

2nd Workshop on Political Economy

From 28/Nov/2008 to 29/Nov/2008 in Dresden

Organizers:

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Jointly organized workshop by CESifo, the Center of Public Economics at TU Dresden and the Ifo Institute for Economic Research Dresden.

Conference venue:

Ifo Dresden
Einsteinstrasse 3
01069 Dresden
Germany

Summary program:

Friday, 28 November 2008

| | |
|---------------|--|
| 12:30 - 12:45 | Welcome address |
| 12:45 - 17:15 | Working Group Sessions |
| 17:30 - 18:30 | Keynote Lecture: DENNIS C. MUELLER (University of Vienna) |
| 20:00 | Conference Dinner |

Saturday, 29 November 2008

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|---------------|--|
| 09:00 - 10:30 | Working Group Sessions |
| 11:45 - 12:45 | Keynote Lecture JAKOB DE HAAN (University of Groningen) |
| 12:00 - 16:00 | Working Group Sessions |
| 16:00 | End of conference |



Friday, 28 November, 2008

- 12:30 - 12:45 **Welcome address**
MICHAEL BERLEMANN (HSU, CESifo, ifo Research Professor)
- 12:45 - 13:30 **Working Group Session**
Central Bank Policy (room 1.5) **Does Central Bank Communication Really Add Information? A Horse Race of Indicators of ECB Communication**
JAN-EGBERT STURM (KOF, ETH Zurich, CESifo)
Discussant: Till Müller (FU Berlin)
- Coffee Break
- Working Group Sessions**
- 13:45 - 15:15 **Democratic Institutions** (room 1.5) **Are there only Black Sheep's in Parliament? Moonlighting Data from Germany**
KARSTEN MAUSE (University Bremen)
Discussant: Niklas Potrafke (University of Konstanz)
Which Democracies Pay Higher Wages?
JAMES C. ROCKEY (University of Leicester)
Discussant: Anandi Mani (University of Warwick)
Tax Compliance (room 1.7) **New Empirical Evidence on the Economics of Tax Evasion: Moral Commitment as a Filter for Deterrence**
GUIDO MEHLKOP (TU Dresden)
Discussant: Martin Gassebner (ETH Zurich)
Patriotism and Tax Compliance
SALMAI QARI (WZ Berlin)
Discussant: Andreas Böhn (TU Dresden)
- Coffee Break
- Working Group Sessions**
- 15:45 - 17:15 **Devolution** (room 1.5) **Reforming Legislatures: Is One House Better than Two?**
GIOVANNI FACCHINI (University of Essex and di Milano, CEPR, CESifo, LdA)
Discussant: Benedikt Goderis (University of Oxford)
Is it Reasonable to Allocate Power to Appointed Regional Authorities?
CLAUDIO PARES BENGOCHEA (Toulouse School of Economics)
Discussant: Mario Mechtel (University Tübingen)
Elections (room 1.7) **The Design of Political Institutions: Electoral Competition and the Choice of Ballot Access Restrictions in the United States**
MARCUS DROMETER (LMU)
Discussant: Stefan Eichler (TU Dresden)
Unambiguous Campaign as a Signal of Competence in Electoral Competition
SIVAN FRENKEL (Tel-Aviv University)
Discussant: Tanja Greiner (LMU)
- Coffee Break
- Keynote Lecture**
- 17:30 - 18:30 **Democracy and Citizenship** (room 1.5)
DENNIS C. MUELLER (University of Vienna)
Chair: Christian Lessmann (TU Dresden)
- 20:00 Conference Dinner, Restaurant „Piazza Nova“

Saturday, 29 November, 2008

Working Group Sessions

- 09:00 -09:45 **Logrolling** (room 1.5) **Global Horse Trading: IMF loans for votes in the United Nation Security Council**
 AXEL DREHER (University of Göttingen, CESifo)
Discussant: James C. Rockey (University of Leicester)
- Checks and Balances** (room 1.7) **Human Rights after 9/11 and the Role of Constitutional Constraints**
 BENEDIKT GODERIS (University of Oxford)
Discussant: Sivan Frenkel (Tel-Aviv University)
- Coffee Break

Working Group Sessions

- 10:00 - 11:30 **Political Cycles** (room 1.5) **Fiscal Rules and the Opportunistic Behaviour of the Incumbent Politician: Evidence from Italian Municipalities**
 RAFFAELLA SANTOLINI (Università Politecnica delle Marche)
Discussant: Christian Bruns (University of Göttingen)
- Political Cycles in Active Labor Market Policies**
 MARIO MECHTEL / NIKLAS POTRAFKE (Uni Tübingen / Uni Konstanz)
Discussant: Axel Dreher (University of Göttingen, CESifo)
- Development** (room 1.7) **Domestic Political Constraints to Foreign Aid Effectiveness**
 LISA MONTANARI (University of Bologna)
Discussant: Edith Sand (Tel-Aviv University)
- Travelling Agents: Political Change and Bureaucratic Turnover in India**
 ANANDI MANI (University of Warwick)
Discussant: Karsten Mause (University Bremen)
- Coffee Break

Keynote Lecture

- EMU and Labour Market Reform** (room 1.5)
 JAKOB DE HAAN (University of Groningen, CESifo)
Chair: Gunther Markwardt (TU Dresden)

Lunch Break

Working Group Sessions

- 13:30 - 15:00 **Demography** (room 1.5) **Immigration and Social Security: The Role of Demography in a Political Economy Equilibrium**
 EDITH SAND (Tel-Aviv University)
Discussant: Alexander Kemnitz (TU Dresden)
- The Demographics of Expropriation Risk**
 PHILIPP HARMS (RTWH Aachen, Study Center Gerzensee)
Discussant: Salmai Qari (WZ Berlin)
- Central Bank Policy** (room 1.7) **Monetary Policy and Inflation under Endogenous Conservatism**
 MICHAEL BERLEMANN (HSU, CESifo, ifo Research Professor)
Discussant: Jan Klingelhöfer (IIES, Stockholm University)
- Political Determinants of Central Bank Independence A Political Economy Approach**
 TILL MUELLER (FU Berlin)
Discussant: Rongrong Sun (Bergische Universität Wuppertal)
- Coffee Break

Working Group Sessions

- 15:15 - 16:00 **Corruption** (room 1.5) **Greasing the Wheels? The Impact of Regulations and Corruption on Firm Entry**
 MARTIN GASSEBNER (ETH Zurich, KOF)
Discussant: Mohammad Reza Farzanegan (TU Dresden)
- Public Spending** (room 1.7) **It's the Media, Stupid - How Media Activity Shapes Public Spending**
 CHRISTIAN BRUNS (University of Göttingen)
Discussant: Guido Mehlkop (TU Dresden)

Book of Abstracts

Keynote Lectures

Friday, 28 November 2008, 17:30 – 18:30, Room 1.5

Democracy and Citizenship

DENNIS C. MUELLER

University of Vienna

Saturday, 29 November 2008, 11:45 – 12:45, Room 1.5

EMU and Labour Market Reform

JACOB DE HAAN

University of Groningen, CESifo

Working Group Sessions

Friday, 28 November 2008, 12:45 – 13:30

Does central bank communication really add information? A horse race of indicators of ECB communication

JAKOB DE HAAN / JAN-EGBERT STURM

University of Groningen, CESifo / ETH Zurich, KOF, CESifo

The purpose of this paper is to re-examine to what extent ECB communication adds information compared to the information provided by a properly specified Taylor-rule model using as many indicators of ECB communication as possible. Since monetary policy is increasingly becoming the art of managing expectations, communication has developed into a key instrument in the central bankers' toolbox in recent years. First, communication may be used to guide private sector expectations. Second, communication may be used to reduce noise in financial markets. Greater disclosure and clarity over policy may lead to greater predictability of central bank actions, which, in turn, reduces uncertainty in financial markets. There is a strongly-held belief among central bankers nowadays that a high degree of predictability is important. The extent to which central bank communication has been successful is very much an empirical issue. Therefore, it is no surprise that the empirical literature on central bank communication has seen major developments in recent years. A substantive number of these studies refer to the communication policy of the ECB. There is substantive evidence that ECB communication move financial markets in the intended direction. There is also a consensus that ECB communications increase the predictability of interest decisions by the ECB. However, there is less agreement as to whether communication adds information compared to the information contained by variables typically included in a Taylor-rule like model. The different outcomes can be caused by many factors, including the use of different indicators of ECB communication and different specifications of the Taylor-rule model.

Friday, 28 November 2008, 13:45 – 15:15, Room 1.5

Are there only Black Sheep in Parliament? Moonlighting Data from Germany

KARSTEN MAUSE

University of Bremen

Using a new data set for the German national parliament, this paper examines the extent and type of German MPs' moonlighting activities. In July 2007, detailed information about the ancillary activities of representatives of the German Bundestag was published for the first time. The published data on the one hand reveal that there are not only 'black sheep' in parliament; that is, there are considerable differences between MPs regarding (i) the number and type of sideline activities and (ii) the amount of outside income generated with these activities. On the other hand, a multiple regression analysis shows that the factors party affiliation, duration of parliamentary membership, age, and number of children, contribute to the explanation of the observable differences. However, the empirical findings for MPs' outside income have to be viewed with skepticism as the established disclosure rules for parliamentarians do not create full income transparency.

Keywords: Moonlighting, Outside Income, Political Corruption, Disclosure Rules

JEL Classification: D 72, H 11, K 42

Which Democracies Pay Higher Wages?

JAMES C. ROCKEY

University of Leicester

This paper asks if and how constitutions affect labor market outcomes. This question is motivated by Rodrik (1999), who suggests that "democracies pay higher wages" and Persson and Tabellini (2003) who provide evidence that differences in democratic constitutions impact economic outcomes. An empirical analysis employs a Bayesian Model Averaging approach to estimate the treatment effect of these differences in the form of democracy on the labor share. The results provide robust causal evidence that presidential democracies are associated with lower wages, after controlling for other potential determinants such as the level of income per capita.

Keywords: Democracy, Constitutions, Wages, Bayesian Model Averaging

JEL Classification: P16, J31, C11

Friday, 28 November 2008, 13:45 – 15:15, Room 1.7

New Empirical Evidence on the Economics of Tax Evasion: Moral Commitment as a Filter for Deterrence

GUIDO MEHLKOP / PETER GRAEFF / ROBERT NEUMANN

Dresden University of Technology / University of Bielefeld / Dresden University of Technology

According to the seminal work of Gary S. Becker (1968), tax evasion and criminal behaviour in general is the result of a rational decision making process, i.e. the deliberation on costs and benefits. In our model we also include the extent of individual commitment to moral norms as a filter for deliberation. It will be argued that there are at least two different patterns of decision making depending on the personal commitment to moral standards: tax compliance due to internalized norms on the one hand and rational deliberation on costs and benefits in the absence of moral sentiments on the other hand. The relevance of the model is shown by using survey data from Germany. By applying a new technique to uncover interaction effects in nonlinear models, different decision patterns are revealed. Actors who have strongly internalized norms do not deliberate on costs and benefits of tax evasion but comply *ceteris paribus*. Actors who feel less obliged to moral norms evade taxes as long as the extent of deterrence (the product of the probability of being detected and the severity of the punishment) does not exceed the expected benefits of crime. However, a certain amount of tax evasion is necessary for a rational choice.

Keywords: Rational Choice, Crime, Norms, Quantitative Methodology

Patriotism and Tax Compliance

KAI A. KONRAD / **SALMAI QARI**

WZB, CESifo / WZB

We study the effects of patriotism for tax compliance. If individuals feel a (random) patriotic warm glow from honest tax compliance, this has implications for optimal auditing and tax compliance. A higher expected warm glow reduces the government's optimal audit probability and yields higher tax compliance. Also, individuals with higher warm glow are less likely to evade taxes. This prediction is confirmed empirically by a multivariate analysis on the individual level while controlling for several other potentially confounding factors. On the aggregate level, we provide evidence for a negative correlation between average patriotic warm glow and the size of the shadow economy across several countries.

Keywords: patriotism, tax evasion, warm glow

JEL classification: H26, K42

Friday, 28 November 2008, 15:45 – 17:15, Room 1.5

Reforming legislatures: Is one house better than two?

GIOVANNI FACCHINI / CECILIA TESTA

University of Essex, Universit di Milano CEPR, CESifo, LdA / Royal Holloway University of London,
University of Essex STICERD-LSE

During the last decade unicameral proposals have been put forward in fourteen US states. In this paper we propose a theoretical framework casting some lights on the drawbacks of bicameral state legislatures and on the effects of the proposed constitutional reforms. In a setting where lawmakers interact with a lobby through a bargaining process and with voters by means of elections, we show that when time constraints are binding, bicameralism might lead to a decline in the legislator's bargaining power vis-a-vis the lobby and to a reduction in his electoral accountability. On the other hand, when the time constraint is not binding, bicameralism might improve electoral accountability. Hence, arguments suggesting that bicameralism is a *panacea* against the abuse of power by elected legislators should be taken with due caution and the proposed unicameral reforms in US states may indeed reduce corruption levels among elected representatives.

Keywords: Bicameralism, corruption, lobbying, bargaining, elections.

JEL classification: D72, C78, H19

Is it Reasonable to Allocate Power to Appointed Regional Authorities

CLAUDIO PARES BENGOCHEA

Toulouse School of Economics

Political decentralization involves an incentive game in which the President and regional authorities have to share power to provide public goods. In such a game, it is never reasonable to allocate political power to appointed Governors. In fact, when formal authority goes to the President - i.e. under administrative decentralization -, no real authority is allocated to Governors. In other words, mere delegation does not exist because regional incentives are never high enough. On the other hand, if formal authority is given to regions - i.e. under democratic decentralization where regional authorities are elected -, Governors may receive some real authority if their incentives are high enough. Additionally, other results of the model say that communication between regions makes the President more accountable and may revert a decentral allocation made under no communication. Finally, asymmetric regions prefer different power allocations and power concerns lead national politicians to avoid proposing decentralizing reforms.

JEL classification: D72, H70

Friday, 28 November 2008, 15:45 – 17:15, Room 1.7

The Design of Political Institutions: Electoral Competition and the Choice of Ballot Access Restrictions in the United States

MARCUS DROMETER / JOHANNES RINCKE

University of Munich

Recent contributions to the political economics literature (Trebbi et al. 2007; Aghion et al. 2004) have challenged the view that political institutions are exogenous to the behaviour of agents in the political arena. We explicitly address the potential endogeneity of institutions by examining the link between the degree of electoral competition and the design of ballot access restrictions in the United States. Exploiting exogenous variation in electoral competition at the state level induced by the federal Voting Rights Act of 1965, our main finding is that restrictions to the entry of minor party and independent candidates have been systematically adjusted to changing degrees of electoral competition.

Keywords: political institutions, electoral competition, ballot access

JEL Classification: D72, D78

Unambiguous Campaign as a Signal of Competence in Electoral Competition

SIVAN FRENKEL

Tel-Aviv University

The level of competence that voters attribute to different candidates plays a major role in the results of elections. In addition, it is observed that some candidates tend to be more ambiguous in their campaign regarding their future plans, while others commit to specific policies. In this paper, we offer a model where politicians vary in their level of competence, or policy expertise, and compete by making costly campaign declarations. We show that a separating equilibrium exists, where the ambiguity of candidate's campaign declaration reveals her level of competence. We therefore present a possible way for voters to learn the competence of candidates through campaign declarations, and also provide an explanation for different levels of campaign ambiguity.

Keywords: electoral competition, competence, ambiguity, commitment

JEL classification: D72, D82

Saturday, 29 November 2008, 09:00 – 09:45, Room 1.5

Global Horse Trading: IMF loans for votes in the United Nations Security Council

AXEL DREHER / JAN-EGBERT STURM / JAMES RAYMOND VREELAND

Göttingen University, KOF, CESifo / ETH Zurich, KOF, CESifo / Yale University

We investigate whether temporary members of the United Nations Security Council receive favorable treatment from the International Monetary Fund (IMF) using panel data for 197 countries over the period 1951 to 2004. Our results indicate a robust positive relationship between temporary Security Council membership and participation in IMF programs even after accounting for economic, political, and country-specific factors. There is also evidence that Security Council membership reduces the number of conditions included in IMF programs. IMF loans seem to be a mechanism by which the major shareholders of the Fund win favor with voting members of the Security Council.

Keywords: IMF, United Nations Security Council, Voting, Aid

JEL Classification: F33

Saturday, 29 November 2008, 09:00 – 09:45, Room 1.7

Human Rights after 9/11 and the Role of Constitutional Constraints

BENEDIKT GODERIS / MILA VERSTEEG

University of Oxford / University of Oxford

After 9/11, the United States and its allies took measures to protect their citizens from future terrorist attacks. While these measures aim to increase security, they have often been criticized for violating human rights. But violating rights may be difficult in a constitutional democracy with separated powers and checks and balances. We develop a theoretical model to analyze the effect of the post-9/11 terror threat on human rights. We test the predictions of the model empirically using difference-in-difference estimation for 152 countries between 1978 and 2006. The results support the theoretical predictions: the post-9/11 terror threat led to a systematic increase in human rights violations in US ally countries. This effect was significantly smaller in countries with independent judicial review (counter-majoritarian checks), but did not depend on the presence of veto players in a country's political process (majoritarian checks).

Keywords: human rights, terrorism, 9/11, checks and balances, constitutions, constitutional courts

JEL Classification: K19, D72, F52

Saturday, 29 November 2008, 10:00 – 11:30, Room 1.5

Fiscal Rules and the Opportunistic Behaviour of the Incumbent Politician: Evidence from Italian Municipalities

DAVID BARTOLINI / RAFFAELLA SANTOLINI

Universit`a Politecnica delle Marche / Universit`a Politecnica delle Marche

Previous studies on electoral competition show that fiscal variables are manipulated by incumbent politicians in order to be re-elected. This phenomenon has been addressed by the literature on electoral budget cycle and, in a decentralised economy, by the literature on yardstick competition. Our objective is to consider the effect of the introduction of a fiscal rule on the opportunistic behaviour of the incumbent politician. We conduct a panel data analysis on the current expenditures of 246 Italian municipalities. The introduction of the domestic stability pact (DSP) seems to sharpen the electoral cycle, by increasing the magnitude of the expenditure during pre-electoral periods and reducing it in the following periods. The analysis of yardstick competition shows that municipalities affected by the DSP are more sensitive to changes in fiscal policies of neighbouring jurisdictions during pre-electoral periods. We conclude that the introduction of the DSP, besides significantly reducing the level of local public spending, strengthens the opportunistic behaviour of incumbent politicians in pre-electoral years.

Keywords: Fiscal rules; Electoral budget cycle; Yardstick competition; System GMM; Spatial econometrics

JEL Classification: C23; C21; D72; H72

Political Cycles in Active Labor Market Policies

MARIO MECHTEL / NIKLAS POTRAFKE

Eberhard Karls University Tübingen / University of Konstanz

This paper examines a framework in which politicians can decrease unemployment via active labor market policies (ALMP). We combine theoretical models on partisan and opportunistic cycles and assume that voters are rational irrational. It is shown that politicians have incentives of a strategic use of active labor market policies that leads to a political cycle in unemployment and budget deficit. We test the hypotheses predicted by the theoretical model using data from German states from 1985 to 2004. The results illustrate that opportunistic behavior of political decision makers can explain the development of ALMP approximated by job-creation schemes.

Keywords: active labor market policies, political cycles, labor market expenditures, opportunistic politicians, partisan politicians, rational irrational voting

JEL Classification: P16, J08, H72, E62, H61

Saturday, 29 November 2008, 10:00 – 11:30, Room 1.7

Domestic political constraints to foreign aid effectiveness

LISA MONTANARI

University of Bologna

In the last years the Aid Effectiveness Literature has dedicated wide attention to investigate the effects of foreign aid on economic growth through country policies. Different results have been reached across different studies mainly due to their sensitivity to policy measures and data samples. The domestic political setting of LDCs may influence the effect of aid over policy distortions and it represents a reason for this ambiguity. I present a model in which the government has complete control over the policy implementation. The interaction with a domestic special interest group which benefits from distortions and a benevolent donor agency affects its decisions. I extend a lobbying model *a la* Grossman and Helpman to the aid context in order to analyze how the presence of active interest groups in the recipient countries might divert the desired objective of the loans. I show that, while the government is always better off when foreign aid is present, the economy may be characterized by a more or less distorted equilibrium depending on the way aid modifies the policy effect on economic welfare. When aid is more effective (it reduces the negative effect of the distortion on welfare) the government has an incentive to pursue higher levels of distortion in order to extract a larger contribution from the lobby. Aid and the policy distortion become substitutes in the government's utility function. Hence the distortion in equilibrium is larger than the "natural" level it would occur in the absence of aid. In such a case, if the lobby is able to extract gains from aid the equilibrium non trivially becomes less distorted. The same result generally yields when aid is conditional on the policy implemented. Anyway I show that the possibility for more-distorted equilibria to arise does not completely disappear. When the "natural" distortion of the economy is large, a benevolent donor might still have an incentive in not properly addressing conditionality issues. Finally, the case of conditional aid is extended to an asymmetric information framework. When neither the domestic lobby and the international donor know which is the weight the government attaches to public welfare with respect to illegal contributions, conditionality of aid is not enough to obtain less distorted equilibria. When the range of uncertainty over the government's preferences is large the presence of aid might lead to the implementation of worse policies. Compared to the previous literature, this is a new channel through which the observed ineffectiveness of conditional policies can be explained.

Keywords: foreign aid, policy distortion, lobbying, political economy

JEL Classification: E61, F35, O19, P16

Traveling Agents: Political Change and Bureaucratic Turnover in India

LAKSHMI IYER / ANANDI MANI

Harvard Business School / University of Warwick

We develop a framework to examine how politicians with short term electoral pressures control bureaucrats with longer term career concerns. Empirical analysis using a unique data set on the career histories of Indian bureaucrats supports the key predictions of our framework. We find that politicians use frequent reassignments (transfers) across posts of varying importance as a means of control. High-skilled bureaucrats face less frequent transfers and a lower variability in the importance of their posts. There are alternative routes to career success: officers of higher initial ability are more likely to choose to invest in developing expertise to succeed, but officers who belong to the same caste as the politician are also able to obtain important posts. Bureaucrats are less likely to be transferred if politicians have alternative means of control, through subordinate politicians. Districts with higher rates of politically induced bureaucrat transfers are somewhat less successful in poverty reduction over the long run.

Keywords: career concerns, bureaucracy, bureaucrat reassignment

JEL Classification: D23, D73, D78, H83, J45

Saturday, 29 November 2008, 13:30 – 15:00, Room 1.5

Immigration and Social Security: The Role of Demography in a Political-Economy Equilibrium

EDITH SAND / ASSAF RAZIN

Tel-Aviv University / Tel Aviv University, Cornell University, CEPR, NBER, CESifo

In the political debate people express the idea that immigrants are good because they can help pay for the old. The paper explores this idea in a dynamic political-economy setup. We characterize sub-game perfect Markov equilibrium where immigration policy and pay-as-you-go (PAYG) social security system are jointly determined through a majority voting process. Our analysis demonstrates that even if immigrants increase the work force and are net contributors to the solvency of the social security system, migration can actually pose a political threat to the system that in the absence of migration would have been assured. This result from the fact that by having a higher population growth rates than the native born population, immigrants can change the future demographic balance towards the young favoring lower social security benefits and thereby threaten the political sustainability of the social security system.

JEL Classification: F22, H55, J11, P16

The Demographics of Expropriation Risk

PHILIPP AN DE MEULEN / **PHILIPP HARMS**

RWTH Aachen University / RWTH Aachen University

It is often argued that capital flows to developing countries could prevent a looming “asset price meltdown” in aging industrialized economies. In this paper, we scrutinize this argument using a two-country model that explicitly accounts for capital market imperfections in the form of expropriation risk. We relate a government’s decision to expropriate foreign investors to conflicting distributional interests within the host-country population and analyze the effect of varying the population growth rate. While higher population growth would, indeed, spur foreign investments in a world of perfect capital markets, it reduces the volume of capital inflows if the risk of expropriation is taken into account. However, this effect may vanish over time, and in the medium run, higher population growth may raise the feasible volume of foreign investment.

Keywords: Demographic Economics, Political Economy, International Investment

JEL classification: J1, D78, F21

Saturday, 29 November 2008, 13:30 – 15:00, Room 1.7

Monetary Policy and Inflation under Endogenous Conservatism

MICHAEL BERLEMANN / ANDREA SCHNEIDER

Helmut-Schmidt-University Hamburg, CESifo / Helmut-Schmidt-University Hamburg

In the standard Barro-Gordon-model the monetary authority's degree of conservatism determines the magnitude of the inflation bias. However, we show the voters' degree of conservatism to react quite sensitive to macroeconomic outcomes. Employing a dynamic version of the Barro-Gordon-model with time-lags of monetary policy and a feedback of macroeconomic outcomes on conservatism we show that government-dependent central banks might engage in destabilizing monetary policies and study the circumstances under which this result is likely to occur. Thus, isolating the central bank from the voters' political pressure does not only ease the inflation bias but also increases dynamic macroeconomic stability.

Keywords: monetary policy, endogenous conservatism, inflation

JEL Classification: E31, E58

Determinants of Central Bank Independence: A Political Economy Approach

TILL MÜLLER

Free University Berlin

From a normative perspective, it is striking that the degree of central bank independence (CBI) varies considerably across countries. Taking a political economy perspective, this paper demonstrates how different degrees of CBI may be the result of 'strategic policy-making'. While an independent central bank reduces the incumbent politician's chances to influence current monetary policy it also raises the costs of future policy changes for political successors. Hence, when deciding on the degree of CBI, incumbent politicians face a trade-off: current influence on monetary policy versus policy durability. This paper shows how various factors change this trade-off and hence the institutional choice. The model predicts that the level of CBI incumbent politicians choose will increase in politicians' ability to screen central bankers' preferences, in the degree of political polarization, and in the weight politicians place on future policy outcomes. In contrast, the likelihood for the implementation of an independent central bank decreases in the re-election prospects of incumbents and in the utility central bankers receive from holding office.

Keywords: Central Bank Independence, Political Economy, Signaling

JEL Classification: D78, E42, E58

Saturday, 29 November 2008, 15:15 – 16:00, Room 1.5

Greasing the wheels? The impact of regulations and corruption on firm entry

AXEL DREHER / MARTIN GASSEBNER

Göttingen University, KOF, CESifo / ETH Zurich, KOF

The paper investigates whether the impact of regulations on entrepreneurship depends on corruption. We first test whether regulations robustly deter firm entry into the markets. Our results show that some regulations are indeed important determinants of entrepreneurial activity. Specifically, more procedures required to start a business and larger minimum capital requirements are detrimental to entrepreneurship. Second, we test whether corruption reduces the negative impact of regulations on entrepreneurship in highly regulated economies. Our empirical analysis for a maximum of 43 countries over the period 2003-2005 shows that corruption is beneficial in highly regulated economies. At the maximum level of regulation among our sample of countries, corruption significantly increases entrepreneurial activity. Our results thus provide support for the 'grease the wheels' hypothesis.

Keywords: corruption, start-ups, grease the wheels, entrepreneurship, regulation, doing business

JEL Classification: D73, F59, M13, L26

Saturday, 29 November 2008, 15:15 – 16:00, Room 1.7

It's the Media, Stupid - How Media Activity Shapes Public Spending

CHRISTIAN BRUNS / OLIVER HIMMLER

Göttingen University / Göttingen University

Politicians seeking reelection need voters to know what they have done for them. Thus, incentives may arise to spend more money where media coverage is higher. We present a simple model to explain the allocation of public spending across jurisdictions contingent on media activity. An incumbent seeking to maximize the probability of reelection will shift more money to jurisdictions where an extra dollar gains more votes because a larger share of the electorate is informed about his policy. This prediction is tested using US data on county-level public spending, Designated Market Areas (DMAs) and location of licensed television stations. Instrumenting for the possible endogeneity of media activity to public spending, 2SLS results confirm a positive effect of media coverage on county-level public spending. Spatial regression rules out the possibility of confounding media effects with spatial autocorrelation.

Keywords: public spending, information, television, elections

JEL Classification: D7, D8, H7

List of Participants

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|---------------------------------|--|
| Heike Auerswald | TU Dresden |
| David Bartolini | Università Politecnica delle Marche |
| Claudio Pares Bengoechea | Toulouse School of Economics |
| Michael Berlemann | HSU, CESifo, ifo Research Professor |
| Andreas Bühn | TU Dresden |
| Christian Bruns | University of Göttingen |
| Jakob de Haan | University of Groningen |
| Axel Dreher | University of Göttingen |
| Marcus Drometer | LMU |
| Stefan Eichler | TU Dresden |
| Giovanni Facchini | Univeristy of Essex, CEPR, CESifo, LdA |
| Mohammad R. Farzanegan | TU Dresden |
| Sivan Frenkel | Tel-Aviv University |
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| Alexander Kemnitz | TU Dresden |
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| James C. Rockey | University of Leicester |
| Edith Sand | Tel-Aviv University |
| Raffaella Santolini | Università Politecnica delle Marche |
| Helmut Seitz | TU Dresden, ifo, CESifo |
| Christian Schmidt | Leibniz Graduate School |
| Jan-Egbert Sturm | ETH Zurich, KOF Swiss Economic Institute |
| Rongrong Sun | Bergische Universität Wuppertal |
| Cecilia Testa | Royal Holloway University of London, STICERD - LSE |
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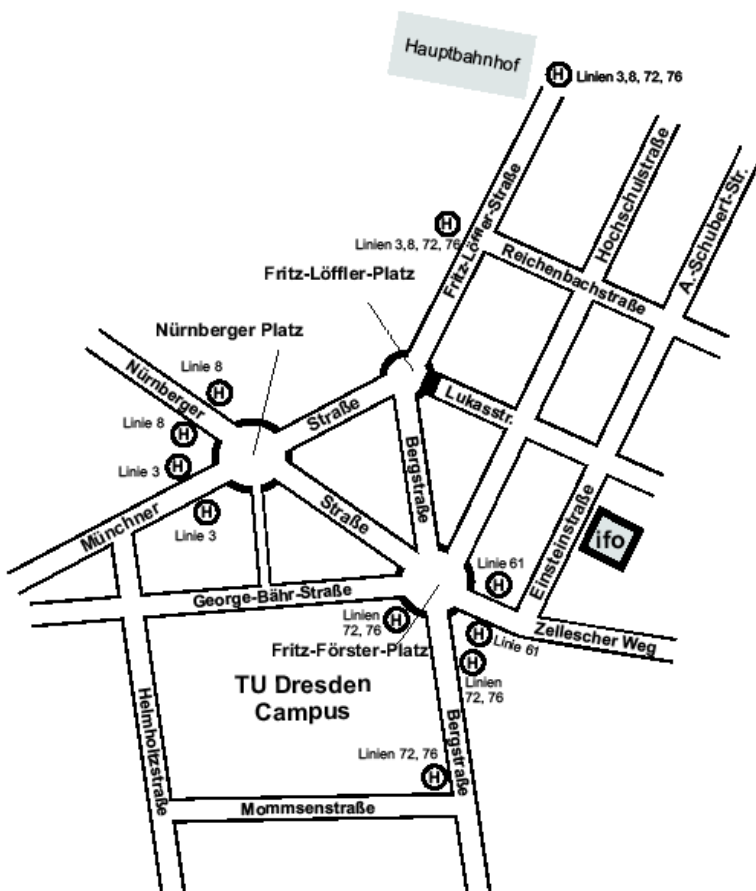
How to reach Ifo:

By air: From Dresden-Klotzsche Airport, take the train (S-Bahn) to Dresden Hauptbahnhof (Central Railway Station). Continue with local public transportation (see below).

By rail: Exit the train at Dresden Hauptbahnhof (Central Railway Station) and continue with local public transportation (see below).

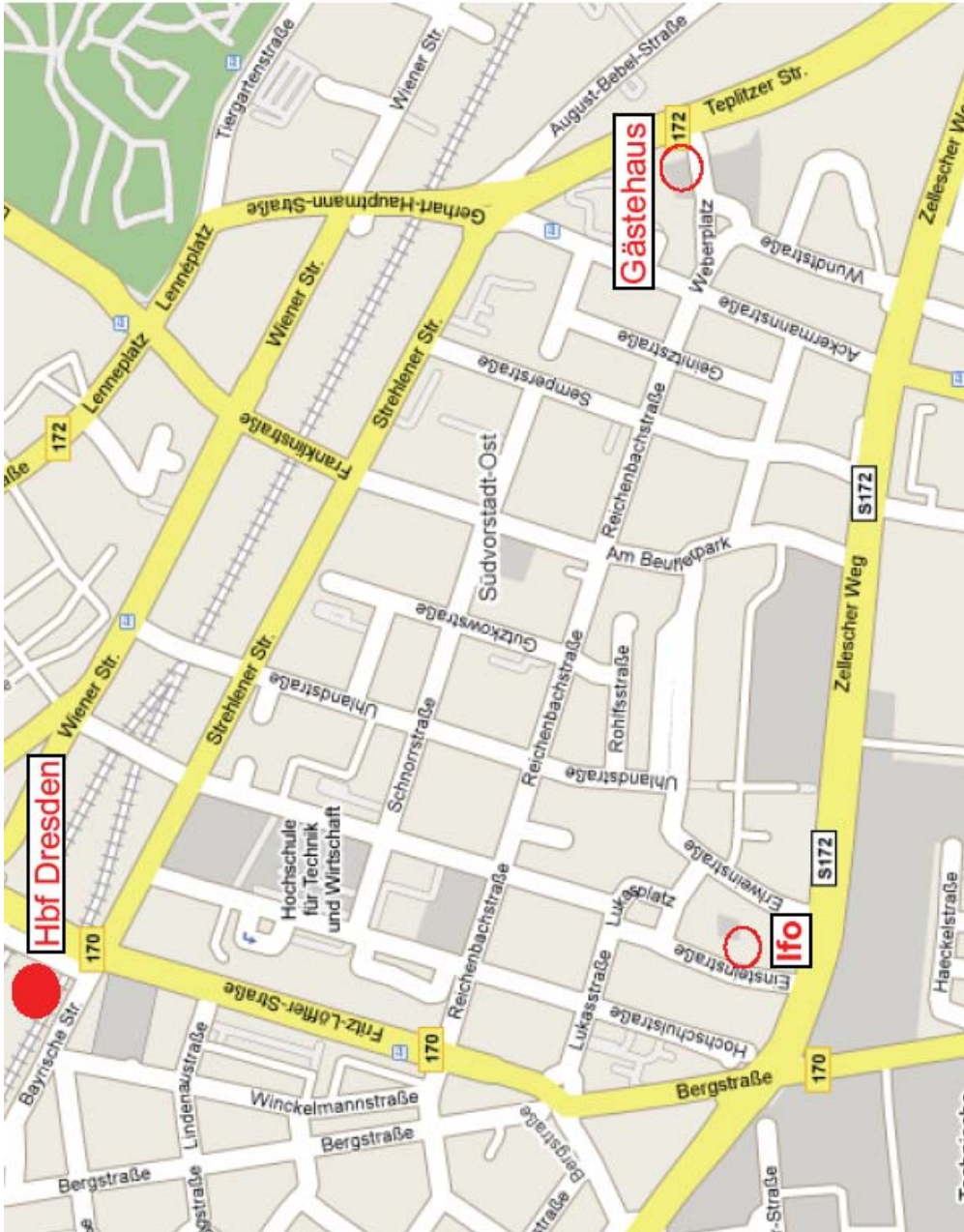
By car: Leave the Autobahn (A 4) at the exit "Dresden Altstadt" and follow the signs for "Zentrum", "Hauptbahnhof" or "Universität". After crossing the tracks of the Central Railway Station, turn left into Reichenbach Strasse at the second traffic light. At the second junction, turn right into Andreas-Schubert-Strasse and drive up the hill towards Lukas Church. Driving around the church on the right-hand side, you reach Einsteinstrasse. The Institute is on your left, number 3.

Local transportation: Take the bus 72 (direction Coschütz) or 76 (direction Südhöhe) from the Central Railway Station. Get off at the second stop (Technische Universität). For details see the attached map.



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