



INSTITUTE FOR
INTERNATIONAL
ECONOMIC STUDIES
Stockholm University

Annual Report

2005/2006

Research Activities
Staff and Organization
Publications



The Institute for International Economic Studies

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HARRY FLAM
JOHN HASSLER
HENRIK HORN
ASSAR LINDBECK
MATS PERSSON
TORSTEN PERSSON
PETER SVEDBERG
FABRIZIO ZILIBOTTI

Visiting Professors

PER KRUSELL
KJETIL STORESLETTEN

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ETHAN KAPLAN
DIRK NIEPELT
DAVID STRÖMBERG
JAKOB SVENSSON

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THOMAS EISENSEE
GIOVANNI FAVARA
DARIA FINOCCHIARIO
VIRGINIA QUEIJO VON
HEIDEKEN
MARTIN BECH HOLTE
ANNA LARSSON
MARTIN LJUNGE
JOSÉ MAURICIO PRADO JR.
ZHENG (MICHAEL) SONG
MIRCO TONIN
GISELA WAISMAN

Visiting Fellows

ORIANA BANDIERA
London School of Economics
TIM BESLEY
London School of Economics
MICHELE BOLDRIN
University of Minnesota
STEFANO DELLA VIGNA
University of California at Berkeley
ARINDRAJIT DUBE
University of California at Berkeley
GENE GROSSMAN
Princeton University
PAUL KLEIN
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University College London
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University of Durham
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Princeton University

News at the Institute 2005/2006

LARS CALMFORS was awarded His Majesty the King's Medal of the eighth grade for "important contributions to economic research and development". He became chairman of the European Economic Advisory Group (EEAG) set up by the CESifo institute in Munich in June 2006. He was also appointed chairman of the Söderberg Foundation Prize Committee for 2007.

THOMAS EISENSEE successfully defended his doctoral thesis in January 2006. He currently holds a position at the Swedish Ministry of Finance.

HARRY FLAM stepped down as Dean of the Stockholm University School of Business on March 31 and returned to the Institute on a full-time basis

ANDERS FREDRIKSSON was admitted as a graduate student at the Institute in June 2006.

JINFENG GE and ETTORE PANETTI joined the Institute as research assistants and they are both enrolled in the graduate program at Stockholm University.

BART GOLSTEYN, from Maastricht University, spent the spring term of 2006 at the Institute as a visiting graduate student.

CHRISTINA LÖNNBLAD became editorial secretary of *Ekonomisk Debatt* in the autumn of 2005.

DIRK NIEPELT was appointed Program Director of Doctoral Courses at Study Center Gerzensee in the autumn of 2005.

ELENA PALTSEVA, from the Stockholm School of Economics, has accepted a post doc position at the Institute for the academic year 2006/2007.

STEPHEN PARENTE from University of Illinois will spend the autumn of 2006 at the Institute as a visiting researcher.

TORSTEN PERSSON was elected Second Vice-President of the Econometric Society. Under the normal election procedures of the Society, this honor implies that Torsten will become its President during the calendar year 2008.

ÅSA ROSÉN from SOFI, Stockholm University will spend the autumn of 2006 at the IIES.

FABRIZIO ZILIBOTTI has continued as the managing editor of the *Review of Economic Studies*. He is on leave of absence from the Institute since August 1, 2006, and is currently based at University of Zurich. The German economic newspaper “Handelblatt” has ranked him as the best macroeconomist (and the sixth best economist across all fields) based in a German-speaking university.



The popular IIES Faculty Club lunch, from the left: John Hassler, Peter Fredriksson, Assar Lindbeck, Nathan Nunn, Bård Harstad, Nicola Gennaioli, David Strömberg and Fabrizio Zilibotti

Staff Research Activities 2005/2006

LARS CALMFORS published (1) “Nominal Wage Flexibility, Wage Indexation, and Monetary Union”, *Economic Journal* 116, 2006 (with Åsa Johansson); (2) *What Remains of the Stability Pact and What Next?*, Swedish Institute for European Policy Studies, 2005:8; (3) *Report on the European Economy 2006 of the European Economic Advisory Group* (EEAG) at the CESifo Institute March, Munich (with Giancarlo Corsetti, Seppo Honkapohja, John Kay, Gilles Saint-Paul, Hans-Werner Sinn, Jan-Egbert Sturm and Xavier Vives); (4) “Budgetpropositionen 2005” (The Budget Bill 2005), Nationalekonomiska föreningens förhandlingar (The Deliberations of the Swedish Economic Association), *Ekonomisk Debatt* 2006:1; (5) “Globalisering, löner och arbetslöshet” (Globalisation, Wages and Unemployment), *Ekonomisk Debatt* 2006:4; and (6) “Fri tjänstehandel kräver fri lönebildning” (Free Trade in Services Requires Free Wage Setting), in Ögren, M., (ed.), *Sanningen om Sverige – en antologi om jobben som försvann* (The Truth about Sweden – An Antology on the Jobs that Disappeared), Bokförlaget DN 2006. In addition, he wrote (7) “Is There a Scandinavian Economic Miracle” for publication in the *Report of the European Economy 2007* by the EEAG group. He was the faculty opponent on Karl-Oskar Lindgren’s dissertation “Roads from Unemployment -- Institutional Complementarities in Product and Labor Markets” at the Department of Political Science in April 2006.

HARRY FLAM stepped down as Dean of Stockholm University School of Business on March 31 and returned to the IIES. He published (1) a review of Gual, J. (ed.), *Building a Dynamic Europe: The Key Policy Debates*, Cambridge University Press, in *Journal of Economic Literature* 94, 2006. He delivered the key-note address (2) “Regionalism vs. Multilateralism in World Trade” at the Sri Lanka Economic Association Annual Sessions, forthcoming in *Sri Lanka Economic Journal*, and the public lecture (3) “Trade, Markets and Economic Growth” for the Central Bank of Sri Lanka, to be published in the Bank’s lecture series.

NICOLA GENNAIOLI wrote four new papers: (1) “Economics and Politics of Alternative Institutional Reforms” (with Francesco Caselli); (2) “Bankruptcy, Creditor Protection and Debt Contracts” (with Stefano Rossi); (3) “Judicial Fact Discretion” (with Andrei Shleifer); and (4) “Precolonial Centralization and Institutional Quality in Africa”, in Gradstein, M. and K. Konrad, (eds.), *Political Economy and Development*, MIT Press, forthcoming (with Ilia Rainer). He also revised the following papers: (5) “The Evolution of Precedent” (with Andrei Shleifer); (6) “Contracting in the Shadow of the Law”; (7)

“The Modern Impact of Precolonial Centralization in Africa” (with Ilia Rainer); and (8) “Dynastic Management” (with Francesco Caselli). He presented papers at the following seminars: Central European University, George Mason, IGIER (Bocconi), Kellogg MEDS, Kellogg Finance, New York University and Umeå University. He was invited to the following conferences: BREAD/CEPR conference on “Barriers to Entry and to Expansion in the Developing World: the Role of Institutional Constraints” (Amsterdam), ESSIM CEPR (Tarragona), Political and Institutional Constraints to Growth: Lessons from the European Union at EUI (Fiesole).

During the year, JOHN HASSLER and José V. (Sevi) Rodríguez Mora at University Pompeu Fabra worked on a project where they let political preferences depend on reference points, i.e., what individuals feel they are entitled to. So far, the project has resulted in the paper (1) “Read My Lips: The Commitment Value of Empty Promises under Loss Aversion” that has been presented at seminars and conferences in Sweden, Spain, Israel and China. John also worked with Tore Ellingsen and Richard Friberg on a project aimed at explaining why firms tend to be quicker in increasing prices than in decreasing them. The project has resulted in the paper (2) “Explaining Asymmetric Price Adjustment”, which has been submitted to the *American Economic Review*.

ETHAN KAPLAN worked on (1) “The Fox News Effect: Media Bias and Voting”, *Quarterly Journal of Economics*, forthcoming (with Stefano Della Vigna); (2) “The Iceberg Theory of Campaign Contributions: Political Threats and Interest Group Behavior” (with Marcos Chamon); (3) “Playing Parties Against Eachother in Proportional Representation Systems” (with Marcos Chamon) which was presented at an invited session of the 2006 European Economic Association Meeting; (4) “Outsourcing, Wages and Benefits” (with Arin Dube); and (5) “Imperfect Common Knowledge and Exchange Rate Determination”. He also worked on a project with Galina Hale for the Sveriges Riksbank on using order-flow to predict exchange rate movements at a monthly or quarterly frequency. He gave seminars at London School of Economics, Oxford University, Study Center Gerzensee, Uppsala University, Gothenburg University, the International Monetary Fund, and the European Economic Association 2006 Meeting.

PER KRUSELL spent four months at the IIES (the rest being spent at Princeton University) and worked on a variety of research topics within macroeconomics broadly defined: inequality, growth, labor-market theory, financial economics, political economy, and public economics. Per also gave a short course in macroeconomics and inequality at University of Porto as well as a course in the microfoundations of modern monetary economics at the Sveriges Riksbank. He published (1) “Growth Accounting with Investment-Specific

Technological Progress: A Discussion of Two Approaches”, *Journal of Monetary Economics*, forthcoming (with Jeremy Greenwood).

ASSAR LINDBECK continued his studies of economic reforms, social change and social policy in China. In this area he published (1) “An Essay on Economic Reforms and Social Change in China” (Working Paper, World Bank); and (2) “Ekonomiska reformer och social utveckling i Kina” (Economic Reforms and Social Change in China), *Ekonomisk Debatt* 2005:6. Other work focused on the financial sustainability of welfare-state arrangements. This research includes the following publications: (3) “The Welfare State – Background, Achievements, Problems”, *Palgrave Dictionary*, forthcoming, 2006; (4) “Sustainable Social Spending”, *International Tax and Public Finance* 4, 2006; and (5) “Market Reforms, Welfare Arrangements and Stabilization Policy – A Triple Interaction in Employment Policy”, mimeo, OECD Minister Conference, June 15-16, Toronto. Assar also analyzed, theoretically and empirically, how induced changes in social norms concerning work and social benefits affect the functioning of the welfare state. Further research along similar lines deals with issues such as the determinants of sickness absence, and the consequences of greater freedom of choice relating to human services (education, health care etc.). Publications related to this area include: (6) “Job Security and Work Absence: Evidence from a Natural Experiment” (IIES Seminar Paper 743, IUI Working Paper 660, Stockholm, and CESifo Working Paper 1687)(with Mårten Palme and Mats Persson); and (7) “A Model of Income Insurance and Social Norms”, revised, (with Mats Persson). Moreover, (8) “Raising Children to Work Hard: Altruism, Work Norms and Social Insurance”, *Quarterly Journal of Economics*, forthcoming (with Sten Nyberg); and (9) “The Stability Pact – Rationales, Problems, Alternatives”, *Kyklos*, forthcoming (with Dirk Niepelt), have both been accepted for publication. Assar has also written an essay on (10) “Dag Hammarskjöld as Economist and Government Official” for *Sveriges Riksbank Economic Review* 3, 2005.

DIRK NIEPELT published a paper on balanced budget rules, (1) “Starving the Beast? Intra-Generational Conflict and Balanced Budget Rules”, *European Economic Review*, forthcoming; and a paper on the Stability and Growth Pact, (2) “The Stability Pact—Rationales, Problems, Alternatives”, *Kyklos*, forthcoming (with Assar Lindbeck). Joint with Martín Gonzalez-Eiras, he continued to work on dynamic models of intergenerational transfers in politico-economic equilibrium, revising the paper (3) “Sustaining Social Security” (CESifo Working Paper 1494) and starting new work on a project entitled (4) “Transfers versus Public Investment: The Politics of Intergenerational Redistribution and Growth”. He also started work on the paper (5) “Debt and Maturity without Commitment”. Dirk presented his work at conferences and seminars at University of Berne, the CESifo/CEBR meeting in Copenhagen, the Econometric Society World



Jakob Svensson, recently tenured at the Institute

Congress in London, the Center for Financial Studies Research Conference on New Perspectives on Fiscal Sustainability (Frankfurt), Study Center Gerzensee, IIES, the Swiss National Bank, and the Society for Economic Dynamics Annual Meeting in Vancouver.

MATS PERSSON published (1) “Taxation and Tournaments”, *Journal of Public Economic Theory* 7, 2005 (with Agnar Sandmo); (2) *En hållbar sjukpenningförsäkring. Valförädrådets rapport 2005* (A Sustainable Sick Pay Insurance. Report of the SNS Social Welfare Council 2005), SNS Förlag, 2005 (with Agneta Kruse, Laura Larsson and Mårten Palme); (3) “Incentive and Incarceration Effects in a General Equilibrium Model of Crime”, *Journal of Economic Behavior & Organization* 59, 2006 (with Claes-Henric Siven); (4) “Time Consistency of Fiscal and Monetary Policy: A Solution”, *Econometrica* 74, 2006 (with Torsten Persson and Lars E. O. Svensson); (5) “Kina, Sverige och globaliseringen” (China, Sweden, and the Globalization), *Ekonomisk Debatt* 34:2006 (with Marian Radetzki); (6) “Svar till Bigsten och Holmlund” (A Reply to Bigsten and Holmlund), *Ekonomisk Debatt* 34:2006; (7) “The Becker Paradox and Type I vs. Type II Errors in the Economics of Crime” (Seminar Paper 741) (with Claes-Henric Siven); (8) “Job Security and Work Absence: Evidence

from a Natural Experiment” (Seminar Paper 743) (with Assar Lindbeck and Mårten Palme); (9) “A Model of Income Insurance and social Norms” (Seminar Paper 742) (with Assar Lindbeck).

TORSTEN PERSSON wrote the new papers (1) “Democracy and Development: A Nexus of Political and Economic Change” (NBER Working Paper 12175) (with Guido Tabellini); (2) “Economic Approaches to Political Institutions”, in Blume, L. and S. Durlauf, (eds.), *The New Palgrave*, McMillan, 2006 (with Timothy Besley); (3) “Democracy and Development: The Devil in the Details”, *American Economic Review* 96, Papers and Proceedings (with Guido Tabellini). He also published (4) “Time Consistency of Fiscal and Monetary Policy: A Solution”, *Econometrica* 74, 2006 (with Mats Persson and Lars E.O. Svensson); (5) “Electoral Systems and Economic Policy”, in Weingast, B. and D. Wittman, (eds.), *Handbook of Political Economy*, Oxford University Press, 2006 (with Guido Tabellini); (6) *Advances in Economics and Econometrics: Theory and Applications, The Ninth World Congress*, Cambridge University Press, (ed., with R. Blundell and W. Newey). During the year, he gave a large number of seminars and lectures elsewhere in Europe and the US. As part of longer visits to the London School of Economics, in October/November, and Northwestern University, in March, he gave series of lectures to graduate students.

KJETIL STORESLETTEN is a part-time professor at the Institute, and during 2005/2006 he spent about four weeks here. He continued his long-standing cooperation with John Hassler, Per Krusell and Fabrizio Zilibotti. They got two papers accepted and/or published: (1) “The Dynamics of Government”, *Journal of Monetary Economics* 52, 2005 (with John Hassler, Per Krusell and Fabrizio Zilibotti); and (2) “Democratic Public Good Provision”, *Journal of Economic Theory*, forthcoming (with John Hassler and Fabrizio Zilibotti). Kjetil has also worked on a project with Fabrizio Zilibotti and Zheng (Michael) Song, about the dynamics of government debt when government cannot commit to future policies on taxation, public good provision and debt. During the year, Kjetil continued his work on macroeconomics with heterogeneous agents, and published two papers: (3) “Two Views of Inequality over the Life-Cycle”, *Journal of the European Economic Association: Papers and Proceedings* 3, 2005 (with Jonathan Heathcote and Gianluca Violante); and (4) “Asset Prices and Intergenerational Risk Sharing: The Role of Idiosyncratic Earnings Shocks”, in Mehra, R. (ed.) *Handbook of Investments: Equity Risk Premium*, Elsevier, 2006.

DAVID STRÖMBERG revised the paper (1) “How the Electoral College Influences Campaigns and Policy: The Probability of Being Florida”; and worked on the papers (2) “Media Markets’ Impact on Politics” (with Jim Snyder); and (3) “News Droughts, News Floods and U.S. Disaster Relief”, *Quarterly Journal of Economics*, forthcoming (with Thomas Eisensee).

PETER SVEDBERG published the following articles: (1) “Declining Child Malnutrition: A Reassessment”, *International Journal of Epidemiology* 2006; (2) “The Real, Real Price of Nonrenewable Resources: Copper 1870-2000”, *World Development*, 2006 (with John E. Tilton); (3) “Malnutrition and Hunger: Alternative Perspectives”, in Lomborg, B. (ed.), *Global Crises, Global Solutions*, Cambridge University Press, 2006 (update of first version published in 2004); (4) “Aid and Economic Growth: An Alternative Interpretation of the Empirics”, *Swedish Economic Policy Review* forthcoming. The latter paper was presented at a conference in Stockholm on Foreign Aid Policy, arranged by the Swedish Economic Council. He also wrote two “portraits” of (5) Bent Hansen and (6) Anders Östlind as development economists for the 9th Nordic Doctrine Meeting in Stockholm and a paper (7) “Child Malnutrition and Poverty in Shining India” for a WIDER conference in September 2006. Papers in progress include (8) “Child Malnutrition, Income Distribution and Economic Growth in China 1982-2002”; and (9) “Inter-state Variability in Economic Growth in India: Paradoxical Results”.

During the year JAKOB SVENSSON published the following papers (1) “Political Budget Cycles: Do They Differ Across Countries and Why?”, *Journal of Public Economics* 90, 2006 (with Min Shi); (2) “Are Corruption and Taxation Really Harmful to Growth? Firm Level Evidence”, *Journal of Development Economics*, forthcoming (with Ray Fisman); (3) “Survey Techniques to Measure and Understand Corruption”, *World Development*, forthcoming (with Ritva Reinikka); (4) “How Corruption Affects Service Delivery and What Can Be Done About It?”, in Rose-Ackerman, S. (ed.), *Handbook of Corruption*, Edgar Elgar, forthcoming (with Ritva Reinikka). Jakob has also worked on the papers; (5) “The Power of Information: Evidence from a Newspaper Campaign to Reduce Capture” (with Ritva Reinikka); (6) “Working for God? Evidence from a Change in Financing of Not-for-profit Health Care Providers in Uganda” (with Ritva Reinikka); (7) “Controlling Spending: Electoral Competition, Polarization, and Primary Elections”, revise and resubmit *Scandinavian Journal of Economics*; (8) “Bribes, Lobbying and Development” (CEPR Discussion Paper Series 5759) (with Bård Harstad); (9) “Improving Schooling by Combating Corruption: Evidence from a Newspaper Campaign in Uganda”(with Ritva Reinikka); (10) “Power to the People: Evidence from a Randomized Experiment of a Citizen Report Card Project in Uganda” (with Martina Björkman).

FABRIZIO ZILIBOTTI mainly worked in the areas of macroeconomics, economic growth and development and political economy. He published (1) “The Macroeconomics of Child Labour Regulation”, *American Economic Review* 95:5, 2005 (with Matthias Doepke); (2) “The Dynamics of Government”, *Journal of Monetary Economics* 52, 2005 (with John Hassler, Per Krusell, and Kjetil Storesletten); (3) “Distance to Frontier, Selection, and Economic Growth”, *Journal of the European Economic Association* 4:1, 2006 (with Philippe

Aghion and Daron Acemoglu). The paper (4) “Democratic Public Good Provision” is forthcoming in *Journal of Economic Theory*. He continued to work on theoretical and empirical aspects of industrial organization and innovation, as well as on positive and normative aspects of fiscal policy with John Hassler, Per Krusell, Zheng Song and Kjetil Storesletten. He has continued his cooperation with Matthias Doepke, with whom he has used a theory of endogenous preferences to explain the socio-economic transformations that occurred during the British Industrial Revolution. He has started a project with Dirk Niepelt on the distributional implications and political support of different pensions systems in a world where agents are inequality-averse. A revised version of his paper (5) “Technology, Information and the Decentralization of the Firm” has been solicited by *Quarterly Journal of Economics* (with Daron Acemoglu, Philippe Aghion, Rachel Griffith, Claire Lelarge and John Van Reenen).



Italian research assistants Dario Caldara and Ettore Panetti

Articles published or Accepted in Leading Journals by IIES Staff 2005/2006

FABRIZIO ZILIBOTTI, “The Macroeconomics of Child-Labor Regulation”, *American Economic Review* 95:5, 2005 (with Matthias Doepke).

THOMAS EISENSEE and DAVID STROMBERG, “News Droughts, News Floods and U.S. Disaster Relief”, *Quarterly Journal of Economics*, forthcoming.

HENRIK HORN, “National Treatment and the Gatt”, *American Economic Review* 96:1, 2006.

ASSAR LINDBECK, “Raising Children to Work Hard: Altruism, Work Norms and Social Insurance”, *Quarterly Journal of Economics* 121:4, 2006 (with Sten Nyberg).

MATS PERSSON and TORSTEN PERSSON, “Time Consistency of Fiscal and Monetary Policy: A Solution”, *Econometrica* 74:1, 2006 (with Lars E.O. Svensson).



Fabrizio Zilibotti adds yet another top publication to his list

Visiting Fellows 2005/2006

During their visit to the Institute, ORIANA BANDIERA and IMRAN RASUL worked on two joint papers. The first paper, entitled “Social Connections and Incentives in the Workplace: Evidence from Personnel Data” is co-authored with Iwan Barankay and part of a large project in which they run field experiments to present evidence on the interplay between social connections, incentives, and productivity in the workplace. The paper at hand addresses three questions - (i) whether and how social connections between workers and managers affect the performance of connected workers; (ii) whether and how they affect overall firm performance; and, (iii) whether the effect of social connections depends on the strength of managerial incentives. They identify these effects by combining panel data on individual worker’s productivity from personnel records with a natural field experiment in which they engineered an exogenous change in managerial incentives from fixed wages to performance pay conditional on workers’ average productivity. They find that when managers are paid fixed wages, they favor workers to whom they are socially connected, but when they are paid performance bonuses they do not. Although the favoritism generated by social connections increases the performance of connected workers, we show that favoring connected workers is not optimal for the firm’s overall performance.

In a second project, coauthored with Valentino Larcinese, titled “Motivated or Slackers? Quasi-Experimental Evidence on Graduate Students’ Behavior”, they explore how graduate students respond to information on their previous exam performance. They use data from a university where different academic departments have different disclosure policies regarding exam performance. In all departments, the students’ final assessment depends on their performance in exams and in a dissertation. The key distinction across departments is that, at the time when they write their dissertation, students have different amounts of information about their performance on their previous exams. They explore how the provision of such information affects student performance on their dissertation, and whether this varies by the student’s ability.

MICHELE BOLDRIN visited the Institute for a week in March 2006 and he planned to complete two papers, “On Booms and Busts in Babies and Goodies” (with Larry E. Jones and Alice Schoonbroodt) and “A Theory of Growth and Cycles” (with Jesus Fernandez Villaverde). The former is an attempt to formalize and quantify Easterlin-like

theories of fertility that claim that past and expected growth in labor productivity are the main determinants of fertility choices. The latter, which was also the object of his seminar presentation at the Institute, argues that one can derive a coherent and realistic model of endogenous growth and cycles by jointly using the assumptions that labor and capital are not easily substitutable for every given production technique, that most innovations are labor-saving, and that entrepreneurs innovate only when it is profit maximizing to do so, i.e., when labor is expensive relative to what new machines and production techniques cost them. He did some of this, but mostly he ended up working on future research, as he spent most of his time talking to researchers at the Institute. As it is often the case in a thriving research environment, casual conversations lead to disagreement, disagreement leads to non-casual conversation, the latter brings you to blackboards, and then agreement is often reached on something new and worthy of investigation. This also happened during his visit, and he is most glad it went that way. The two papers he wanted to finish will be completed in any case also thanks to his very productive coauthors. The discussions at the Institute lead him to think more about (optimal and not so optimal) fiscal policy and its impact on income redistribution, and about the role of credit and credit availability in determining expansions and recessions this one, being very close to his research on endogenous growth and cycles, he hopes to pursue further quite soon.

STEFANO DELLA VIGNA from UC Berkeley visited the Institute in August 2005. He worked with David Strömberg and Thomas Eisensee on a joint paper on “The Production Function of the Media: Evidence from Country Coverage”. The idea is to study which foreign countries are covered by the US media, and use this evidence to better understand what kind of events the media features. In turn, this can help uncover the demand for information of the American public. At an Institute seminar, he presented work joint with Joshua Pollet on how companies (and US presidents) dump bad news on Friday (“Strategic Release of Information on Fridays: Evidence from Earnings Announcements”). He also had the chance to experience the crayfish season, try Aquavit and herring prepared 12 different ways.

MATTHIAS DOEPKE visited the Institute for four weeks in May 2006. During his visit he presented “Patience Capital, Occupational Choice, and the Spirit of Capitalism” (with Fabrizio Zilibotti). The paper develops a theory of endogenous preference formation in which parents teach patience to their children. The incentives for doing so interact with occupational choices; in particular, the return to being patient, and thus the incentive for parents to teach patience to their children, is especially high in occupations that are characterized by a steep lifetime income profile. As a consequence, society becomes stratified along occupational lines, where the most patient people are those in occupations requiring most education and experience. The theory can account for the socio-economic

transformation that characterized the British Industrial Revolution, when a new class of entrepreneurs rising from the middle classes and imbued with an ethic emphasizing patience and savings proved most capable of profiting from new economic opportunities, and eventually surpassed the pre-industrial elite. Many of the useful comments received during the presentation found their way into the revised version of the paper, on which Matthias and Fabrizio worked during the remainder of his stay.

ARINDRAJIT DUBE from University of California at Berkeley visited the Institute for three weeks in May, 2006. During his time here, he worked on an existing paper (with Ethan Kaplan) entitled “Outsourcing, Wages, and Benefits”. The paper investigates the substantial growth in outsourcing (or subcontracting) of labor services during the eighties and nineties, and finds that a substantial part of the outsourcing penalty in wages and benefits cannot be explained by heterogeneity in skills. This paper is now submitted for publication. He also presented his paper entitled “Do Firms’ Pay Norms Change the Labor Market? Impact of Wal-Mart Growth on Earnings throughout the Retail Sector”. Using the pattern of spatial diffusion of Wal-Mart, the paper devises a novel empirical identification strategy, and estimates the effect of diffusion of a low-wage firm (Wal-Mart) on earnings of workers in the sector. He finds that the diffusion lowered wages overall, including those of competitors; moreover, the primary impact is not through a change in worker composition, but rather a change in labor market rents. Arin benefited from the comments and discussion with IIES faculty members on this paper. He is also very thankful for the opportunity to practice his Klingon with Annika Andreasson in connection with his visit. Finally, he started work on a new project with Ethan Kaplan on understanding the factors behind differential growth patterns in US and Sweden.

GENE GROSSMAN from Princeton University visited the Institute for one week in June 2006. During his stay, he worked on a new paper that he has tentatively entitled “The Simple Economics of Offshoring” (with Esteban Rossi-Hansberg) and presented the main ideas at the Institute seminar. The paper models the inputs to production as a continuum of small tasks and offshoring as the possibility for (costly) international trade in these tasks. As the technology for offshoring improves, domestic labor markets can be affected via three channels, which the authors term the “factor supply effect”, the “productivity effect” and the “relative price effect”. The paper examines how factor prices, outputs and trade volumes respond to reductions in the cost of offshoring blue-collar tasks and white-collar tasks in a variety of familiar trade settings.

PAUL KLEIN visited from University of Western Ontario. He continued to work on two parallel projects with Gustavo Ventura, both dealing with the effects of relaxing migration restrictions. Also, he started a project with David Domeij on understanding the starkly

different labor market behavior of women with small children in Germany and Sweden. He also completed a new version the paper “Time Consistent Public Expenditure” with Per Krusell and José-Víctor Ríos-Rull.

NATHAN NUNN, from University of British Columbia, visited the Institute for two weeks in September 2005. He presented his paper “Relationship-Specificity, Incomplete Contracts, and the Pattern of Trade”. He benefited from comments and feedback he received during the seminar presentation and the paper is forthcoming in *Quarterly Journal of Economics*. While at the Institute, Nathan was able to obtain feedback on a number of different projects. In particular, his research benefited from numerous discussions with the faculty at the Institute, but particularly from discussions with Torsten Persson, Nicola Gennaioli, and Ethan Kaplan.

ANDERS OLOFSGÅRD spent most of his time at the Institute working on two papers. The first, “The Strategic Benefit of Militant Agitators: Wage Bargaining with Communication Between Union Leaders and Rank-and-file”, analyzes a simple wage bargaining game in which wage offers from the firm are accepted or rejected through secret ballots within the union rank-and-file. The union leader has no real authority but is assumed to be better informed about the consequences if the wage offer is turned down, so he can still influence voting through strategic information transmission. The paper shows how this creates incentives for the union members to appoint (somewhat) militant union leaders in order to increase their bargaining power, even though this may increase the risk for labor market conflicts. In the second paper, “The Logic of Authoritarian Bargains”, the focus is on decision making within authoritarian regimes, and how these regimes use a combination of targeted economic benefits and partial political liberalization to remain in power. Based on a simple theoretical model, we estimate a system of equations with economic benefits and democracy scores on the left-hand side and a set of covariates which determine the optimal combination of the two on the right-hand side. He finds a pretty general support for the authoritarian bargain thesis in our sample, except for military and highly repressive regimes. As in previous years, the time at the Institute was both productive and enjoyable, much thanks to the inspiring and generous attitude of the Institute’s faculty and staff.

NICOLA PERSICO, from University of Pennsylvania, visited the Institute for two weeks in August-September 2005. During this time he pursued two research projects. The first is a project on the admissibility of evidence in courtroom proceedings. The goal of that project is to offer a model where, despite the jury being composed of perfectly rational Bayesian updaters, it may nevertheless be optimal for the judge to withhold information from the jury. The model is designed to match existing institutional features of evidence

rules in the United States and other countries. The second project is related to the legal treatment of racial profiling, a phenomenon whereby minorities are disproportionately the target of police interdiction. The goal of the project is to provide a framework, based on economic analysis, to evaluate the effects of civil rights jurisprudence as applied to racial profiling. During his stay at the institute, Nicola also gave a seminar on “A Theory of Random Crackdowns”, where he discussed the theory and evidence of random policing practices. On a lighter note, Nicola was fortunate to be in town for the annual crayfish party, which he enjoyed immensely.

MIKAEL PRIKS visited the Institute for two weeks in February 2006. During these weeks he worked on two different parts of a project on hooliganism. A general problem in the law and economics literature is to empirically evaluate the causal effect of policing on crime. In the paper “Hooliganism in the Shadow of a Terrorist Attack – Do Police Reduce Group Violence?”, which he presented at the Institute, an exogenous change due to the 9/11 terrorist attack on the US is used to estimate how policing affects hooligan violence. It is found that in the periods when the supporter police in Stockholm was reallocated because of the attack, the Stockholm-related hooligan violence was significantly increased. During the visit, he also studied the motivations of hooligans. Do they react emotionally or are they calculating? Using data from the highest Swedish football league, preliminary results showed that there is more violence surrounding the games when the home team loses, given that there is a sufficient number of home supporters compared to the number of away supporters. This indicates that hooligans are emotional and calculating at the same time. The visit and the interaction with the people at the Institute significantly strengthened the project.

MARK WRIGHT from Stanford University visited the Institute for two weeks in April and May of 2006. While there, he continued his research in the causes and consequences of sovereign defaults and international debt crises. This research aims to understand the incentives faced by countries when deciding whether or not to repay their debts. In particular, it aims to provide advice to creditor country governments and international institutions like the International Monetary Fund on the ways in which they can intervene to minimize the costs of these crises while still providing appropriate incentives for repayment. While there he presented a paper based on this work entitled “Sovereign Debt, Default and Bailouts”, and greatly benefitted from comments by, and discussions with, faculty, students and visitors.

Tenure Track Assistant Professor Position

The Institute for International Economic Studies, Stockholm University, seeks to fill one or two positions at the tenure-track assistant professor level, beginning in the academic year 2007/08. Applicants should have a Ph.D. in economics (or be near completion of the doctorate). A commitment to excellence in research is a prerequisite. The position offers a low teaching load (primarily at the Ph.D. level) with a competitive salary. Applicants in all fields of economics are welcome, but preference will be given to candidates in the following fields (listed in alphabetical order): Applied Econometrics, Applied Theory, Growth and Development, Industrial Organization, International Macro and Finance, International Trade, Labor Economics, Macroeconomics, Monetary Economics, and Public Finance. Applicants must submit a CV, three letters of recommendation, and samples of research such as thesis chapters or publications (application packages will not be returned). To ensure full consideration, applications should be received by regular mail by November 29, 2006. Candidates on a shortlist will be interviewed at the ASSA Annual Meetings in Chicago, January, 2007. Other arrangements may be possible for shortlisted candidates not based in the US and not planning to attend the Meetings.

Contact: Prof. Torsten Persson, Institute for International Economic Studies, Stockholm University, SE-10691 Stockholm, Sweden.

Teaching 2005/2006

LARS CALMFORS taught a second-semester course in economic policy (macroeconomics) in the spring of 2006.

NICOLA GENNAIOLI taught two graduate courses at Stockholm University: first year Mathematics and second year Political Economics.

JOHN HASSLER taught the graduate course Non-standard preferences in macroeconomics and the introductory undergraduate macroeconomics course.

EHTAN KAPLAN taught the graduate courses International Macroeconomics and Political Economy III (with Nicola Gennaioli, David Strömberg and Torsten Persson).

PER KRUSELL taught the second part of the graduate Macro II course.

ASSAR LINDBECK has given a number of lectures in micro- and macroeconomics for first-year students.

DIRK NIEPELT taught two graduate courses, Math II (with Nicola Gennaioli), and Macro I (with Fabrizio Zilibotti).

MATS PERSSON taught a graduate course on “The Economics of the Welfare State” during the spring term of 2006.

TORSTEN PERSSON taught the second year graduate courses Political Economics II (with David Strömberg) and Political Economics III (with Nicola Gennaioli, Ethan Kaplan, and David Strömberg). He also taught a Masters/Ph. D. course on the same topic at the London School of Economics (with Timothy Besley).

DAVID STRÖMBERG taught the graduate courses Econometrics II (with Per Pettersson-Lidbom), and Political Economics II (with Torsten Persson) and III (with Nicola Gennaioli, Ethan Kaplan and Torsten Persson).

JAKOB SVENSSON taught the graduate course Development Economics in 2006.

FABRIZIO ZILIBOTTI taught two graduate courses during the 2005/2006 academic year, Economic Growth and Income Inequality and Macroeconomics I. He also taught one undergraduate course, Advanced Macroeconomics.

Extramural Activities 2005/2006

LARS CALMFORS served as a member of the Committee for the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel at the Royal Swedish Academy of Sciences. He also served as a member of the Academy Board and as an adjunct member of its Financial Investment Committee. He was Chairman of the Scientific Council of the Center for Business and Policy Studies (SNS) in Stockholm, Vice Chairman of the European Economic Advisory Group (EEAG) set up by CESifo in Munich, and a member of the Academic Advisory Council of the Anglo-German Foundation in London. He advised McKinsey & Company on their study of the Swedish economy in the spring of 2006. He gave a number of public lectures and speeches, mainly on macroeconomic policy, labor market issues and globalization at, for example, Bruegel in Brussels, a CESifo-EEAG conference in Brussels, the ECB and Its Watchers' Conference in Frankfurt, the Stockholm School of Economics, the Swedish Prime Minister's Office, the Swedish Center for Business and Policy Research (SNS), the Swedish Institute for European Policy Research (SIEPS), the Swedish Economic Association (Nationalekonomiska föreningen), the Confederation of Swedish Enterprise (Svenskt Näringsliv), the Swedish Association for the Printing Industry (Grafiska Företagens förbund), McKinsey & Company, the Nobel Museum in Stockholm, IQPC, IIR, and Trygghetsrådet.

HARRY FLAM served as member of the board of Första AP-fonden, a Swedish public pension fund.

Throughout the year, PER KRUSELL served as a member of the Committee for the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel at the Royal Swedish Academy of Sciences. He also served as an Associate Editor for *Econometrica* and as a Foreign Editor for the *Review of Economic Studies*. He was appointed and served as Programme Director of the International Macroeconomics Programme of the Centre of Economic Policy Research (CEPR). In addition, he served on the Scientific Advisory Boards of CREI, Barcelona, and of the Institute for Advanced Studies, Vienna.

ASSAR LINDBECK was invited by the International Institute of Public Finance as Keynote Speaker at their 61st Congress on Jeju Island, Korea, in the late summer of 2005; topic: "Sustainable Social Spending". He also gave a seminar on "Achievements and Problems of the Welfare State" at the Korean International Institute of Public Finance in Seoul. Moreover, he gave lectures at universities in China. At the Institute for International

Economics in Washington, he both gave a lecture and presented a painting show. He has also made presentations for, among others, the World Bank (Washington), the International Monetary Fond (Washington) and the OECD Finance Ministers (in Toronto), and given lectures at the I.S.E.O. (Institute for Studies on Economics and Employment) Summer School in Iseo, Italy.

MATS PERSSON was a member of the SNS Social Welfare Council, which published the report *En hållbar sjukpenningförsäkring. Välfärdsrådets rapport 2005* (A Sustainable Sick Pay Insurance. Report of the SNS Social Welfare Council 2005), SNS Förlag, 2005.

TORSTEN PERSSON served as second Vice President, on the Executive Committee of the Econometric Society (from January 2006). He was a member of the Academy Council (the governing board of the Royal Swedish Academy of Sciences), and the Boards of the Swedish Research Council.

JAKOB SVENSSON served as a member of the Board of Directors for the Swedish Agency for Development Evaluation (Sadev). He has also been in the reference group for the Expert Group of Environmental Studies (Expertgruppen för miljöstudier) as well as a member of the Panel of Experts for the U4 Helpdesk (Transparency International).



Team Italy fought well at this year's crayfish party games. From the left: Ettore Panetti, Astrid Wåke, Gisela Waisman, Erika Färnstrand Damsgaard and Torsten Persson

Completed Thesis 2005/2006

In January 2006, THOMAS EISENSEE defended his Ph.D. thesis *Essays on Public Finance: Retirement Behavior and Disaster Relief*. The first paper, “News Droughts, News Floods and U.S. Disaster Relief”, shows that the provision of U.S. disaster relief depends on the occurrence of other newsworthy events at the time of a disaster, such as the Olympic Games or the O.J. Simpson Trial. The explanation is that relief decisions are driven by news coverage of disasters and that this news coverage is crowded out by other major news events. The second paper, “Fiscal Policy and Retirement in the Twentieth Century”, shows that social security has been a major determinant of retirement behavior in the second half of the twentieth century. It also provides an explanation to the two major puzzles in the literature (i) the small contemporary retirement elasticities and (ii) the drop in the retirement age prior to the introduction of social security. The third paper, “Sustained Fiscal Policy and the Retirement Decision” is concerned with social security reforms and retirement behavior in economies with aging populations. It is shown that reforms to sustain fiscal policy will result in falling interest rates as the government reduces debt. Since this reduces retirement wealth, it also results in a general delay in retirement. This effect on retirement behavior can be substantially larger than the direct effect of changing social security incentives.

In September 2005, ZHENG (MICHAEL) SONG defended his thesis, *Essays on Dynamic Political Economy*, comprising three papers. In the first paper, “Ideology and the Determination of Public Policy over Time”, he investigates how public policy responds to persistent ideological shocks. The main finding is that the relationship between ideology and the size of government turns out to be non-monotonic. The second paper “Dynamic Inequality and Social Security” analyzes the dynamic interaction between inequality and the repeated political decision on social security. He shows that this interaction may lead to growing social security programs. The third paper, “A Markovian Social Contract of Social Security”, analyzes the sustainability and evolution of the social security system in a majority voting framework with intra-cohort heterogeneity. He finds that the impact of income inequality on the equilibrium social contract induces a non-monotonic relationship between income inequality and social security.

Theses in Progress 2005/2006

MARTINA BJÖRKMAN worked on topics related to health, education and gender within the field of development economics. In her first paper, “Income Shocks and Gender Gaps in Education: Evidence from Uganda”, she uses exogenous variation in rainfall across districts in Uganda to estimate the causal effects of household income shocks on children’s enrollment and cognitive skills conditional on gender. This paper finds that adverse income shocks have large negative effects on female enrollment and test scores, while boys are only marginally affected. In her second paper, “Does Money Matter for Student Performance? Evidence from a Grant Program in Uganda”, she assesses the effect on student performance of an untied public grant in the education sector. To capture the causal effect of the grant, she exploits the variation in program exposure introduced by a newspaper campaign aimed at boosting schools’ and parents’ ability to monitor local officials’ handling of the grant program. Further, in a joint project with Jakob Svensson, “Power to the People: Evidence from a Randomized Experiment of a Citizen Report Card Project in Uganda”, she is studying the health sector in Uganda. This project is a randomized evaluation of a community-based monitoring intervention intended to enhance rural communities’ ability to hold primary health care providers accountable.

ERIKA FÄRNSTRAND DAMSGAARD worked on topics related to macroeconomics, economic growth and intellectual property rights. In her paper “Patent Scope and Technology Choice” she analyzes how patent scope affects the total amount of R&D investment in an industry, and its allocation across potential research projects. Erika spent the spring semester at Massachusetts Institute of Technology, where she attended courses in macroeconomics and political economy.

GIOVANNI FAVARA has been working on two projects. In the first “Agency Costs, Net Worth and Endogenous Business Fluctuations”, he studies the role of credit frictions as a source of instability and oscillating investment dynamics. In this project he proposes a theory where a double-sided incentive problem in a lending relationship, prevents entrepreneurs from engaging in unproductive activities, while booms facilitate the adoption of unproductive arrangements in a way that recessions sow the seeds for a subsequent boom and expansions create the conditions for their own demise. In a second paper, “Imperfect Information and Housing Price Dynamics”, coauthored with Zheng Song, he shows how market participants’ disparate beliefs about the economy can explain the

excess sensitivity of house prices to changes in fundamentals, such as income shocks. In studying heterogeneous expectations about income shocks, within a noisy rational expectations model, he identifies the main driver of house prices in the level of income inequality.

DARIA FINOCCHIARO has been working on topics related to wealth heterogeneity and propensity to plan. In the paper “Inattentive Consumers in General Equilibrium”, she investigates how in a simple endowment economy where agents receive equal income streams, propensity to plan generates wealth heterogeneity. She studies an economy populated by two kinds of agents: “Attentives” and “Inattentives”. The Attentives plan their consumption pattern period by period, while the Inattentives plan every other period. In partial equilibrium, when interest rates are fixed, the inattentive consumers face more uncertainty and save more for precautionary reasons. In general equilibrium, the inattentive group suffers from the effect of prices on their suboptimal savings. Numerical simulations indicate that inattentive consumers will accumulate more bonds when the interest rate is low and reduce their bonds holdings when interest rates are high. This “terms-of-trade” effect could potentially lead to lower wealth. Which of the two effects dominates is unclear and the results depend on the parameterization of the model.

VIRGINIA QUEIJO VON HEIDEKEN has been working on topics related to financial frictions, long-term interest rate volatility and Bayesian estimation. In her first paper, “How Important are Financial Frictions for the U.S. and the Euro Area?” (Seminar Paper. 738), she evaluates the importance of frictions in credit markets for business cycles in the U.S. and the Euro area. Her results indicate that financial frictions are relevant in both areas, and the size of such frictions is larger in the Euro area. In a second paper, she aims to explain the excess volatility of long-term interest rates observed in the data, which is hard to replicate using standard macro models. In this paper, she shows empirically that the consideration of different monetary policy regimes can explain the volatility puzzle and that using yield curve data may make it possible to empirically distinguish between different monetary policy regimes.

MARTIN BECH HOLTE has been working on topics in macroeconomics and political economy. One general question of interest is on the economy-wide incentive levels in society. In one project, Martin studies how the ability of a self-interested ruler to create high-powered incentives in a Communist society evolves over time as the economies develop. In another project, he studies how firms restructure their organizations in response to changes in the progressivity of tax rates, and he ties this response to the evolution of income inequality. Another broad topic of interest is on interdependencies of preferences. Currently, Martin is working on a project on how such preferences affect consumption-



Institute Deputy Director Mats Persson taking his bike for a spin

saving choices and portfolio choices. Martin spent the academic year 2005-2006 at Harvard University, and had a wonderful time there. He spent the summer of 2006 at University of Oslo.

ANNA LARSSON continued her work on the macroeconomic consequences of monetary regimes. In the paper “Monetary Regimes, Labour Mobility and Equilibrium Employment” she considers the strategic interaction between unions and an independent central bank pursuing either an inflation target or an exchange rate target, and shows that when labor mobility is introduced across sectors, the choice of monetary regime does not matter for the labor market outcome. In a second paper, she studies the game between unions, an independent central bank and the government. An important objective of the paper is to study to how the monetary regime affects the scope for fiscal policy in the presence of large wage setters. Anna plans to defend her thesis early in 2007.

JOSE MAURICIO PRADO JUNIOR is working under the supervision of Per Krusell on several papers in macroeconomics. One paper, “Heterogeneous Firms in the Informal Economy”, delivers quantitative predictions for the elasticity of informality with respect to taxation and enforcement and suggests some policy implications in public finance. In the paper “Ambiguity Aversion, Portfolio Choice, and the Equity Premium”, with Irasema Alonso, he examines the potential importance of consumers’ ambiguity aversion for the macroeconomic fluctuations. In a third paper, “Determinants of Capital Intensive and R&D Intensive Foreign Direct Investment”, with Marin Gonzalez-Eiras, he shows how industry and host country characteristics determine FDI composition.

MIRCO TONIN’s main area of research concerns the fiscal implications of the minimum wage and in particular its role in the economy when there is tax evasion through underreporting of earnings. During the year he completed the paper “The Effects of the Minimum Wage in an Economy with Tax Evasion” and presented it at seminars at the Institute of Economics of the Hungarian Academy of Sciences, at the Hungarian National Bank, at the Economics Department of Uppsala University, at the Stockholm School of Economics in Riga, and at the Institute of Labour and Social Research in Vilnius as well as at several conferences. The paper develops a theory to explore the interaction between tax evasion and minimum wage legislation in the labor market. The paper “Did the Minimum Wage Increases in 2001-2002 Reduce Tax Evasion in Hungary?” was written empirically exploring the same issues using Hungarian panel data. He worked on this paper also while visiting the Institute of Economics at the Hungarian Academy of Sciences in February and the Hungarian National Bank during the summer. He started a research project on “In-Work Benefits, Unemployment, and Labor Force Participation” with Ann-Sofie Kolm at the Department of Economics at Stockholm



Robert Barro explaining his research at an Institute seminar

University. He published the paper “Flexibility and Security in the Labour Market. The Wage Dimension” comparing wage setting institutions in five Central and Eastern European countries as Flexicurity Paper 2004/6, International Labour Office.

GISELA WAISMAN’s area of interest is political economy. She is currently working on a paper called “Immigration and Unemployment”. The purpose of this paper is to study the effect of the discrimination of immigrants on all workers’ performance in the labor market. A theoretical model analyzes the effect of increases in the level of discrimination and the proportion of immigrants on wages and unemployment. The interaction between discrimination and the percentage of immigrants is of particular interest since some Swedish regions are characterized by high levels of both variables. We exploit variations among Swedish municipalities to test the model empirically. The level of discrimination is proxied using votes for extreme right parties and survey data on attitudes towards immigrants. This paper is written together with Birthe Larsen.

Seminars and Publications

Seminars

Seminars at the IIES normally take place on Tuesdays and Thursdays between 15.00 and 16.30. most speakers (about 85% of the total) are non-Swedish. The people in charge of the seminars are Professor Fabrizio Zilibotti, Associate Professors David Strömberg and Jakob Svensson, and Christina Lönnblad (administration).

Information about seminars of past and current academic years is to be found on our web: www.iies.su.se/seminars.htm. Invitations and papers presented at seminars can be received electronically or by regular mail (most papers can be downloaded from the web).

Publications

A list of the IIES Seminar Papers is found on our web, where all papers from SP No. 600 are downloadable as pdf-files.

For the most exhaustive information on the publications of individual IIES researchers, visit their own web pages.

The theses of our Ph.D. students are published in our Monograph Series, where all monographs from Monograph No. 46 are downloadable as pdf-files.

The IIES Reprint Series was discontinued at the end of 2001. Our web contains a list of previous and recent publications



Front Cover: Olle Baertling, Irga, 1965, Oil on canvas 180 × 92.

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