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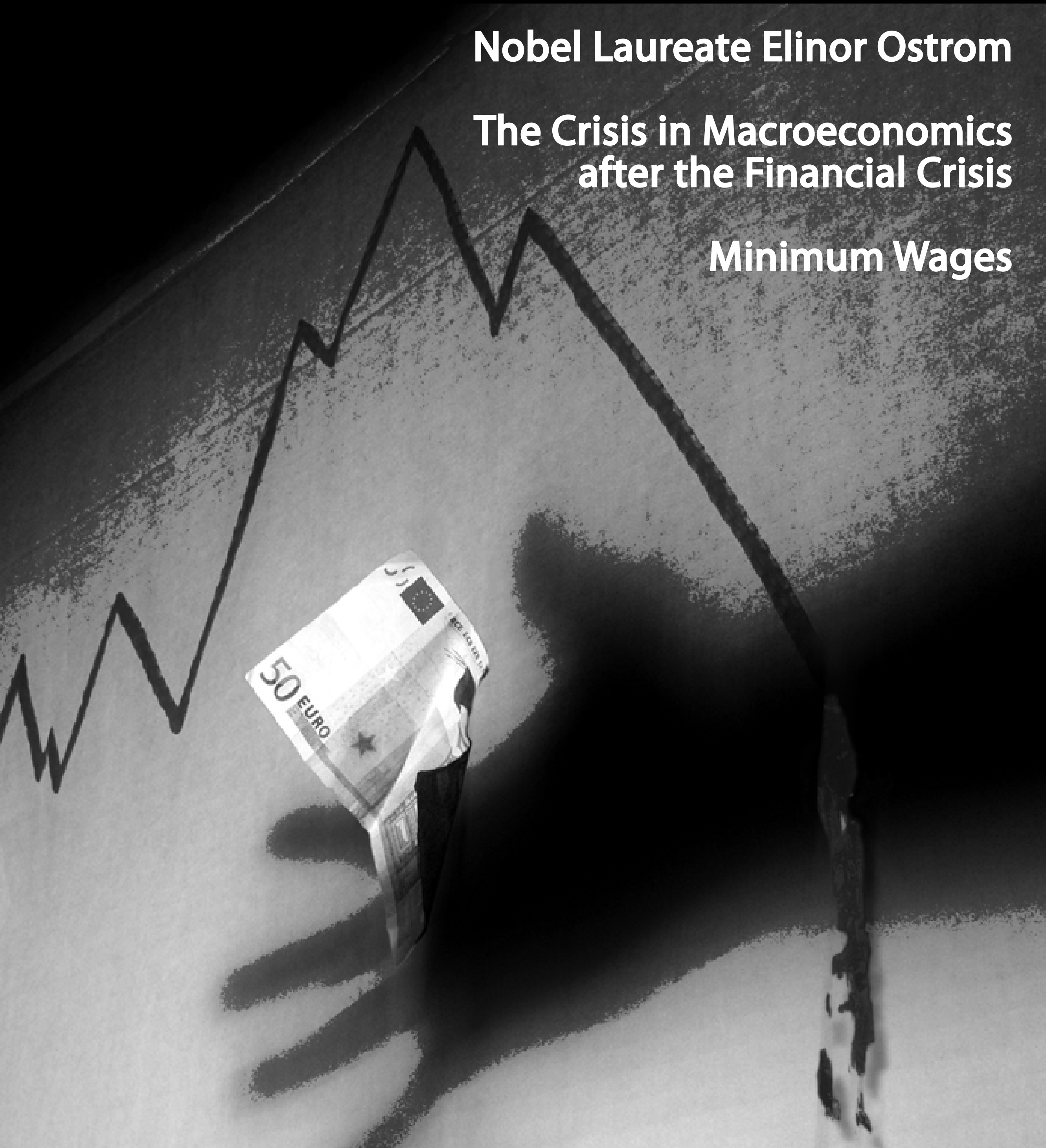
THE NETWORKER

Nobel Laureate Elinor Ostrom

The Crisis in Macroeconomics after the Financial Crisis

Minimum Wages



Content

Dear Reader,

you might have guessed it from the name: This magazine is meant for you. You as an economics or infonomics student, you as a world citizen interested in any world affair that is only loosely related to economics, you as a potential academic interested in economics as a science, you as a member of the IES Network.

Another six months of your studies have passed since the first issue of this magazine was published in last year's June - interesting months, without any doubt: Elinor Ostrom was awarded the Nobel Prize, world leaders gathered at the Copenhagen summit to tackle global warming, minimum wages were fiercely debated in the run-up to the German elections, the IES Network organised various trips and lectures for its members.

Beyond university and academics, the emerging winter and its calmness let us reflect on the No. 1 favorite of all media - the crisis. At first, we considered this topic as stale, since everything was said and even the worst tabloid commented on it. Then, a sudden flash of insight hit our minds and we realised that this is still a magazine meant for you - you as an economics student, you as … you know. Therefore, we decided to ask Prof. Joan Muysken to write on the implications of the crisis that is most relevant to you: the implications on economics as a science. And as we publish this magazine during the first skills block it made perfect sense to recap our very first skills block...

Before you are now left with the articles, let me spend some words on the magazine itself. Below the headings of this issue's articles, you will find multiple names: I invite everybody to contribute and to write for the magazine! Everybody is encouraged to share his or her thoughts. You will find more information on the very last page.
However, for now - enjoy everything before.

Cheers!

Perke

Perke, Chief Editor

The Crisis in Macroeconomics after the Financial Crisis

by Joan Muysken[1]

1 Thanks to Tom van Veen and Erik de Regt for their comments on an earlier version of this articles.

Wyplosz (2009) observes that economists have "a pathological tendency to disagree about just everything and to do so in public." A typical example is that leading Chicago economist Robert Barro (2009) states in his article "Voodoo Multipliers" that the Obama-team assumes that the multiplier of government spending exceeds unity. This implies that GDP rises by more than the increase in government expenditures. Barro argues that apparently "the government spending is a good idea even if the bridge goes nowhere or if government employees are uselessly filling holes. This deal would make Charles Ponzi proud." Using calculations from World War II Barro then argues that the multiplier is well below unity.

In his blogs of 22-23 January Nobel price laureate Paul Krugman comments on Barro that during WWII consumer goods were rationed and there was full employment. He concludes: "I can't quite imagine the mindset that leads someone to forget all this and think that you can use World War II to estimate the multiplier that might prevail in an underemployed, rationing-free economy."

These exchanges have triggered Clive Crook to name his Financial Times column of 9 February 2009 "Politics is reducing economics to a truly dismal science". Crook states that "Economists are failing to express anything resembling consensus on the most basic questions of economic policy." However, "This impression of disarray – that economists have nothing clear to say on these questions – is not the fault of economics as such. It is a mostly false impression created by some of its leading public intellectuals, Mr Krugman amongst them." (The latter because Clive Crook is shocked that Krugman has stated that raising trade tariffs can make the world temporarily better off.)

I think that Crook his picture of economics as such is far too rosy. Leading macroeconomists, like Acemoglu (2009), Buiter (2009), Eichengreen (2009), de Grauwe (2009), Krugman (2009), Spaventa (2009), Stiglitz (2009) and Wyplosz (2009), indicate that serious soul searching amongst macroeconomists is taking place. An example is Stiglitz's (2009) (another Nobel laureate) conclusion that once the Great depression faded into memory "Dogmas and doctrines holding that markets worked well and that they were self-correcting once again came to predominate. This time, the theories were more sophisticated, but the underlying assumptions were equally irrelevant. These ideas helped shaped the intellectual milieu which gave rise to the flawed policies that, in turn, gave rise to the crisis, and to some extent, they are shaping policies today as we attempt to respond to the crisis." This was while "other strands of modern economic theory, including the theory of imperfect information …, were simultaneously explaining why markets often do not work so well." And he concludes "One would have thought that this powerful combination of theory and evidence might have dampened the enthusiasm for unfettered and under-regulated markets. But evidently it did not. I understand the unbridled enthusiasm of special interests who found the arguments for deregulation profit enhancing; I am not so clear what motivated so many economists." He does not pursue this latter point. Krugman (2009), however, makes an interesting remark when he states that "the economics profession went astray because economists, as a group, mistook beauty, clad in impressive-looking mathematics, for truth. … , the central cause of the profession's failure was the desire for an all-encompassing, intellectually elegant approach that also gave economists a chance to show off their mathematical prowess." In line with Stiglitz's observations, Krugman continues "Unfortunately, this romanticized and sanitized vision of the economy led most economists to ignore all the things that can go wrong. They turned a blind eye to the limitations of human rationality that often lead to bubbles and busts; to the problems of institutions that run amok; to the imperfections of markets — especially financial markets — that can cause the economy's operating system to undergo sudden, unpredictable crashes; and to the dangers created when regulators don't believe in regulation."

Where to go from here?

The latter notion is elaborated elegantly by Eichengreen (2009): "What got us into this mess, in other words, were not the limits of scholarly imagination. It was not the failure or inability of economists to model conflicts of interest, incentives to take excessive risk and information problems that can give rise to bubbles, panics and crises. It was not that economists failed to recognize the role of social and psychological factors in decision making or that they lacked the tools needed to draw out the implications. In fact, these observations and others had been imaginatively elaborated by contributors to the literatures on agency theory, information economics and behavioral finance. Rather, the problem was a partial and blinkered reading of that literature. The consumers of economic theory, not surprisingly, tended to pick and choose those elements of that rich literature that best supported their self-serving actions. Equally reprehensibly, the producers of that theory, benefiting in ways both pecuniary and psychic, showed disturbingly little tendency to object. It is in this light that we must understand how it was that the vast majority of the economics profession remained so blissfully silent and indeed unaware of the risk of financial disaster."

The question then is how to proceed. Acemoglu (2009) provides a very interesting analysis where he emphasizes that we have learned from the crisis that (1) "aggregate volatility is part and parcel from the market system" which should be analysed further – this point is also made by Buiter (2009), de Grauwe (2009), Eichengreen (2009) and Krugman (2009); (2) market regulation should recognise the opportunistic behaviour of market participants and pay more attention to the institutional environment under which markets operate – see also Eichengreen (2009),

> "Three elements which are very important in my view ... are economic growth, global imbalances and post-Keynesian theories"

Stiglitz (2009) and Wyplosz (2009); (3) we cannot trust the long-lived large firms to monitor themselves, which implies that we have to give more weight to the reputations of firms in thinking about regulations and institutions and we have to analyse the internal working of firms better.

Spaventa (2009) and Wyplosz (2009) make a similar observation, but then in relation to the political sector: As Wyplosz states: "It is all well to give fine advice, but we also need to understand whether the policy makers can do what we ask them to do." And Spaventa (2009) warns us: "As in churches, the message to the congregation must be clear and unequivocal, even if clerics are not bound by the simplistic orthodoxy of an elementary catechism and are allowed to express doubts and draw distinctions among themselves. Though economists would not provide simple truths in their research work, some were ready to distil them for popular use in OpEds and blogs, and few in any case objected to the vulgate version which became popular with the congregation. They should have been suspicious, because theirs was a peculiar congregation, consisting not only of policymakers, central bankers and sundry regulators, but even more of private sector agents in search of arguments justifying financial deregulation for their own private interest."

Three elements which are very important in my view, but receive only little attention in the articles cited below are economic growth, global imbalances and post-Keynesian theories (not to be confused with the new Keynesian theories, criticized above). Not surprisingly, Acemoglu (2009) is the only one who emphasises that economic growth is an important element which has not been included in the discussion of economic crisis. "Economic growth ought to be a central part of the discussion, not an afterthought." The reason is obvious: sustainable growth is the ultimate source of our welfare. Second, in particular Krugman and Buiter have stressed many times in their blogs that global imbalances are an important element in the analysis of the financial crisis. It is obvious including global imbalances complicates the macroeconomic analysis considerably – but at some stage this cannot be avoided. Last but not least I think more attention should be paid to post-Keynesian thinking, how hopelessly divided the authors of this group might be amongst themselves. The emphasis of Minsky (2008) and Skidelsky (2009) on uncertainty as opposed to risk, and the eclecticism with respect to the use of macroeconomic models that follows from it, is refreshing in these days. Similarly the radical proposals discussed in e.g. The Levy Economics Institute of Bard College can stimulate us to adopt new ideas.

With respect to the latter, Galbraith (2009) reports on a recent conference where such ideas were discussed. The proposals follow from the recognition that economic activities with strong external effects for the public sphere should be under government control. For instance, there is no reason why "the 'critical system infrastructure' [of the financial sector] presently administered by large banks,

… should not be managed in the public sector, as a public utility." There is "no alternative to the permanent restoration of national or equivalent public power (in the case of the EU, European power) over all financial institutions. Banks are public-private partnerships, funded partly at public risk (via deposit insurance and implicit guarantees). They cannot logically operate independently of the power that guarantees their funding, and the attempt to allow them to do so is intrinsically destabilizing." Next to that one should recognize that "efforts to revive the economy by first reviving the financial sector cannot work. The correct approach to increase the level of economic activity and employment should instead consist of measures run through the public sector, the household sector, and the business sector." In that context one should also see the proposal on the Job Guarantee as elaborated in Mitchell and Muysken (2008) to guarantee full employment without inflationary pressures.

I think it is obvious that the macroeconomic discipline is in a disarray, and some serious changes will occur. The New-Keynesian approach has manifestly failed. One might be tempted to follow Buiter's (2009) half-hearted advice to "shed the conventional wisdom of the typical macroeconomics training of the past few decades. In its place is an intellectual potpourri of factoids, partial theories, empirical regularities without firm theoretical foundations, hunches, intuitions and half-developed insights. It is not much, but knowing that you know nothing is the beginning of wisdom." This would also be in line with Krugman's (2009) conclusion. Whatever the case, I agree with Stiglitz (2009) that "There is a rich research agenda ahead." I hope we will live up to the challenge and will succeed in finding a more constructive and productive form for our public debates.

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A Glimpse at Deirdre McCloskey's Thoughts

by Ralph Lütticke

On 28 October, Deirdre McCloskey –well known to most of you from the Arjo Klamer's Speaking of Economics– followed the Network's invitation and came to Maastricht for a flying visit at the SBE. We used the shuttle to Schiphol Airport to go beyond her lecture and to document more of her thoughts on future profession.

Thoughts on Economics

Before any discussion about economics could start, Deirdre McCloskey insisted on spelling out the right expressions. According to her, neoclassical economics is not the right term for the most influential and criticized branch of economics nowadays. Actually, neoclassical economics refers to the Marginalist School of the 1920s and 1930s of which Alfred Marshal was one of the leading scholars. What most people mean when they talk about neoclassical economics is Samuelsonian economics. Samuelsonian economics is obviously named after Paul Samuelson (RIP) who laid the founding blocks of nowadays economics in the 1950s. His PhD thesis was modestly named "Foundations of Economic Analysis". This is when Max U. came into the world and started the tradition of utility maximizing individuals, which is a cornerstone of modern economics.

McCloskey criticizes the all-pervasive use of Max U., which implies formalism and simple optimization, but maintains that mathematics is indispensable for economic analysis. Economists, however, came to use mathematics in an ill-advised way. According to McCloskey, they focus on proofs and formalism rather than testing mathematics for its applicability. Economists tend to work the way mathematicians work. This could be called a philosophical approach towards mathematics, whereas physics and applied sciences such as engineering pursue more pragmatic mathematics; meaning that the inquiry into the world is at centre stage and not the sophistication of the mathematics used.

"Empirical economics does not care about the magnitude of effects, but mainly asks whether there are effects or not."

This corresponds to McCloskey's key criticism of Economics. The central question to be posed should be "How Much? – Is the magnitude of the effect big or not that big?" and not whether there is an effect, because this question brings the inquiry to an end before it becomes interesting and meaningful. In order to be testable, theorising must come to the point where propositions are made about the magnitude of the effect in question.

A similar criticism applies to empirical economics, as well. The accusation goes like this: Empirical economics does not care about the magnitude of effects, but mainly asks whether there are effects or not. Although it seems to be hardly possible, just think about it for a moment. I cannot help but agree that significance tests like the T-test and F-test are at the heart of all econometrics courses. The first question that is always asked is therefore whether there is a statistically significant effect or not. It is not asked whether the coefficient implies a large effect and is consequently of importance for us regardless of its significance level. The p-value just gives the likelihood of the coefficient being not different from zero. Thus, even with a p-value of 50%, by our standards way above any feasible criterion, the coefficient could equally be zero or not. Obviously, as basic intuition should tell anyone, one should still include the coefficient in the model if it describes an effect that is of real importance in the world. Hence, meaningfulness should be the first criterion for building econometric models and not significance – and furthermore meaningfulness can just be "tested" by humans and not by computer programs.

Thoughts on the Crisis

While the world economy is experiencing the most severe downturn since the Great Depression and economics is being accused of getting it all wrong, Deirdre McCloskey just describes it as capitalism as usual. McCloskey's laid-back opinion towards the crisis is rather controversial and can just be understood in the context of her academic aspirations. She considers herself rather a historian, than a present day policy-involved economist. The main goal of her current research is to understand what triggered the enormous growth in output over the last 250 years, i.e. to comprehend the making of the modern world. Thus, McCloskey puts the crisis in a long-term perspective, thereby just spotting one of the usual ups and downs, which are inherent to the capitalist system. No point for further discussion.

Thoughts on Academia

Deirdre McCloskey's perception of economics, of course, implies unusual career advice. On a general level, she opposes the Bologna process in so far as it tries to copy the United States, because the world apparently does not need a second US university system. Europe should keep its own research agenda and way of managing universities. It is diversity and creativity that matters.

McCloskey was part of the incarnation of these very principles at the faculty of economics at the University of Chicago in the 1970s. According to her, it was perhaps the most productive economics department in history, eventually resulting in eight Nobel Prizes between 1976 and 1995, many more than at any other university (Friedman, Becker, Lucas, Schultz, Coase, Fogel, Stigler and Miller). McCloskey continues that one cannot overestimate the vastness of the tertiary education sector in the US. The well-known private universities are not the only good places to go to. The US has very good state colleges, which are not that expensive. One of these colleges might come up with the next big thing in economics as Chicago once did.

When asked about concrete examples of European economics faculties with bright and creative researchers, McCloskey responded that Zürich, for instance, seems to be on such a way in Europe.

What has been remarked on universities also applies to the individual level. McCloskey encourages us to widen our academic horizons in order to have many methodologies at hand for inquiries into the world. Not to mention, the first step is just that one should be able to see the world in different perspectives and thus comprehend it as a whole. Then one can start to compose the different pieces in order to come up with a holistic conception.

Having heard this, it is worthwhile to start your future academic explorations by studying McCloskey. Her standpoint is always controversial, encouraging you to think everything through yourself and leading you on new paths without a doubt.

What may Economists Learn from Physicists?

by Nicolas Nerl

Jean-Philippe Bouchaud, head of research at Capital Fund Management and a physics professor at the Ecole Polytechnique both in Paris, gave a guest lecture at SBE where he pointed out short comings of the traditional economics methodology. Furthermore he gave some insights into how the quantitative success of Physics and its way of thought might improve economic models. For the purpose of this article his most crucial and radical points will be presented.

Firstly, as physicist, he is puzzled by the fact that economist cling to very strong assumptions such as the rationality and the complete knowledge of agents, which they utilize in order to maximize individual profits. Thus the invisible hand guides the economy into an equilibrium state. Bouchaud however pointed out that empirical evidence does not support those axioms and in physics one would be suspicious of such axioms. Furthermore, he believes that models that are not backed up by empirical data need to be amended or trashed no matter how mathematically convenient and conceptually beautiful they are. According to Bouchaud, economists are far to dogmatic and that the way of teaching economics only cements such orthodox/unfunded axioms by ignoring the virtue of empirical data.

Secondly, Bouchaud rejects the idea that shocks must be exogenous by definition, where he is in clear opposition with Keynesian models. He sees an equilibrium state of an economy as nearly impossible to reach, as markets are susceptible to hypes and thus fairly volatile. Moreover, his research, on financial markets, points into the direction, that most price fluctuations are unrelated to news but seem to come from within the markets.

Thirdly, Bouchaud promoted econophysics as taking methods of statistical physics to economics as it focuses more on mechanisms and analogies than on axioms and theorems, which according to him misguide today's economists. Furthermore, he believes economists should utilize the fact that physicists have far greater experience in deriving models from large quantities of empirical data that at first glance appear to be random fluctuations.

Finally, Bouchaud strongly supports the idea of adding more natural sciences to economic studies in order to change the mindset of future economists. According to him economist need to turn their focus towards the empirical data and away from dogmatic ideas in order to turn economics into a more pragmatic and realistic representation of the world.

Bouchaud arguments definitely have merits especially in the light of the very limited success of classical economic models in preventing or foreseeing economic meltdowns, such as the latest financial crises. Breaking up orthodoxy ways of thought and enrich the subject with tools from natural sciences can only improve economics as a science in service of humanity.

Learning to Smile at Bangkok

by Jan Bergerhoff and Nadin Hess

The first skills block just passed – time to plan this year's second one. Wouldn't it be great to review last IES study trip? Voilá!

After almost a whole day of travelling, a group of 24 economics students and our tutor Nils Holinski arrived at Bangkok international airport. We were soon to realize the first cultural differences: First, we got on an airport bus, which was not designed to carry a group of our size, let alone our luggage. Afterwards, squeezed and melting in the humid heat we drove to Sukumvit, where our hostel was located, while the bus driver, kindly, left the doors open to cool down his passengers.
The first night was mainly used to discover how cheap everyday products were. It is no problem to have a full dinner on the street at 60 to 80 cents - an opportunity many of us used gladly. The second distinction to note was that the Thai mentality is substantially different from the West European. As Thailand is still in the stage of development, much of its infrastructure is unfinished and social problems frequently catch the visitos' attention. Maybe because of this, Thais are relatively relaxed about rules and regulations. Friendliness and service, however, are of an extremely high standard, which might reflect Thailand's very hierarchical society.

The following days we visited many fascinating institutions. The entire first day was devoted to our partner university, Chulalongkorn. Staff as well as students made it easy for us to feel welcome. We were given an insight not only into studying and student life in Bangkok, but especially into the Thai culture itself. We learned a lot about festivities, food and music – of course we did not get around trying to speak some Thai.

Safecoms and two daughter companies of the Allianz group were meant to leave an impression about how business is done in Thailand. None fell short of expectation. At Allianz Mondiale we were introduced to a car insurance scheme, which is already the largest on the Thai market. Because of a fatalistic culture insurance companies face problems convincing consumers of the necessity of their products. Allianz Mondiale overcame this difficulty by arranging business-to-business relationships with all major car manufacturers except Toyota. Roadside insurance from Allianz Mondiale is part of almost all new cars you buy in Thailand.

Further we were presented a marketing strategy aiming at establishing a direct consumer relationship. Further, not all of us were convinced by the concept of an insurance café and a lively discussion rounded off the visit.
Safecoms particularly drew our attention to the growing internet connectivity in Thailand and the resulting market for the firm's products. All companies made a point about the complex social norms, which govern the Thai workplace. Our alumni at Allianz, Ayudhya, is very concerned with a positive work atmosphere and therefore walks around the office frequently to actively check whether there are queries. After the interesting presentations given, a lively discussion arose among some students and our hosts, debating about country specific differences in working and lifestyle. Luckily, some of us had the chance to intensify this discussion during a comfortable dinner later that day.

At the different "economics-related" institutions we tried to find out how Thailand was coping with the financial crises and how the political instability had affected the economy. Additionally, we were interested in the Thai AIDS prevention policy and in the soft aspects of the Thai economy – the security of property, the degree of corruption and the demographic development. Both UNESCAP and the World Bank provided detailed answers to these questions and the question round at the Thai Stock Exchange gave a great insight. Thailand has not experienced a credit crunch, because tight regulation was introduced after the Asian financial crises. However, declining exports have hit the Thai industry and encouraged the government to pass a fiscal spending package. At the Thai Board of Investment we were provided with a very economic view of the current investment situation. At the Dutch embassy and the Dutch Chamber of Commerce we obtained a valuable economic estimation of the consequences of the political turbulence placing it at two to three percent growth reduction. We also learned that the Netherlands are the major source of European FDI, which is rooted in a historic Dutch-Thai partnership. Enjoying the beautiful atmosphere at the adjoining park, we were able to pose questions especially about the work life that embassy members have.

Another special visit was our day at Shell. The very warm welcome and the amazing dedication to arrange a pleasant visit were overwhelming. The many short and different presentations gave complete picture of the company and many were surprised how diverse Shell's tasks are. The special focus was laid on Shell's achievements in the field of bio fuels, an environment friendly solution to the energy problem. Another interesting aspect of the presentations was the contributions to the Thai society.

Besides the economically interesting insights, of which we gained many, experiencing the Thai culture was a major part of our program. Although the groups split for different events everybody gained a good personal impression of Thailand and of Bangkok's nightlife. Having a cocktail in a rooftop bar enjoying the view of an ocean of lights of a 12 million people city is an experience that will be remembered. Many of us got hand tailored suits and dresses as more permanent, but no less beautiful memories. The trip to Bangkok was a great success and it has stirred many participants' curiosity about Asia.

Study Trip Brussels

by Maximilian Hoyer


Photo: Mario Cutroneo

On 24 November, the first study trip lead the Network to one-day tour though Brussels. One of its participants summarises his experiences for those of you who had to stay in Maastricht.

For the first trip of this academic year the IES Network embarked on a one-day journey to Brussels, deviating from the all-to-known thematic focus on strictly economic topics and exploring the intricacies of international politics.

The main visit of the day was the first one, which took the group into the heart of Western military cooperation, the NATO headquarters. Here the participants were exposed to a part of Brussel's political sphere, which maybe to some is no longer the focal point of political affairs in the . Still, even though the good old North-Atlantic treaty focusses on military matters, it became apparent that at least in the eyes of the outer representatives "the alliance" also has role to play when it comes to the economic development of the countries in which the NATO-missions take place.

Albeit critics might have a different perception, the press official who hosted the group pointed out several times that one central message is understood: Military security can never be achieved without having a decent level of economic development and social stability and this is only possible if the forces cooperate as closely as possible with other institutions and stakeholders in the respective areas. At the same time, it was stated that conversely the aim of social and economic stability cannot be reached without the participation of military forces in countries such as Afghanistan.

> " 'The Alliance' has a role to play when it comes to economic development"

In our second meeting at the headquarters we talked to two Dutch representatives (one of them a studied economist from Maastricht), which gave some interesting insights into the daily work of a delegation in a major international. Especially the difference between work the delegations from larger and smaller countries proved interesting, with the latter having to cope with less resources, but in exchange being much freer in the daily negations. The impression that the decision processes of the larger nations are chained by multiple responsibilities and interdependencies of different offices is surely one which is believable looking from outside at the speed of the decision processes of some nations.

Photo: Michael Montanari

After having spent half of the day at the NATO, the group went to the second station of the trip at the European Commission. Our host here was a member of the human rights working group. Albeit starting later than planned in the early evening, the discussion still offered some interesting insights into the possibilities and problems in trying to promote human rights internationally from Brussels. For example a term like conditionality, certainly not new to anybody who ever read a textbook about development economics and international aid, is of course not always as simple as it sounds once it leaves the textbook. The application of this principle, which is based on the idea that concessions to developing countries are only made in exchange to compliance with certain principles, is already difficult when it comes to aid. In the context of trade policy, however, it becomes even more intricate, with both trade regulations and conflicting interests making a simple solution more and more difficult. Still, also in this context, the adherence to a strictly defined conditionality policy is one of the most efficient tools in order to really strengthen the rule of human rights throughout the world.

Like all of the EC's foreign policy activities, this area is also going to be reassigned and changed in the course of the coming into force of the Lisbon treaty, which entails the transition of some, but not all of these tasks into the new External Action Service under the leadership of Catherine Ashton. The resulting remodelling of responsibilities will completely change the structure of the foreign policy units of the European Commission and is still in the process of being formed and finalised; a process that of course brings an element of surprise to the nearer future of the employees' job profiles, as expressed by our host.

Finally, after a long day of debating, the end of the trip was conducted in the city centre of downtown Brussels in direct vicinity and delight of some Belgian beers.

Focus: German Minimum Wages – Nigthmare or Salvation?

a paper by Jörg Kattner and Ralph Lütticke

Below, you will find the introduction and the conclusion of a paper on the potential effects of minimum wages on the German economy. You may ask what for heaven's sake drove us to start printing course papers by students.
Well, this is meant to establish a category that allows you to publish your academic work and make it available to those who might be interested, even if you are an undergrad student. Along with the digital version of this magazine, you can find the complete version of the paper published on www.iesnetwork.nl. If you would like to publish your paper in the next issue, feel free to contact us!

Introduction

The election campaign for the "Bundestagswahl 2009" in Germany has just been in all news. One of the central issues that were extensively discussed is the different promises for minimum wages made by the parties. The Christian Democratic Party (CDU), the party of chancellor Merkel, has a rather liberal point of view. It proposes to set up a commission which examines each industry by itself and then sets an appropriate minimum wage if beneficial. In contrast, the Social Democratic Party (SPD) led by chancellor candidate Steinmeier is in favor of a national minimum wage set by law. Their intended minimum hourly wage is EUR 7.50 for all industries. The CDU claims that a national minimum wage of EUR 7.50 would lead to a substantial increase in unemployment and worsen the already bad fiscal situation of the government. The SPD on the other hand points to the positive effect of the introduction of minimum wages in England in the last decade and argues that the same beneficial effects could be expected in Germany.

This paper sets out to explore the open question of the impact of minimum wages to be or not to be introduced in Germany. The debate on minimum wages is first put into perspective by describing the development of the German welfare state. It will be shown that the emergence of minimum wages as a viable option for the parties to campaign for marks a turning point in the political economy of Germany. The long-lasting corporatist model seems to be a relic of bygone times and a new hybrid model arises putting minimum wages high on the political agenda of the egalitarian minded German people.

In order to assess the likely effect of the introduction of minimum wages, the existing impact studies for Germany which predict by and large adverse employment effects are critically reviewed - and rejected. It will be argued that the highly controversial assumption of perfectly competitive markets, which is shared by all of the studies, is driving the results. Elaborating on the long-standing tradition of imperfectly competitive labor market models, the modern conception of monopsony power is used to firstly criticize the neoclassical approach towards minimum wages and secondly to argue that theory is a bad guide for labor market reforms in general. Instead, we make a strong case for relying on empirical studies to evaluate policy options.

Having said that, the results of the introduction of a nationwide minimum wage in the United Kingdom (UK) in 1999 are inspected and the final conclusion is drawn that the German people can without serious worries vote about minimum wages as they please, because no unambiguous theoretical prediction can be made and empirics do not show any significant drawbacks if minimum wages are going to be introduced in Germany.

Conclusion

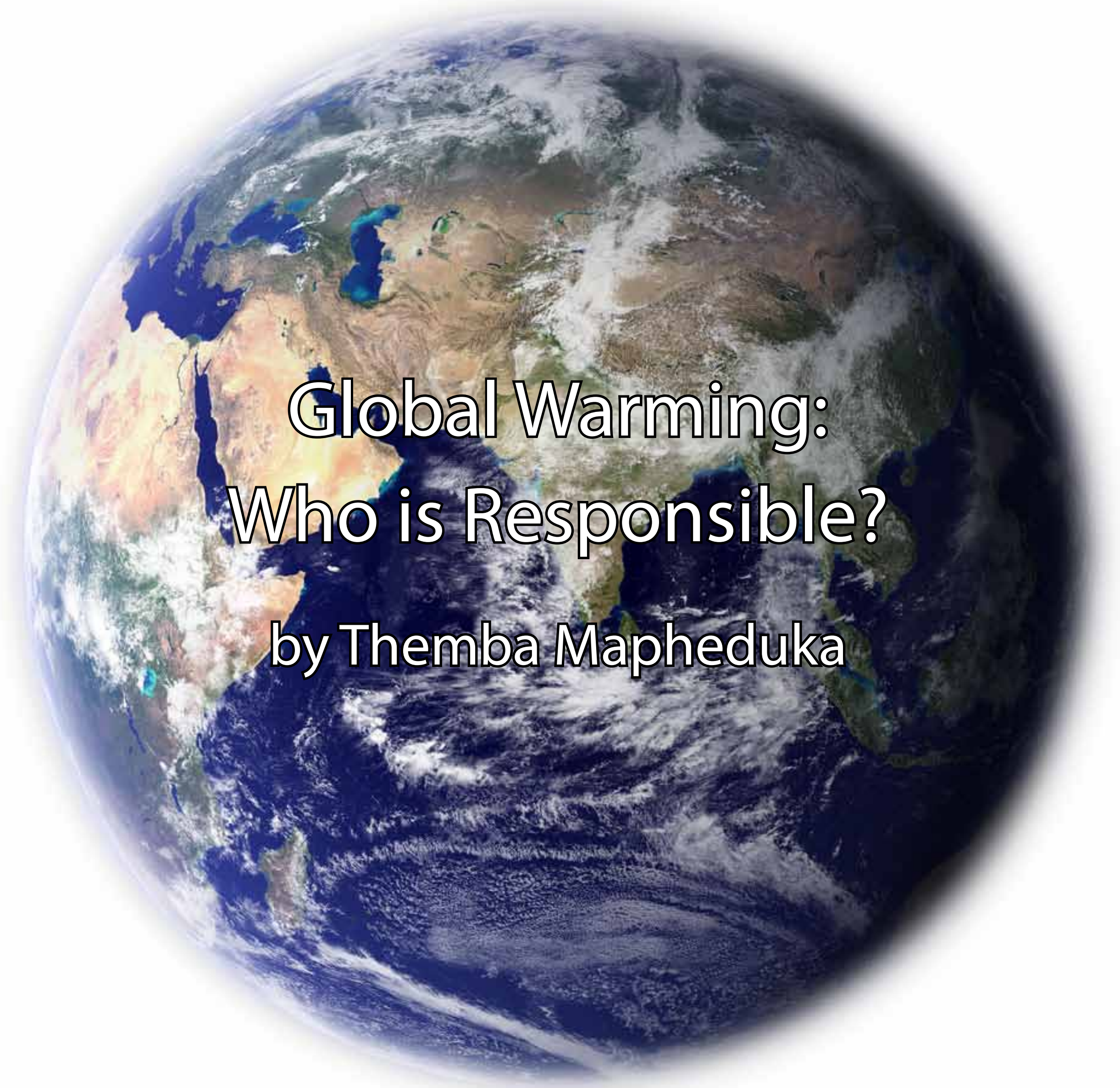
It should come as no surprise that minimum wages were fiercely debated in the German election campaign. The debate signifies the collapse of the corporatist welfare state model which has been subtly eroded through the bleeding of social partners in terms of members and influence in the last two decades. This development should be interpreted in the broader picture of the vanishing explanatory power of the taxonomy of welfare states as the within-model variance in the levels of different institutions is increasing. The German people are just searching for the next best instrument to make up for the incapability of trade unions to provide wage floors nowadays.

The desire for minimum wages has been sharply confronted by the majority and most influential part of the German economists who predicted disastrous effects on employment and public expenditure in many impact studies if a nationwide minimum wage of EUR 7.50 was introduced in Germany. However, it has been shown that this result is driven by a severe misconception of labor markets. Since very recently, the growing body of work on monopsony power, which is linked to a long-lasting tradition that recognizes the labor market as prime example of imperfect competition, provides the theoretical weaponry to prove the neoclassical impact studies as arbitrary.

As monopsonistic models of the labor market come closer to reality, it is not possible to make straightforward theoretical predictions regarding the effect of minimum wages anymore. Instead, careful analysis of empirical studies should be used as a guide for policy reforms. In contrast to the horror scenarios told by most impact studies, empirics do not show any significant and consistent negative effects of minimum wages. The British experience even points towards positive effects as the binding minimum wage introduced in 1999 led to a decrease in monopsony power of firms rather than a decrease in employment.

> "... the predictions of the neoclassical models have nothing to do with the facts."

Similar results seem to be most likely for Germany as well. As it has been shown, several indicators suggest that monopsony power is highly relevant in the German labor market, even more so than in the UK. Hence, the predictions of the neoclassical studies have nothing to do with the facts. There are no a-priori reasons against the introduction of a minimum wage in Germany. The success of such a policy is more likely than not and crucially depends on finetuning.



Global Warming: Who is Responsible?

by Themba Mapheduka

Especially today, in the aftermath of Copenhagen, global warming is not only a well-known topic but also an often-raised issue for smalltalk, as nobody seems to understand the poor progress in tackling the problem. An explanation.

Global warming is defined as the increase in the average temperature of the Earth's near-surface air and oceans since the mid-20th century and its projected continuation. Some extremist still argue though global warming does not exist and it is only a liberal's way of whinning. However there is irrefutable scientific evidence to suggest that global warming does exist and that is the stance the rest of this article will take.

It is very unfortunate that current political agendas at national and international levels revolve more around Terrorism, relegating issues on Environment to the background. The development versus environment debate makes it even more difficult for environmental issues to come to the centre stage of politics. But the problem about global warming is here to stay for several decades. The group of developed nations has not yet arrived at an agreement on implementing significant cuts in greenhouse gas emissions. The principle of "differentiated responsibilities" included in the Climate Change Convention, however, places a greater responsibility on developed countries in emissions reductions.

On the other hand, developing nations are caught between a rock and a hard place in the global warming debate. Understandably they want the right to economically expand the fastest way they can, as developed nations have been doing for the past 100 years. Therefore at the Kyoto conference they were the most hesitant to agree upon any sort of convention that required them to limit their greenhouse gas emissions. The irony is that developing countries have the most to lose

Protesters at the Copenhagen summit (Photo: Chuck Olsen)

should global warming occur. Many developing countries have neither the resources nor the technology to defend against rising sea levels, increased incidence and ferocity of tropical storms, and expansion of tropical diseases. As developing countries build their economies, in most cases heavily dependent on manufacturing and energy-costly industries, they increase their risk to be negatively affected by global climate changes.
Developing countries face a difficult decision, whether to sacrifice their economic development for protecting against possible ecological problems in the near future. Environmental degradation has never been an agenda of rich nations but it did for poor countries as it directly affects them by hampering their poverty elimination efforts and subjecting them to catastrophic disasters. The fact that the majority of Africans and other developing nations like Bangladesh are poor should not give rise to the notion that they are only concerned about their daily food need and not the environment. In fact, developing nations should demand a just compensation from those who have brought the environment degradation.

"No one has suggested a way out of the current impasse."

In December, leaders and experts from all over the world have gathered at a summit on climate change in Copenhagen. Unfortunately, they failed to pass any reasonable follow-up document to the Kyoto protocol. The world has invested enormously in the Kyoto approach, and the success achieved is impressive. But no one has suggested a way out of the current impasse. Perhaps the time to start exploring alternatives is now. Global warming is too important to simply rely on the hope that somehow a solution will emerge; and too important to simply to rely on the goodwill of the United States, especially given its flawed political system where campaign contributions from oil companies and others who benefit from emissions play such a key role. The well being of our entire planet is at stake. We know what needs to be done. We have the tools at hand. We only need their political realisation.

Top Economics Blogs

by Maximilian Hoyer

While the financial crisis had the benefit of spilling some of the most prominent representatives of the profession of Economics into the general news media, this is surely not the end of the line for a student who wants to stay up-to-date with the economic developments in the world. Luckily, nowadays there is a tool available which allows us to keep in touch with the important discussions without having to read all the academic journals or to work through every single The Economist issue from front to back:

A number of prominent writers and researchers are running blogs, which led you be among the first to know about their ideas and are often enough considerably more entertaining and fresh in their writing style than anything you will find on paper about economics. In this article we present you some of the authors personal favorite picks for you to check out and maybe even keep on reading. All of them are of course conveniently accessible via a feed-reader, which is also the recommended way of consumption. You can find a basic introduction into this technique in the box at the end.

Conscience of a Liberal Blog (Paul Krugman)

Economics' superstar is running one of the undoubtedly most entertaining and interesting blogs you can find. With rather short articles (the longer stories are saved for his NYT-column) he often enough blasts out openly biased thoughts, which are very enlightening to read, even if you do not agree on the content.

The Freakonomics Blog

Another NYT-hosted block, which is carrying the spirit of the well-known book over to a day-to-day basis. In the relatively frequent postings (about five a weekday) you will find pieces of information oscillating between the surprising and the useless, certainly boosting your repertoire of small talk tidbits.

Greg Mankiw's Blog

As on all the blogs mentioned, you will find a number of interesting and educating thoughts on this block. What sets it apart is the frequent insight Greg gives about the works and problems of a Harvard-Econ professor as himself.

The Atlantic Business Channel

Not even called a blog, US-magazine The Atlantic's "Business" section is another high posting frequency source that can be most warmly recommended. One should not be mistaken by the name, this site's content is really much closer to an economics magazine than anything else. The team of authors certainly manages to blend professionalism with personal opinion in the way you expect it from a good blog.

Marginal Revolution

Sometimes more of a very good link collection than a repository of original content, authors Tyler Cowen and Alex Tabarrok still produce a potpourri of entertaining thoughts, among which we find "Christmas Game Theory" and "Asteroid Deflection as a Public Good". Still the biggest pro for his site are the very well-collected, up-to-date links to stories out there in the web, which are often enough both entertaining and educational.

VoxEU.org

Again a website which is certainly not a representation of what one would classically call a blog, this is a cooperation of five different European institutions which publishes columns and articles about economic topics. Focused on a European audience, you can find articles concerning the union covering questions which might sometimes get lost in the typically rather US-centric mainstream publications. Publication frequency varies somewhat, but some articles are of a really high quality. Since the site is actively edited you will find articles which are basically fit to be placed in a commercial publication, next to excerpts of the work of renowned professors.

Links

http://krugman.blogs.nytimes.com
http://freakonomics.blogs.nytimes.com
http://gregmankiw.blogspot.com
http://business.theatlantic.com
http://www.marginalrevolution.com
http://www.voxeu.org

What is a newsfeed?

Nowadays you are able to get updates on almost every major website by using so called feeds. That means that your computer is keeping track of articles on those website by itself and you get notice of new ones without having to access the site manually. This is a very useful tool to keep track of websites which are actualized with little regularity. You have to click on the green button either somewhere on the page or in your browser toolbar, depending on the browser. Nowadays every major browser has an integrated "feedreader", while the more traditional way is to read feeds in an email-program. Firefox for instance has integrated the technology by using so called live bookmarks.

Background Article: Elinor Ostrom

by Max Schützeberg

Alright – we know that she was the first woman to win the Nobel Prize in Economics and she devoted her research to this public good stuff. At the same time, however, we are convinced that there must be more to Elinor Ostrom's work. Let's see.

Elinor Ostrom is an extraordinary professor. Not only because she received the 2009 Nobel Memorial Prize in Economic Sciences as the first female ever in the history of this award. She is also one of the few that are no pure economists. Mrs Ostrom was awarded for her analysis of economic governance especially for common pool resources. Her main accomplishment has been to collect relevant information from a diverse set of sources about the governance of such.

Common pool resources are resources that are of common use for a community, such as fish stocks, pastures, forests and water for drinking and irrigation. Thinking in larger dimensions, air and oceans are also common pools. For these resources there exists a natural dilemma. The term tragedy of the commons was first introduced in 1968 by Garrett Hardin, when he presented the example of cattle-owners, who increase the size of their herds to initiate higher short-run profits. The herd is increasing but the grasslands are not, the opposite occurs, the more the herd uses the land the less can regenerate and be used for the next season. Therefore, in the long-run, not only the extra cattle are of no benefit, but the whole herd is threatened of existence. Similar situations exist for almost all common-pool resources.

Most of us get introduced to social dilemmas during our first year of study; the prisoner's dilemma is one of the most commonly used game theoretical concept economists know about. In a two-player-game with a Prisoner's dilemma, rational egoistic behaviour will always lead to a sub-optimal outcome. A subgame perfect equilibrium results, although both parties would be better off if there was some kind of cooperation.

Economic governance is about the organisation of cooperation. Markets need suitable contracts formulated and enforced to function properly. Therefore the functioning of the institutions that implement these requirements is of core importance. Many economic activities, however, take place beyond markets in firms, families and all different kinds of communities. Good economic governance is impossible if we want to solve problems of all these different kinds using the same solution.

Much of Elinor Ostrom's work was collecting all the relevant literature about social dilemmas. She conducted a series of laboratory experiments on behaviour in social dilemmas. Studying socio-economic systems is essential to understand dynamic processes. Those systems are complex and different for all kinds of communities; irrespective of if they are families, businesses, regional, subregional or even religious. Of course there are similarities but they are not identical. Under what circumstances do we need government intervention? When does it prove harmful? How can we intervene safely? These questions should concern us more then ever, in times of financial crises, climate change and other economic challenges.

It seems rather difficult to examine a system comprising economic, social and other kinds of variables. A panacea-solution, a solution that solves the problems of all kinds of communities with each different kind of resources is very unlikely. As mentioned above, policy analysts commonly believe that the only solution to the tragedy of the commons is to either privatise or have government regulation. This common belief is based on findings in game theory.

For many cases privatisation does not work because of difficulties in monitoring and controlling. Whether or not this is possible, depends on the resource and on the technologies available for measurements and control. An alternative solution is to let central government own the resources and levy a tax under which an equilibrium can be achieved. However, this works only in theory, as transaction costs have to be subtracted from the optimal outcome. Depending on transaction costs, the market, the firm or the government may constitute the best governance mechanism. Elinor Ostrom points out many cases where government intervention has created more bad than good because of authorities' lack of knowledge about local conditions. She developed many case studies in which the environment is too complex to use this approach.

"Under what circumstances do we need government intervention? When does it prove harmful?"

Indeed situations exist where privatisation or government intervention is necessary to reach a better outcome. The prisoner's dilemma is an example of such a situation. This dilemma can be represented by a scenario in which two prisoners are held in two different rooms for interrogation and there is no possibility for them to communicate. The police interviews both of them separately and offers a reduction of punishment if one of them betrays the other. The best payoff for both prisoners is if no one talks. However, the optimal outcome, although desirable, will never occur in this situation. Instead, each player must believe that his partner will talk to save his own skin (i.e. get a better payoff). Therefore, both players betray each other and they will end up at their worst outcome. In this example, an external authority should intervene.

The prisoners` dilemma is usually used in theory to analyse similar games in many different situations. In reality, however, the games are much more complex. In repeated games, with the end of the game unknown, players behave very different from games only played once or games in which information on the previous times is available. In particular, outcomes depend on the payoffs, the initial situation and the duration of the game. Each of these may be difficult to measure, when all influences are unknown.

Many variables are taken out of the equation by premises of the prisoners` dilemma. However, cooperation is probably the most relevant variable to forecast realistic outcomes of games and is completely left out in the PD. Elinor Ostrom among others showed that cooperation might emerge and does so in most real world situations. This variable is so important, that a high level of cooperation leads in nearly all cases to a more desired outcome!

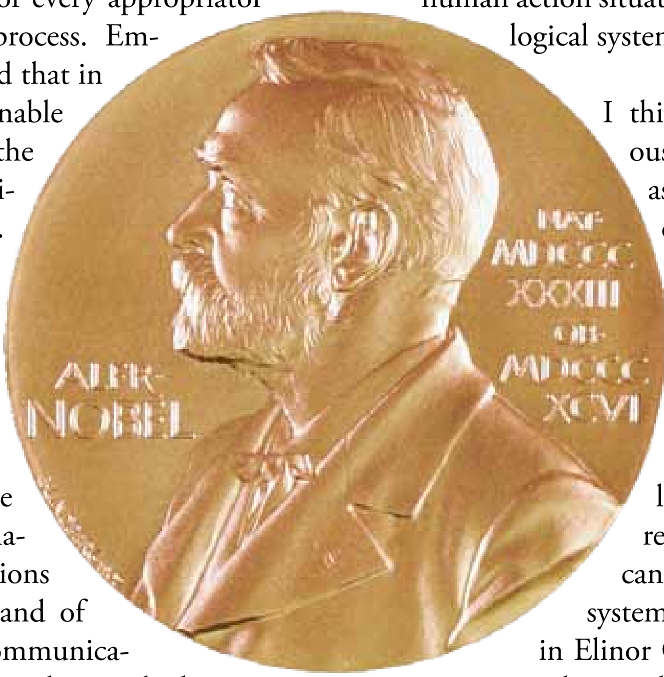
Experience from field and laboratory experiments showed that cooperation depends on many variables, while it is difficult to pin down all of them. The number of players, just to name a relatively easy one, is negatively related to cooperation. Other influences on cooperation are communication, information on the other player and the game structure, trust and reciprocity among other individual motives. Trust is essential in how people cope with dilemmas.

Another interesting finding showed that people tend to take an extra cost in order to punish uncooperative behaviour. This behaviour is contradicting classical economic game theory, which predicts that players care only about profit maximisation. Face-to-face communication, called "cheap talk", was found to improve cooperation compared to formal communication, which was supposed to be necessary for the compliance of rules. Also reputation plays an important role for trust.

In Elinor Ostrom`s chapter in Trust and Reciprocity, she criticises and neglects the plausibility of many commonly accepted game theoretical assumptions. Of particular importance is the fact that outcomes depend highly on individual characteristics and structural variables instead of profit-maximising incentives only. The common belief that social dilemmas of communities with common pool resources (CPR) can only be solved by privatisation and government intervention can be rejected for nearly all cases. Her empirical evidence supports the predictions about behaviour and outcomes from non-cooperative game theory only insignificantly.

Ostrom and her colleagues examined many different kinds of CPRs managed by local communities, among them 47 irrigation systems and 44 fisheries. Those self-organised communities tend to function much better than predicted and even better than most of the cases in which external authorities interfere. More than 70 % of farmer-managed systems had high performance compared to over 40% high performing government controlled irrigation systems. It was also found that many informal fishery groups allocated space, time, information and technology to reduce over-harvesting. Groups that did not communicate, however, were more likely to overuse resources. A study on police departments in smaller and larger districts showed that smaller local departments monitored more effectively than larger ones.

Elinor Ostrom found eight design principles for stable local CPR management. Using a common set of protocols for research in this field of study enabled her to increase the amount of available data. She examined how humans interact with ecosystems to maintain long-term sustainable resource yields. One of her findings is that the boundaries of users and resources have to be clearly defined. The data shows that the rules regarding the distribution of the resources should be adapted to local conditions. Also collective-choice arrangements have to be implemented to ensure the participation of every appropriator in the decision process. Empirical data showed that in almost all sustainable forests around the world, users monitored themselves. Another finding showed that a clear scale of sanctions has to be established to punish infringements. For the case of a conflict, mechanisms and resolutions should be cheap and of easy access. Communication is a key factor here, which also lowers the transaction costs and brings the outcome closer to the optimal. The self-organisation has to be recognised by some higher authority to make sure that all rules and rights are legitimate. For larger pools of resources it is important to have an "organization in the form of multiple layers of nested enterprises, with small local CPR at the base level". All these principles are fulfilled for governance that manages the usage of common pool resources in a sustainable way.



Obviously, many communities are not hopelessly trapped in dilemmas. Evidence shows that self-organisation works in many cases on a sustainable level and even has many advantages compared to privatisation or government regulation: more effective adaptation to changes in the environment, an increased level of relevant information and better knowledge about practical problems are just some of the examples. Governance of larger common pools is more effective if it uses local communities at the base level. Polycentric systems may enable a much better fit between human action situations and nested ecological systems.

I think it is now obvious that game theory as a concept is very complex. Solving a complex problem may be difficult, but not necessarily chaotic. Contrary to the belief that social problems are chaotic in reality, scientific work can illuminate complex systems, as demonstrated in Elinor Ostrom's work. Humanity has to deal with complexity rather than neglecting it. A further analysis of economic governance requires a look over the edge of economic theory. A recognition and integration of knowledge from biology, geology, physics and chemistries is needed to develop technologies for measurement and usage of resources, sociology and psychology are needed to develop a more nuanced analysis of individual's motives. A better understanding of those variables, which do not belong to economic analyses yet, is essential for our progress in governance.

Picture Source: Canada Science and Technology Museum

This progress is relevant and needed especially in times of climate change. The changes in temperature and the environmental conditions require effective and adaptive governance of the commons. According to Ostrom, self-organisation is more effective and adaptive, partly because information can be shared in the group; either to react faster on possible threats or to identify opportunities. Further, we may also achieve a reduction of transaction costs and corruption possibilities. Exploitation won't be possible, as locals work together closely and monitor each other. Elinor Ostrom examined many CPRs, as forests in Brazil, fisheries at the coasts of Africa, irrigation systems in Nepal. CPRs will benefit or suffer from environmental changes caused by climate; either way, self-organisation can help a government to adapt to the changes. For resources like gold mines and oil fields in Africa, self-governance could reduce the high level of corruption and exploitation. Scientific findings that increase the ability to adapt to environmental or other changes benefit all communities and humanity as a whole.

"There cannot be any singular panacea solution"

I want to emphasize that there cannot be any singular panacea solution, as Ostrom would say. The situations are too different from another to believe that there is only one solution. Government intervention is needed in some very uncooperative communities, but is clearly inferior if the community can self-organise. Governments can always try to encourage communities to find their own solutions. Elinor Ostrom combined many disciplines of academic research to find the answers to these kinds of problems. She lives what she teaches and her work increased cooperation by formulating a common set of protocols to ensure the comparison of data found by researchers all around the globe. According to her, better governance in common-resources, especially for the oceans, is one of the top priorities in safeguarding our future. In an interview during the UN conference in Copenhagen she pointed out that top-down rules are not enough to save our planet from climate change. "I propose a so-called polycentric approach to tackling climate change", which means that small communities should take the initiative.
As the "new Era of Responsibility" is approaching, I think the world's governments are ready to give some of their power and responsibility back to the people.

Elinor Ostrom helped humankind to progress. A better understanding will increase sustainability of our resource management. Her work laid the foundations for new research and for new approaches to handle our problems. Now, the rest is up to us.

Interested?

Everybody is invited to contribute to the next issue of The Networker, which will be published during the summer skills 2010.

Contact Ina under info@iesnetwork.nl

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