Abstracts

Fragile States and Development Policy
Timothy Besley, London School of Economics and Torsten Persson, IIES, Stockholm University

It is widely recognized that fragile states are key symptoms of under-development in many parts of the world. Such states are incapable of delivering basic services to their citizens and political violence is commonplace. As of yet, mainstream development economics has not dealt in any systematic way with such concerns and the implications for development assistance. This paper puts forward a framework for analyzing fragile states and applies it to a variety development policies in different types of states. (JEL: D70, F53, H40, O11, P33)

Do House Prices Drive Consumption Growth? The Coincident Cycles of House Prices and Consumption in the UK
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This paper uses a realistic structural life-cycle model of consumption and housing decisions to understand how data might distinguish different mechanisms that explain the correlation between house prices and consumption. The model includes price and earnings shocks estimated from data (the latter including aggregate and idiosyncratic components), and incorporates realistic features of the UK mortgage market. We simulate the model using more than 30 years of realized shocks and under counterfactual scenarios. Our results confirm the intuition of earlier studies: house price shocks should have a larger effect on the consumption of older households and earnings shocks on young households. (JEL: D91 E21)

The Return of the Wage Phillips Curve
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The standard New Keynesian model with staggered wage setting is shown to imply a simple dynamic relation between wage inflation and unemployment. Under some assumptions, that relation takes a form similar to that found in empirical wage equations—starting from Phillips' (1958) original work—and may thus be viewed as providing some theoretical foundations to the latter. The structural wage equation derived here is shown to account reasonably well for the comovement of wage inflation and the unemployment rate in the U.S. economy, even under the strong assumption of a constant natural rate of unemployment. (JEL: E24, E31, E32)

Must-Take Cards: Merchant Discounts and Avoided Costs
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Antitrust authorities often argue that merchants cannot reasonably turn down payment cards and therefore must accept excessively high merchant discounts. The paper attempts to shed light on this "must-take cards" view from two angles. First, the paper gives some operational content to the notion of "must-take card" through the "avoided-cost test" or "tourist test": would the merchant want to refuse a card payment when a non-repeat customer with enough cash in her pocket is about to pay at the cash register? It analyzes its relevance as an indicator of excessive interchange fees. Second, it identifies four key sources of potential social biases in the payment card systems' determination of interchange fees and compares the industry and social optima both in the short term (fixed number of issuers) and the long term (in which issuer offerings and entry respond to profitability). (JEL: D490, E420, G280)
A Model of Ethnic Conflict
Joan Esteban, Institut d'Anàlisi Econòmica (CSIC) and Debraj Ray, New York University and Institut d'Anàlisi Econòmica (CSIC)

We present a model of conflict, in which discriminatory government policy or social intolerance is responsive to various forms of ethnic activism, including violence. It is this perceived responsiveness -- captured by the probability that the government gives in and accepts a proposed change in ethnic policy-- that induces individuals to mobilize, often violently, to support their cause. Yet, mobilization is costly and militants have to be compensated accordingly. The model allows for both financial and human contributions to conflict and allows for a variety of individual attitudes ("radicalism") towards the cause. The main results concern the effects of within-group heterogeneity in radicalism and income, as well as the correlation between radicalism and income, in precipitating conflict. (JEL: D72, D74, O16)

Individual Risk Attitudes: Measurement, Determinants, and Behavioral Consequences
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This paper studies risk attitudes using a large representative survey and a complementary experiment conducted with a representative subject pool in subjects' homes. Using a question asking people about their willingness to take risks "in general", we find that gender, age, height, and parental background have an economically significant impact on willingness to take risks. The experiment confirms the behavioral validity of this measure, using paid lottery choices. Turning to other questions about risk attitudes in specific contexts, we find similar results on the determinants of risk attitudes, and also shed light on the deeper question of stability of risk attitudes across contexts. We conduct a horse race of the ability of different measures to explain risky behaviors such as holdings stocks, occupational choice, and smoking. The question about risk-taking in general generates the best all-around predictor of risky behavior. (JEL: D0, D81, C90, J10)

Control Rights In Complex Partnerships
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This paper develops a theory of the allocation of authority between two players who are in a "complex" partnership, that is, a partnership which produces impure public goods. We show that the optimal allocation depends on technological factors, the parties' valuations of the goods produced, and the degree of impurity of these goods. When the degree of impurity is large, control rights should be given to the main investor, irrespective of preference considerations. There are some situations in which this allocation is optimal even if the degree of impurity is very low as long as one party's investment is more important than the other party's. If the parties' investments are of similar importance and the degree of impurity is large, shared authority is optimal with a greater share going to the low-valuation party. If the importance of the parties' investments is similar but the degree of impurity is neither large nor small, the low-valuation party should receive sole authority. We analyze an extension in which side payments are infeasible. We check for robustness of our results in several dimensions, such as allowing for multiple parties or for joint authority, and apply our results to interpret a number of complex partnerships, including those involving schools and child custody. (JEL: D02, O23, H41, L31)