seminars

Monday 3:15 p.m. CES, Schackstr. 4, Munich

1 February 2010*

Liam Delaney

University College Dublin

3 February 2010*

Ted Temzelides

Rice University

8 February 2010*

Daniel Koch, Jin Cao, Moritz Hahn

LMU München

* The topic will be posted at www.vwl.unimuenchen.de/forschung/forschungseminare/fo_sem/index.html

Ifo Economic Forecast 2010: A Lacklustre Recovery

The world economy has come through the worst recession since World War II. Since spring 2009 production and trade have again increased, stimulated by billions of euros allocated to economic stimulus programmes, massively expansive monetary policy and comparably low oil prices. In addition, a turnaround in the global inventory growth cycle has

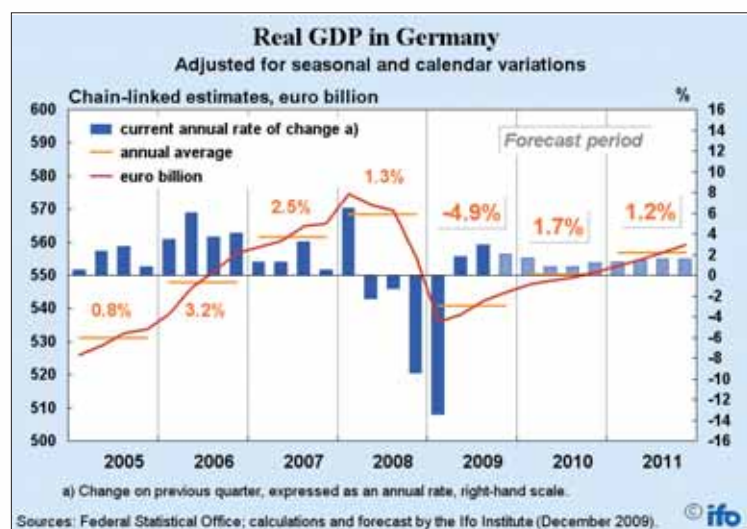
sation of the world economy will continue.

The pace of growth will remain low, however. A key problem is still the weakening of the international financial markets, whose viability is still limited in important areas. In addition, the banking system has suffered tremendous equity losses resulting from the high value-adjustment requirement of structured securities. A real-estate crisis is weighing down some major industrialised economies, which increases the

economic output, and here especially the production in export-dependent industries, remained overall at a very low level, however. The rate of capacity utilisation – extrapolating from the Ifo capacity utilisation measurement in manufacturing – is currently some 10 percentage points below the long-term average. On the whole, and seasonally and calendar adjusted, economic output has increased again in the final quarter of 2009, although at a somewhat slower pace (0.5 percent) than in the previous quarter. For the second half year of 2009 in comparison to the first half of the year, there was a 1.2 percent increase in economic output, seasonally and calendar adjusted; in comparison to the previous year, which was marked by a strong decline in the winter half year, the result is a drop of 3.0 percent, however. For 2009 as a whole, real GDP fell by 4.9 percent.

In the forecast period, the road signals of economic activity in Germany remain on yellow, and a green phase is still not expected. To be sure, the endogenous propellant forces are gradually becoming a little stronger again, but the funds made available by the economic stimulus packages are gradually running dry. In addition, the credit constraints for new investments and jobs remain strong. The state of the German economy is thus labile, and a self-sustaining recovery is not evident. On average for 2010, real GDP will likely increase by 1.7 percent, and by 1.2 percent on average for 2011.

On the labour market, which lags economic developments, employment will gradually adjust to the low level of production. The number of unemployed will increase by ca. 180,000 to 3.6 million, on average for the year. The increase in consumer prices will be moderate, with the large gap between the actual and the potential output level exerting a dampening effect. The budget deficit will increase strongly in 2010, amounting to 5.1 percent of nominal GDP. The main influencing factors here are the weak economy and the additional expenditures in connection with the support measures of the federal government.



occurred. The world economy climate derived from the Ifo World Economic Survey improved in the fourth quarter for the third time in succession. The rise in this indicator was the result of both more favourable expectations for the next six months and less negative appraisals of the current economic situation.

The economy climate improved in all major economic regions. The rise in the economic climate indicator was especially marked in Asia, where it even exceeded its long-term average. In Western Europe and North America, the climate indicator also improved noticeably in the fourth quarter of 2009. To be sure, the current economic situation is still assessed quite unfavourably in all major regions, particularly in the euro area, North America, Central and Eastern Europe, and Russia. However, the economic expectations are now optimistic almost everywhere. This indicates that the revitali-

economic stimulus programmes will tail off during the forecast period, while the need to consolidate public budgets is becoming increasingly more urgent. Finally, the central banks will tighten their monetary policy. This all will have a dampening effect on the evolution of supply and demand.

In the United States the increase in GDP at the beginning of 2010 will still be comparably strong, but will flatten out clearly thereafter. In Japan the expansion of the economy will initially remain weak in the forecast period before it slowly livens up again.

In Germany economic output stabilised in spring 2009. In the second quarter real GDP expanded, seasonally and calendar adjusted, by 0.4 percent, and in the third quarter by 0.7 percent. Due to the exceptionally strong decline in the preceding half year by almost 6 percent, total eco-

Poor Education Will Cost Germany 2.8 Trillion Up to 2090

With the large number of its inadequately educated pupils, Germany wastes an enormous growth potential. The follow-up costs of inadequate education in terms of unachieved economic growth sum up over the coming eighty years – the life-span of children born today – to ca. 2.8 trillion euros. This is the result of a study by the Ifo Institute for Economic Research for the Bertelsmann Foundation. This unique study of education by the educational economist Ludger Woessmann calculates the discounted yields of an education reform that clearly reduces the number of “risk pupils”. In this way, the long-term economic effects of education can be calculated for the first time.

Approximately 20 percent of all 15-year-olds in Germany are poorly educated “risk pupils”. According to the PISA studies they are at best only able to read and do math at an elementary school level and have therefore considerable problems in entering the labour market. In his study Woessmann posits an education reform that clearly lowers the share of risk pupils within the coming ten years. He then calculates the additional growth effects achieved by this reform over the coming eighty years.

Ifo educational economist Ludger Woessmann: “The costs of doing nothing and of ineffective measures are horrendous if one looks at the long-term growth effects of education investment. For this reason, sustainable education policies require a long-term horizon similar to that for climate policies.”

Survey of the Survey – Ifo Business Climate a Solid Leading Indicator

In a special survey, the Ifo Institute for Economic Research examined the factors that form the basis for firms’ replies to the monthly business survey. The firms in retailing and wholesaling contacted in this survey participate regularly in the Ifo Business Survey. The results show that in both the assessment of the current business situation as well as in the appraisal of the business outlook, the firms rely on their profit situation and their turnover. The factors in third and fourth place are the cost situation and liquidity. External Factors such as the overall state of the

economy only play a subordinate role in their responses.

“This confirms the value of the Ifo Business Climate as an economic activity indicator. The firms themselves choose the economic factors they use in assessing their business situation and outlook, factors that are also regarded as suitable by economic activity theory. The Ifo Institute gives no rules on how the questions are to be answered”, explains Dr. Klaus Abberger, the person in charge of surveys at the Ifo Institute. This flexibility of the survey questions has proven to be a major advantage of the Ifo Business Survey.

“An examination of the various sub-segments of the distributive trade shows that the firms use different factors in answering the business activity questions dependent on their particular situation. Nevertheless, the responses can be joined together to a total indicator without any problems”, Abberger says.

The special survey also showed that the persons who fill in the Ifo questionnaire also have the information they need to assess both the business situation and the outlook. In the great majority of firms the questionnaires are filled in by a member of upper management.

Investments in Broadband Infrastructure Boost Economic Growth

A new study entitled “Broadband Infrastructure and Economic Growth” provides new evidence on the growth-enhancing effects of broadband infrastructure. The study finds a strong positive impact of broadband infrastructure on economic growth: a 10 percentage-point increase in broadband penetration raises annual per-capita growth by 0.9-1.5 percentage points. Ludger Woessmann, Head of Department Human Capital and Innovation at the Ifo Institute and co-author of the study: “Modern economic growth is driven by innovation and knowledge. Access to fast internet via broadband infrastructure facilitates their diffusion.”

The study analyzes the growth experience of 25 OECD countries between 1996 and 2007. In 2003, the broadband penetration rate in Germany was about 10 percentage points below the leading OECD countries. The size of the estimated effect suggests that German GDP per capita would have

been 3.7 to 5.9 percent higher in 2007 if Germany had been among the leading broadband countries in 2003.

To increase investments in broadband infrastructure, regulatory institutions giving incentives for private investments in modern broadband infrastructure should be preferred over fiscal interventions. Such investments increase an economy’s long-term growth path without increasing government debt.

Lending Policies Remain Restrictive

The credit hurdle for German industry and trade rose in December, as 44.3% of the surveyed firms complained of restrictive lending policies of the banks. The credit hurdle is now 1.4 percentage points higher than in November.

The tightening of credit constraints was particularly strong in construction, with an increase from 47.4% to 50.6%. For the first time in more than three years, more than half of the surveyed building contractors rated banks’ lending policies as cautious. Since construction is one of the key industries, an upswing could be hindered by the credit hurdle in the building sector if the banking system is not put in a position of increasing its credit funds.

Also wholesaling/retailing and the smaller firms in manufacturing increasingly complain of banks’ lending policies. Among mid-sized firms there was no major change in the situation, and among the larger firms, which have been very critical of the banks, there was even some easing of the situation. Still, more than half of the large firms continue to assess bank lending as restrictive.

New Head of Ifo’s Labour Markets Department

Helmut Rainer (36) became the new head of the Social Policy and Labour Markets department at the Ifo Institute last January 1st, accepting also a professorship in economics at the University of Munich (LMU), which is intrinsically tied to the position as Ifo department head.

Born in Graz, Austria, Mr Rainer comes to Ifo from the University of St. Andrews in Scotland, where he has taught at the School of Economics and Finance since 2005.

Studying Shock Waves

Fratscher

There has hardly ever been a better time than now for studying the global transmission channels of economic shocks and how global financial markets affect economic and financial stability. This is what **Marcel Fratzscher**, Head of the International Policy Analysis Division of the European Central Bank (ECB) in Frankfurt, is doing. The importance of financial globalisation and linkages has been painfully apparent during the current financial crisis, which spread quickly and violently from one country and one market segment to almost every corner of the globe.

A second main strand of Mr Fratzscher's research is the role of communication policy and of the media for the conduct of economic policy, an important element at the best of times and fairly crucial in times like these. Much of his research has shown that communication policy has become a primary policy tool, in particular for central banks which rely increasingly on communication to achieve their policy objectives through orally guiding markets and anchoring expectations of agents.

These research interests are reflected in Mr Fratzscher's most recent papers, which have dealt with international financial market linkages and sustainable current account positions, central bank communication, monetary policy and asset prices, exchange rate policy, and capital flows. His papers have been published in



a wide range of academic journals, including the *Journal of International Economics*, *Journal of Financial Economics*, *Review of Economics and Statistics*, *Journal of Money, Credit and Banking*, *Economic Journal*, *Journal of Economic Literature*, *Economic Policy*, and *European Economic Review*.

He was given the Kiel Institute 2006/2007 Excellence Award in Global Economic Affairs for his work on international financial linkages and monetary policy, and the CEPR 2007 Prize for the Best Central Bank Research Paper. In addition to his position at the ECB, he teaches International Finance in the PhD programme in Economics at Goethe University Frankfurt.

Mr Fratzscher's responsibilities at the ECB lie in helping formulate the bank's policy positions on international issues, in particular global economic and financial issues, emerging markets and the international monetary system.

Mr Fratzscher holds a PhD in Economics from the European University Institute (EUI) in Florence, Italy; a Master of Public Policy from Harvard University's John F. Kennedy School of Government; a BA in Philosophy, Politics, and Economics from the University of Oxford, Trinity College; and a BSc in Economics from Kiel University, Germany.

The Economics of Incentives

Roider

Andreas Roider is a professor at the University of Heidelberg's Department of Economics. He studied economics at the universities of Tübingen, Texas at Austin, and Bonn, where he received his BSc in Economics in 1998. Subsequently, he entered the Bonn Graduate School of Economics and the European Doctoral Program, where he obtained his PhD in 2003.

He is also an associate member of the Junges Kolleg of the North Rhine-Westphalia Academy of Sciences.

His research interests range from the theory of economic incentives to institutional, behavioural, and experimental economics. In particular, he is interested in applications to industrial organisation, finance, law and economics, labour economics, and political economy. He has published in such refereed journals as the *American Economic Review*, the *Rand Journal of Economics*, and the *Journal of Economic Behavior and Organization*.

While at CES, Mr Roider plans to work on an ongoing project on commitment problems in principal-agent problems (with G. Muehlheusser, University of Bielefeld, and Florian Englmaier, LMU Munich) as well as on an empirical project on incentive provision using firm data (with F. Englmaier and Uwe Sunde, U. of St. Gallen).



Economics and Sports

Gerd Muehlheusser is currently a Professor of Sports Economics at the University of Bielefeld. He obtained his PhD in 2002 from the University of Bonn, where he was a member of the European Doctoral Programme in Quantitative Economics. From 2003-2008 he was an Assistant Professor at the Department of Economics at the University of Bern. Previous extended research visits have included the London School of Economics, a Jean Monnet Fellowship at the European University Institute in Florence, Northwestern University's Kellogg

School of Management (Department of Management and Strategy), and the University of Southern California's Center for Law and Economics. His research interests are in applied microeconomics, including contract theory, industrial organisation, the economics of sport, law and economics, the regulation of labour markets, and environmental economics.

While at CES, he intends to collaborate with Florian Englmaier (LMU) and Andreas Roider (Heidelberg) on a joint

research project. Further current research includes a joint empirical project with Eberhard Feess (Frankfurt) and Michael Gerfin (Bern) on the incentive effects of long-term contracts, where a legislative change in European professional sports serves as a natural experiment to disentangle incentive from separation effects.



Sporty Labour

Lechner

Mens sana in corpore sano, goes the Latin phrase, positing a positive correlation between mind and body (albeit taken out of context, but that's another story). Could there also be a positive correlation between individual sports activities and labour market outcomes? That is one of the questions that have drawn the attention of **Michael Lechner**, of the Swiss Institute for Empirical Economic Research at the University of St. Gallen.



Labor Market Programs”, published recently in the *Journal of Business & Economic Statistics*.

In labour economics, he focuses on the evaluation of labour market programmes. In a recent paper he wrote jointly with Conny Wunsch (“Are Training Programmes More Effective When

Unemployment is High?”), published in the *Journal of Labor Economics*) he shows that active labour market programmes are more effective when unemployment is high, because the so-called lock-in effects are less relevant.

Michael Lechner is Professor of Econometrics and one of the Directors of the Swiss Institute for Empirical Economic Research at the University of St. Gallen. He is also a member of the German Academy of Sciences Leopoldina.

Mr Lechner is an associated editor with several journals, among them the *Journal of Labor Economics*. He publishes in many journals, including the *Economic Journal*, the *Journal of the European Economic Association*, the *Journal of Econometrics*, and the *Journal of Health Economics*.

In a recent paper (“Long-run Labour Market and Health Effects of Individual Sports Activities”, published in *The Journal of Health Economics*), he indeed finds that such positive effects are present and that they may be of a considerable magnitude. This paper is emblematic of his recent research interests —microeconomics, labour economics, and health economics— sitting at the confluence of these three fields.

In the field of microeconometrics, he is mainly interested in the econometric identification and estimation of causal effects based on microdata. A recent example of this was his paper “Sequential Causal Models for the Evaluation of

Designing Optimal Taxation

Lehmann

One of **Etienne Lehmann**'s current interests is the design of optimal redistributive taxation, in particular in economies where search/matching frictions in the labour market and wage bargaining induce the existence of involuntary unemployment. He has written three papers on this topic with Mathias Hungerbühler (University of Namur), Alexis Parmentier (EPEE, University of Evry) and Bruno van der Linden (IRES Louvain la Neuve).



The idea is to revisit the Mirrlees (1971) model of optimal income taxation where taxation is restricted to be conditioned on endogenous earnings and not on the exogenous characteristics, whose heterogeneity in the population is at the core of the redistribution problem. Instead of assuming that earnings responses are due to labour supply decisions along the intensive margin, these papers assume that earnings are negotiated between employed workers and their employers.

A rise in marginal tax rate makes employers more reluctant to concede wage increases in the negotiation processes. Through this mechanism, a rise in marginal tax rate induces a decline in gross earnings that in turns increases labour demand. The redistributive optimum trades off the equity gain of an increase in marginal tax rate against the efficiency loss of an inefficiently low level of wages that decreases the average wage per labour force participant below its maximised level.

Etienne Lehmann is a professor of economics, currently on leave from University of Paris 2 and appointed as research fellow at CREST (Centre de Recherches en Economie et Statistiques, Malakoff), the research center associated to the French National Institute of Statistics and Economic Studies (INSEE). He is associate editor of *Economics Bulletin*, *Louvain Economic Review* and *Annales d'Economie et de Statistiques*.



Süddeutsche Zeitung MUNICH SEMINARS

Deutschlands große Tageszeitung

sponsored by

BMW Niederlassung München

Wegweisend und voller Wertschätzung für Sie.

Chaired by Hans-Werner Sinn (CESifo) and Marc Beise (*Süddeutsche Zeitung*)

Sponsored by BMW Niederlassung München

Monday, 6 pm, CESifo Conference Centre, Ludwig-Erhard-Hall, Poschingerstr. 5, Munich

19 April 2010

Lady Barbara Judge

Chairwoman of the UK Atomic Energy Authority in Harwell, Oxfordshire

New nuclear – Policies, Problems and Practice

14 June 2010*

Thilo Sarrazin

Member of the Executive Board of the Deutsche Bundesbank

*Topic to be announced. Further seminars will be confirmed in the coming weeks.

For details, visit

www.cesifo-group.org > Conferences > Seminars

Policymaking with Sociotropic and Psychic Concerns

Nelson

Devising trade policy is a tricky thing. You have to strive for a good balance of a number of factors. In the end, though, your ultimate objective must be your citizens' well-being and degree of satisfaction. As a matter of fact, when evaluating trade policy, citizens are concerned more with unemployment than with changes in relative prices, as **Douglas R. Nelson** points out in a recent paper, "A Behavioral Model of



Unemployment, Fairness and the Political Economy of Trade", written jointly with Carl Davidson and Steve Matusz.

A professor of economics at Tulane University in New Orleans and this year a guest professor at ETH Zurich, Mr Nelson argues that when thinking about unemployment, citizens worry about direct economic consequences to themselves, broader psychic consequences (the "unhappiness" caused by unemployment), and the effect of unemployment on fellow citizens (sociotropic or fairness concerns).

He and his colleagues built a general equilibrium model of labour market search that generates unemployment in equilibrium, where citizens have preferences with all three of the above concerns. These preferences are then aggregated into a social welfare function which they then attribute to a policy-maker and solve for optimal policies. They derive a number of propositions about optimal policy and argue that there is evidence of policies that could be rationalised by a policy-maker with such an objective function. These are: 1) a preference for good jobs (long-lasting, easy-to-find jobs); 2) a preference for gradual adjustment to the optimal policy; and 3) a complicated relationship between openness and level of welfare state provision.

Mr Nelson's research focuses on three broad areas: political economy of trade and immigration policy, theory of trade and trade policy with non-convex production sets, and links between globalisation and labour markets.

Currently, in addition to a number of smaller projects, he is working on two major research projects. In the first of these, Political Economy of Trade with

Unemployment, Scarring and Sociotropic Preferences, conducted jointly with Carl Davidson and Steve Matusz, both of Michigan State University, they build on their earlier papers to develop a model of general political economic equilibrium with lobbying, as in the Grossman-Helpman protection-for-sale model, but with the social welfare constraint as developed in the paper mentioned above, in which the SWF reflects both private and sociotropic costs of unemployment.

The second project, Globalisation and Corporate Governance (joint work with Peter Egger and Hartmut Egger), seeks to develop general equilibrium models of cross-country differences in corporate governance to examine: a) the effect of governance structures on patterns of comparative advantage; and b) the effect of globalisation (trade in the first instance) on corporate governance structures.

Douglas R. Nelson is a Professor of Economics at the Murphy Institute and Department of Economics, Tulane University, New Orleans, and a Professorial Research Fellow at Leverhulme Centre for Research on Globalisation and Economic Policy, School of Economics, University of Nottingham. He has previously worked for the US Treasury, the World Bank, and the IMF.

Corporate Gaps

Koethenbuegger

How do taxes work in the presence of corporate agency problems? That question falls smack in the centre of one of the research fields **Marko Koethenbuegger** is exploring.



While visiting CES, he will continue this line of inquiry together with Michael Stimmelmayer. One question they will address is how the corporate tax base should be defined. Previous research has shown that the normal return on investment should be exempted from taxation.

A first conclusion of this research, presented in Mr Koethenbuegger's recent working paper *Corporate Taxation and Corporate Governance*, is that such a policy may lose its attractiveness when shareholders and corporate managers have non-congruent interests: it widens the gap between corporate investments undertaken by the management and those which shareholders would prefer.

A second strand of research while at CES is the analysis of the fiscal consequences of different electoral rules, both theoretically and empirically. The research is motivated by recent electoral reforms at the municipal level in Germany and is being conducted jointly with Peter Egger and Michael Smart.

Marko Koethenbuegger is an associate professor at the economics department of the University of Copenhagen, to which he recently moved after holding positions at the University of Munich and University of Vienna, and is a research professor at the Ifo Institute.

He holds a PhD from the University of Paderborn and a post-doctoral degree from the University of Munich.