



DIWDC Synopsis

Real, Clear Economics: A Newsletter from DIWDC

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September - December 2010

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Managing Editor: *Mr. Bienvenue N. Tien*

DIWDC Board Member Professor Pissarides Wins 2010 Nobel Prize in Economics!



Peter A. Diamond, Christopher A. Pissarides, and Dale T. Mortensen at their interview with Nobelprize.org in Stockholm on December 6, 2010. Courtesy: Nobelprize.org

On October 11, 2010, the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel was awarded jointly to Peter A. Diamond, Dale T. Mortensen, and Christopher A. Pissarides "for their analysis of markets with search frictions." The award, instituted in 1968, is given by the Royal Swedish Academy of Sciences according to the same principles as the Nobel Prizes. DIWDC is honored and privileged to have Professor Christopher Pissarides, the 2010 Nobel Prize in Economics Laureate, on its Board of Distinguished Advisers.

The Royal Swedish Academy of Sciences praised the work of these three scholars who have devoted their lives to formulating a theoretical framework for search markets.

Diamond, Mortensen, and Pissarides looked at markets in a pragmatic way. Outside the classroom and textbooks, markets do not always clear, supply does not always equal demand, economic agents do not have full information, and there are often indirect effects and costs associated with each transaction. These frictions apply to several markets, be it the goods market, the housing market, or the labor market. As the world has experienced in the last two years with the economic and financial crises, there are imperfections in the markets. Very often unemployment and job vacancies can coexist, and job seekers can stay unemployed for a long time while searching. Search theory, the three Nobel winners showed, is an extremely useful tool for welfare analysis of alternative designs for unemployment insurance.

These Nobel Laureates contributed to science and the world because their “models help us understand the ways in which unemployment, job vacancies, and wages are affected by regulation and economic policy.” While Peter Diamond has analyzed the foundations of search markets, Dale Mortensen and Christopher Pissarides have expanded this theory and applied it to the labor market. Their work has “a profound impact on how economists view markets in general and labour markets in particular,” said Professor Bertil Holmlund, Member of the Royal Swedish Academy of Sciences and Chairman of the Economics Sciences Prize Committee, in his award ceremony speech. “You have provided detailed models of how prices and quantities are determined in markets with frictions and how frictions affect unemployment and other labour market phenomena. Your models have become indispensable tools for policy analysis and your work has initiated a large empirical literature.”

The scientific community and the interested public were elated to witness the awards ceremony. On December 10, 2010, the three distinguished scholars went to Sweden to receive their Prize from His Majesty the King of Sweden during the traditional ceremony at the Stockholm Concert Hall in Sweden.



AP Photo. Christopher A. Pissarides receives the shared Nobel Prize in Economics from Swedish King Carl Gustaf XVI.

Prior to the awards ceremony, on December 8, 2010, the Laureates delivered their prize lecture at Aula Magna at Stockholm University. Professor Dale T. Mortensen (Northwestern University) spoke first about “Markets with Search Friction and the DMP Model.” Professor Peter A. Diamond (Massachusetts Institute of Technology) followed with his lecture “Unemployment, Vacancies, Wages.” Professor Christopher A. Pissarides’ (London School of Economics) lecture was on “Equilibrium in the Labour Market with Search Frictions.” In his closing note, Professor Pissarides discussed future studies regarding the role of institutions, imperfect

capital markets, imperfect knowledge and expectations, wage stickiness, and integration of financial and labor markets. ■

Professor Christopher A. Pissarides: Featured Profile of the 2010 Nobelist



DIWDC is privileged to have a winner of the 2010 Nobel Prize in Economics Professor Christopher A. Pissarides on its Board of Distinguished Advisers.

In early October, Professor Christopher A. Pissarides (London School of Economics), was rewarded with the 2010 Nobel Prize in

Economics for his contributions to the analysis of labor markets with search frictions. His research, which shows how the intensity of a job seeker’s search and the timing of the seeker’s decision to accept a job offer determine the distribution of unemployment durations, is of critical importance in our current economic climate.

It should be noted that Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel strictly follows the Nobel Prize criteria. While the prize can be shared among up to three persons, “a shared Nobel Prize is just as honorable as a single Prize, and each Laureate has to be worthy of the Prize alone” (http://nobelprize.org/nobel_prizes/economics/articles/lindbeck/index.html).

Professor Pissarides is a full professor of economics at the London School of Economics, where he has held the Norman Sosnow Chair in Economics since 2006. Professor Pissarides earned his doctorate in economics in 1973 at the London School of Economics. After brief appointments at the Central Bank of Cyprus and the University of Southampton, he returned to the London School of Economics in 1976 as lecturer in economics. He became full professor in 1986, and was the head of the Economics Department from 1996-1999.

Professor Pissarides' research has enriched economics as a science and, in particular, the fields of labor economics and macroeconomics. Professor Pissarides has spent his entire career conducting research on the labor market search, job matching, the influence of labor market frictions in the explanation of unemployment, wage inequality, labor-market policy, and most recently, on growth and structural change. His research has broken new grounds and fundamentally shaped empirical economics. He has advanced the field of economics and given intuitive insights on unemployment as an equilibrium phenomenon.

A pioneering scholar, Professor Pissarides has a prolific career in economics. In addition to writing or editing six books, including his well-known book Equilibrium Unemployment Theory (2nd ed., MIT Press 2000, reprinted 2007), Professor Pissarides has an extensive publication record in peer-reviewed economics journals. Among Professor Pissarides' numerous awards, distinctions, and honors are: Fellow of the British Academy, Fellow of the Econometric Society, member of the European Economic Association, and member of the Society of Labor Economists, member of the Econometric Society, a former member of Council of the Royal Economic Society, and the Council of the European Economic Association. In 2010, Professor Pissarides became the President-Elect of the European Economic Association and will assume the Presidency in 2011.



Among other things, he is the chairman of the Economica board, a research fellow of the Centre of Economic Performance at the London School of Economics and a former head of its Macroeconomics Research Programme, fellow of the Centre for Economic Policy Research (CEPR, London), and fellow of the Institute for the Study of Labor (IZA, Bonn). He is also a Non-National Senior Associate; a member of the Forum for Economic Research in the Arab Countries, Iran, and Turkey; and a former member of the Monetary Policy Committee of the Central Bank of Cyprus (2000-2007). He has served on the European Employment Task Force (2003) and he has been a consultant on employment policy and other labor issues for the World Bank, the European Commission, the Bank of England, and the OECD.

In 2005, Professor Pissarides and Professor Mortensen jointly won the IZA Prize in Labor Economics for their path-breaking contributions to the economics of unemployment and the analysis of markets with search and matching frictions. The IZA Prize in Labor Economics is one of the most important and renowned scientific awards in economics and comes with

a cash prize of 50,000 Euros. In 2008 Professor Pissarides was awarded the Republic of Cyprus "Aristeion" (award) for Arts, Literature, and Science. ■

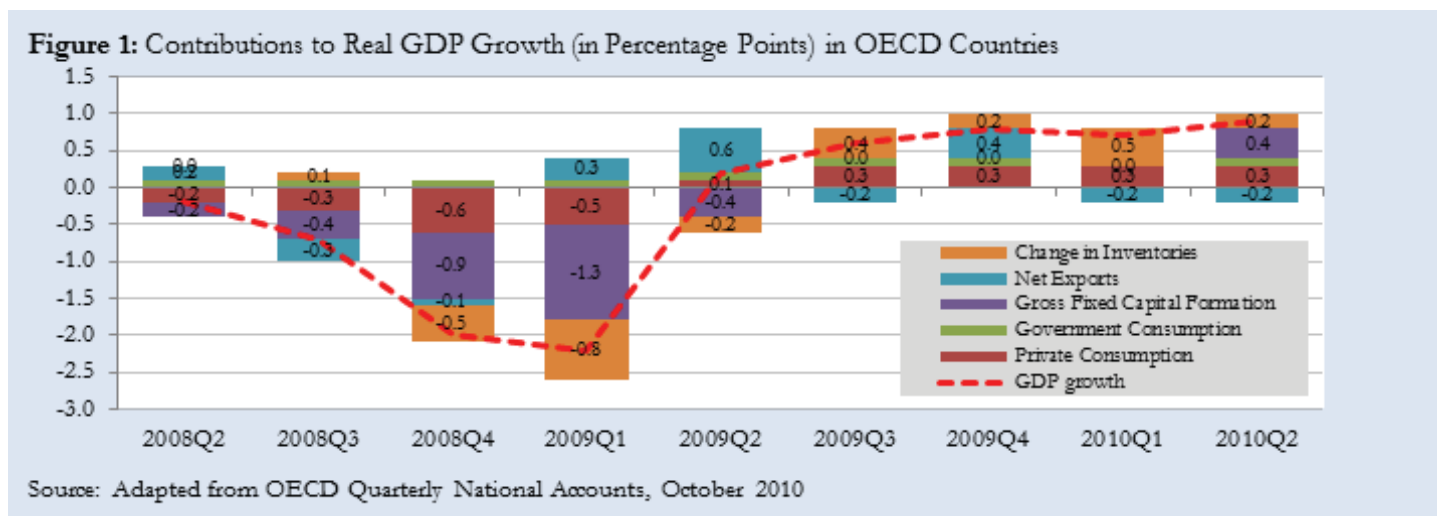


The 2010 Nobel Laureates assembled for a group photo during their visit to the Nobel Museum in Stockholm, 6 December 2010. Back row, l-to-r: Nobel Laureates in Physics Konstantin Novoselov and Andre Geim, Laureates in Economic Sciences Peter A. Diamond, Christopher A. Pissarides and Dale T. Mortensen. Front row, l-to-r: Nobel Laureate in Chemistry Richard F. Heck, Nobel Laureate in Literature Mario Vargas Llosa, Nobel Laureates in Chemistry Akira Suzuki and Ei-ichi Negishi. Copyright © The Nobel Foundation 2010. Photo: Orasis

Lexicographic Speculation: “LUV” for the Global Economy?

For one year now pundits have been speculating about the speed of the global economic recovery. Following the alphabet, the standard question about the economy is: leaving “L” behind, will we have a “U,” a “V,” or a “W”? Amidst this lexicographic debate, a new school of economists have advocated against a single letter because regardless of globalization, different economies of the world may experience a different alphabetic recovery. Accordingly, proponents of this new school talk about a “LUV-shaped” recovery: that is, there will be an L-shaped economic recovery in Western Europe, a U-shaped economic recovery in America and a V-shaped economic recovery in the big emerging economies in Asia and elsewhere (The Economist¹ November 11, 2009).

Recent OECD data plotted in Figure 1 reveal that economic recovery in OECD countries follows a V-shape. Indeed, real GDP in the OECD area increased by 0.9% in the second quarter of 2010 compared to the previous quarter, which is a stronger pace than the previously estimated 0.7%. Looking at the contributions of different macroeconomic aggregates, we notice that gross fixed investment was the main contributor to the GDP increase, adding 0.4 percentage points to overall growth. Gross fixed investment was followed by private and government consumption that contributed 0.3 and 0.1 percentage points, respectively. While inventories became positive and were increasing since the third quarter of 2009, they showed a slower increase (0.2 percentage points) in the second quarter of 2010 compared to the first quarter of 2010 (0.5 percentage points). The noted increase in domestic aggregates was partially offset by negative contributions from net exports in 2010, reducing the overall GDP growth by 0.2 percentage points (OECD Quarterly National Accounts 2010).



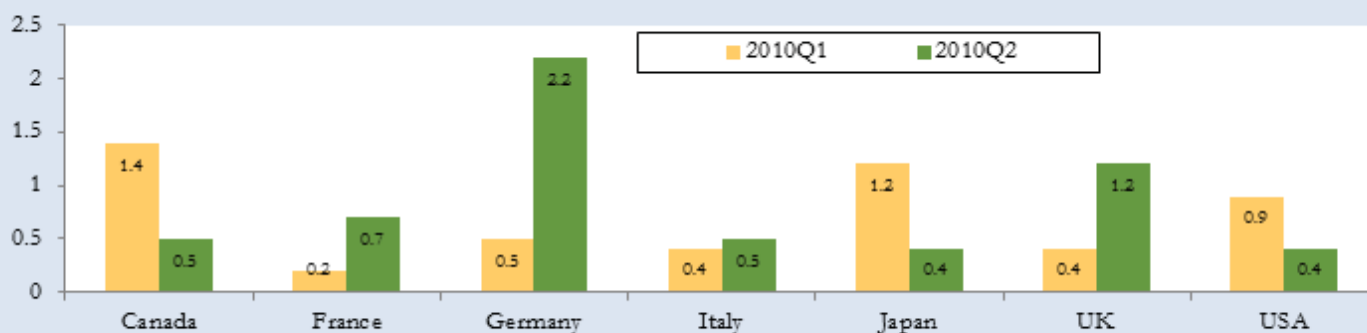
Disaggregating the OECD countries, Figure 2 depicts Germany as having the strongest increase in GDP growth in the second quarter of 2010 (2.2%) compared to the first quarter of 2010. The UK ranks second with a GDP growth of 1.2%. While the strong growth in Germany was largely driven by high investment and net exports, growth in the UK was mainly driven by private consumption and inventories. GDP growth in the U.S., Japan, and Canada was comparatively much lower, and growth in the second quarter was below that in the first quarter. The slower pace of GDP growth in both the U.S. and Canada was due to negative contributions of foreign trade. Japan’s anemic GDP growth of 0.4% was boosted by higher foreign trade surplus (0.3 percentage points) (c.f. OECD Quarterly National Accounts 2010).

Experts agree that foreign trade balances play a substantial role in the overall economic recovery. Up until the recent G-20 summit in Seoul, policy makers from the G-20 member states vigorously raised concerns about the ongoing and deepening global imbalances in foreign trade balance in each member state. Specifically, Figure 3 illustrates the current accounts surplus

¹The Economist (2009). “LUV, actually.” http://www.economist.com/blogs/theworldin2010/2009/11/luv_actually.

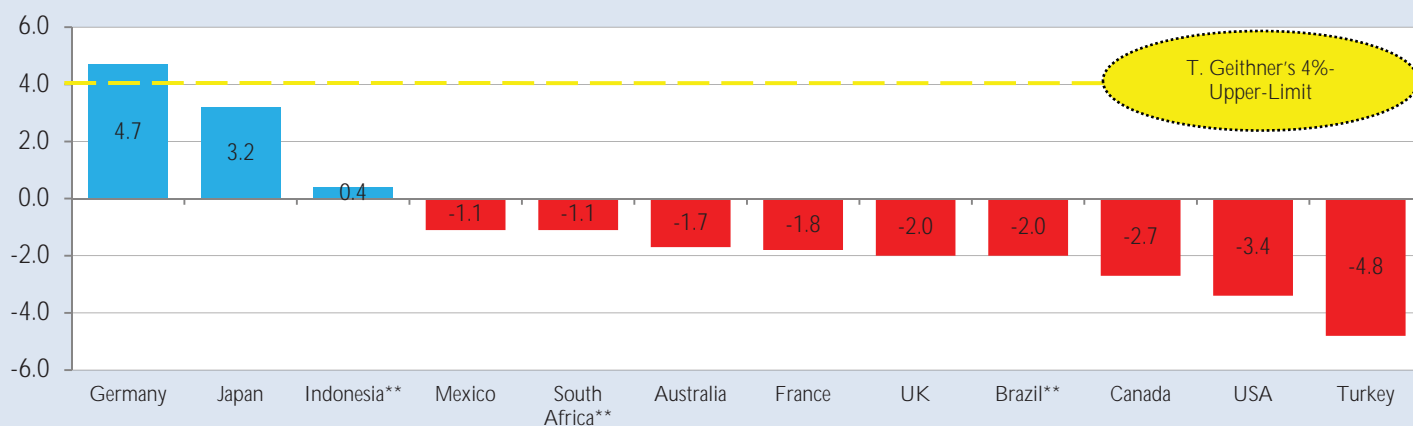
or deficit for some selected G-20 countries for the second quarter of 2010. Germany and Japan lie on the positive end, having a considerable current account surplus of 4.7% and 3.2%, respectively. On the other end there are the U.S. (-3.4%), Canada (-2.7%), the UK (-2.0%), and France (-1.7%), all registering serious current account deficits. To rebalance the world global economic recovery, America's Treasury Secretary Timothy Geithner called for current accounts deficit or surplus targeting that should not exceed 4% of GDP.

Figure 2: GDP Growth in Selected Developed Economies: 2010Q1 and 2010Q2



Source: OECD Quarterly National Accounts; DIWDC's presentation

Figure 3: Current Account as a Percentage of GDP for Selected G-20 Countries: 2010Q2 Seasonally Adjusted



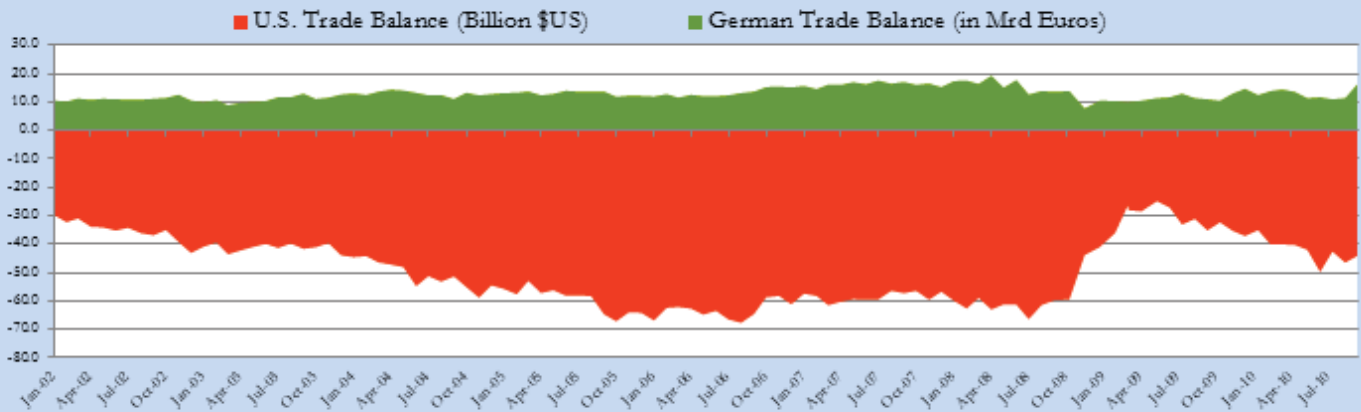
Source: OECD Main Economic Indicators, November 2010; DIWDC's Presentation

Note: ** Values for these countries are of 2010Q1

Comparing the monthly trade balance between the U.S. and Germany from 2002 to 2010, Figure 4 shows that the U.S. trade balance has been negative for quite a while, whereas Germany has been able to sustain a positive trade balance over this period.

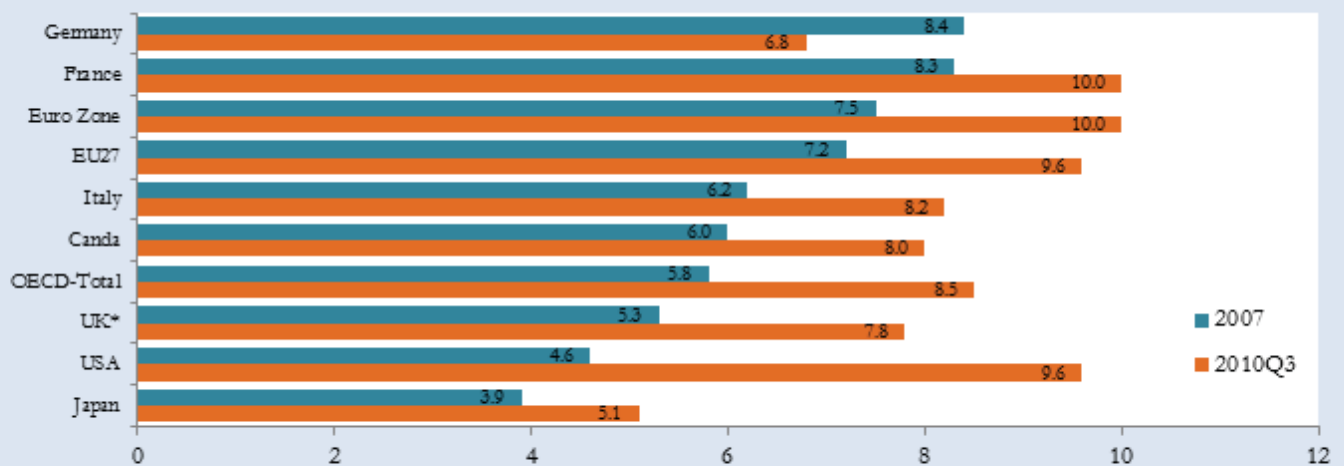
However, the last joint report² from the U.S. Census Bureau and the Bureau of Economic Analysis through the department of Commerce reveals that the trade deficit in goods and services was \$44.0 billion down from \$46.5 billion in August 2010. In contrast, Germany had a trade surplus of 14.6 billion Euros in September 2010 compared to 11.0 billion Euros in August 2010.

² http://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf.

Figure 4: Adjusted Monthly Trade Balance (in Billions) in Germany and the U.S., 2002-2010

Source: U.S. Census Bureau; Statistisches Bundesamt; DIWDC's presentation

Despite the overall economic recovery, unemployment rates remain high in most developed economies. In Figure 5 we report the unemployment rates in the third quarter in 2010 for the OECD countries as a whole, for the EU-27 countries, for the U.S., and for some other selected developed countries; we have juxtaposed these rates to the 2007 pre-crisis rates. The Euro Zone countries reached the highest unemployment rate at 10%. The EU-27 countries have the same unemployment rate as the U.S. (9.6%). Within the EU-27, France scores the highest with an unemployment rate of 10%, Italy is second with 8.2%, and the UK is third with 7.8%. The European *wunder* is Germany, which has the lowest unemployment rate (6.8%). Going against the current of the sweeping global crisis, Germany's unemployment rate decreased from 8.4% in 2007. In fact, Germany's unemployment rate is currently the lowest among developed nations. This is in sharp contrast to Germany's high unemployment rates in 2007, which were clearly above the OECD rate of 5.8% and the EU-27 rate of 7.2%. This success story is partially due to the German government sponsored *Kurzarbeit*-scheme (short-time work) that was reinforced in the midst of the financial crisis of 2008. The *Kurzarbeit*-scheme is a labor-hoarding strategy in which the German government subsidizes employers to keep workers employed and supports shorter working weeks.

Figure 5: Selected Unemployment Rates, Seasonally Adjusted: 2007 and 2010Q3

Note: * Rate for the UK in 2010 refers to 2010Q2

Source: OECD Harmonised Unemployment Rates, as of November 9, 2010; DIWDC's presentation

Figure 5 clearly shows that while all countries were hit hard by the crisis, the U.S. fared the worst. The unemployment rate in the U.S. has more than doubled, going up from 4.6% in 2007 to 9.6% in the third quarter of 2010.

Focusing on Germany, Figure 6 contrasts unemployment rates, job openings and short-time workers in a monthly time series from 2007 to 2010. The number of workers in this short-time scheme exponentially increased in 2008 and reached a peak in May 2009.

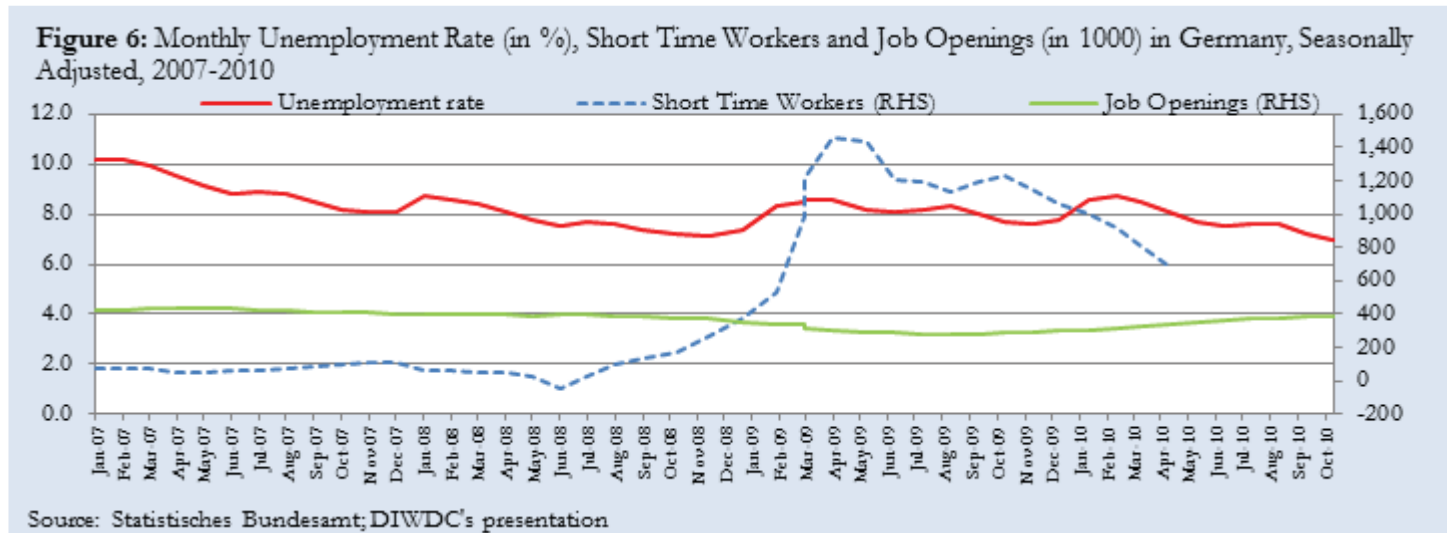
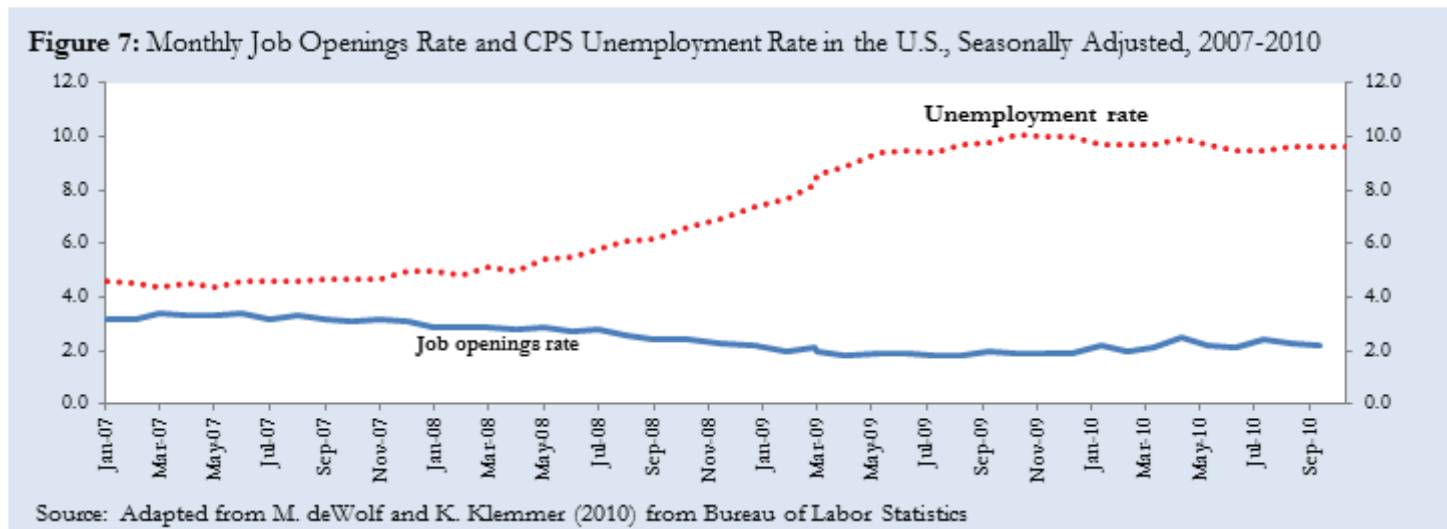


Figure 7 juxtaposes the monthly unemployment rates to the job openings rates in the U.S. from 2007 to 2010. Historically, job opening rates (or job vacancies) and CPS national unemployment rates have moved inversely. As long as job openings remain low, unemployment will remain high. Figure 7 shows that close to December 2007, when the economic recession was officially declared, the difference between the job opening rate and the unemployment rate began to grow rapidly in opposite directions. For instance, in December 2007 the difference between both rates (unemployment rate – job openings rate) was 1.9 percentage points. By December 2008, this difference had reached 5.2 percentage points, and by 2009 it had soared to 8.1 percentage points. Since the beginning of 2010 this gap has been decreasing, going down to 7.4 percentage points by September 2010.



An October 2010 special report of *The Economist*³ (October 2010) showed that the effects of the recession were unevenly spread. By showcasing an analysis of the different job market outcomes across countries, the report documented that in the U.S. it was the conjoined bubbles of the housing and financial markets that caused construction to slump. This slump was inevitably accompanied by the loss of many jobs that are unlikely to return soon. The report also showed that in Germany, the crisis was contained in the export activities that suffered mostly due to the collapse of international commerce; the decrease in exports proved to be more temporary and less pervasive. Further, according to this report, the biggest difference in the resilience of the labor market was the response of companies to the crisis. In most developed nations, companies “cut hours more than bodies.” This has been the case in Germany that implemented the *Kurzarbeit* scheme. Conversely, in the U.S., “firms have proved keener to cut workers than hours,” thus contributing to prolonged unemployment. ■

³The Economist (2010). “A Special Report on the World Economy: From Hoarding to Hiring.” <http://www.economist.com/node/17173957>.

DIWDC's Events: Informing and Educating the Public

November 2010 was a critical month for the nation, as midterm elections were held on Tuesday the 2nd. At DIWDC, November also was an important month, as we organized and held five high profile conferences and talks that were well-attended by Washington's scientific and political community.

Meeting Global Challenges: US-German Innovation Policy¹

Day 1

On Monday November 1, close to 150 policymakers, researchers, academics, and businessmen gathered at the Ballroom of the National Press Club to launch the first series of the Innovation Conference. Leading figures from Germany and the United States participated, discussed, exchanged information, and debated a range of issues of mutual interest: clean energy policy, manufacturing and exports, electric vehicle industries, small business and technology commercialization, and the increasingly important role of universities as drivers of innovative economic engines. The conference successfully apprised the community about the importance of innovation, the current policies on innovation, and the strategies on innovation from both sides of the Atlantic. DIWDC was privileged to co-organize this remarkable conference with DIW Berlin and the National Academy of Science (NAS).



The conference started with two welcome addresses, first by Alan Am. Wolff, Chairman of National Academies Study of Comparative National Innovation Policies and then by Professor Klaus F. Zimmermann, President of DIW Berlin. Dr. John Holdren, Science Adviser to President Obama and Director of the White House Office of Science and Technology Policy, opened the conference by describing the current administration's innovation program. His speech, "A Strategy for American Innovation: Driving Toward Sustainable Growth and Quality Job," covered the current administration's dedication to innovation. In line with the president's wish

to "reaffirm America's role as the world's engine of scientific discovery and technological innovation," the United States intends to increase research and development spending to 3% of its GDP and to double the budgets of key research institutions.

His Excellency Dr. Klaus Scharioth, the German Ambassador to the United States, gave the next presentation. Ambassador Scharioth emphasized the importance of this conference during this time of expansion between Germany and the United States in the fields of science, technology, and innovation. As his Excellency noted, the German Federal Government's spending on science, research, innovation, and education will increase by 12 billion Euros between 2010 and 2013. Moreover, Germany will invest 10% of its GDP in research and education by 2015. As a land of ideas, Germany is determined to strengthen its long-term partnerships with developing countries in the fields of education, research, and development.

¹ The Program of this two-day conference can be found on page 11.

Both the Science Adviser to President Obama and the German Ambassador underlined the crucial importance of innovation as the driving force for future economic growth and welfare. Working hand in hand, the United States and Germany can combine their best resources and ideas to ensure a brighter economic future for all.

After hearty applause from the audience, the conference segued from the opening remarks to the panel sessions. The day went by quickly, with twelve excellent paper presentations slated in the following six panels:

- Panel I: Current Trends in Innovation Policy
- Panel II: Energy Policy: Lessons and Opportunities
- Panel III: Building the Electric Vehicle Industry
- Panel IV: Manufacturing and Trade: Lessons in Export Policy
- Panel V: Helping Small Business: Perspectives from the United States and Germany
- Panel VI: Universities for the 21st Century

The Innovation conference, which focused on comparing innovation policies and measures across the Atlantic, ended with a roundtable chaired by Alan Wm. Wolff. In their closing remarks, co-organizers Professor Klaus F. Zimmermann and Alan Wm. Wolff thanked the participants for their valuable contributions and spirited discussions.

Conference participants migrated to the Reception in the First Amendment Lounge of the National Press Club Building. With the White House in the background, the energetic crowd continued the lively discussions of the day.

Invited participants continued on at the Ambassador's Residence to cap off the evening. Among them were Dr. Amelie



Constant, Executive Director of DIWDC • Mr. Matthias Sonn, Economics Minister at the German Embassy • Professor Rebecca Blank, the Undersecretary of the Department of Commerce • Professor Klaus F. Zimmermann, Chairman of the Board of DIWDC • Professor John Holdren, Science Adviser to President Obama • and Dr. Charles Wessner, Director of TIE at NAS.



Meeting Global Challenges: US-German Innovation Policy

Day 2

The second day of the Innovation Conference was patterned after a standard academic paper presentation. DIWDC, NAS, DIW Berlin, and BIGS co-organized this event at the Fullbright room in Columbia Square. On November 2nd, Dr. Amelie F. Constant, Executive Director of DIWDC, opened the conference by underlining the importance of research efforts in innovation. In a room that was at maximum capacity, Dr. Constant talked about the nexus between innovation and

economics. She explained how innovation is a key factor in the smooth functioning of the labor markets and how it lies at the heart of entrepreneurship and self-employment; and that innovation among immigrants and women as well as innovation in green growth are new areas in economics. “Indeed, the very definition of economics is related to innovation,” she said. Dr. Constant concluded by thanking all of the participants for their contributions.



Dr. Charles Wessner, Director of Technology, Innovation, and Entrepreneurship at the National Academies, gave his opening remarks, starting with a conceptual framework of innovation policy. Session I, which was on *Measuring Innovation*, was chaired by Dr. Anne Golla from the International Center for Research on Women. The first paper was on “The Atlantic Century Report” by Robert D. Aktinson, President of the Information Technology & Innovation Foundation. The second paper, presented by Jens Schmidt-Ehmcke from DIW Berlin, was on the “Innovation Indicator Germany.” The first session ended with a presentation by Dietmar Harhoff, President of the Commission of Experts for Research and Innovation and a professor at the University of Munich. Dr. Harhoff’s presentation was on “Measuring Innovation – New Developments and Progress.” Session II, chaired by Dr. Amelie Constant of DIWDC, was on *Green Innovations*. “Sources of Progress in Photovoltaics” by Ken Zweibel, Director of the George Washington University Solar Institute, was the first paper presentation. The second presenter was Karsten Neuhoff, Director of the Berlin Office of Climate Policy Initiative and DIW Berlin, who talked about “Technology Policies for Photovoltaics.” Christian von Hirschhausen, Technical University Berlin and Research Director at DIW Berlin, presented his paper on “Carbon Capture, Transportation, and Storage (CCTS): Silver Bullet or Wishful Thinking.”

After lunch, the conference continued with Professor Rebecca Blank, Under Secretary of the United States Department of Commerce, who gave the honorary luncheon address. Dr. Blank’s very informative presentation was entitled, “How Does Innovation Help Economic Growth.” Amelie Constant chaired this talk and moderated the numerous questions addressed to Dr. Blank. Following the honorary address, Session III on *Innovations in Security* was chaired by Tim Stuchtey, Director of BIGS. The session started with Alan Schaffer, Principal Deputy Director from Defense Research and Engineering of the United States Department of Defense. His talk examined “Innovation for Enhancing Security.” Richard K. Arning, Vice-President EADS Deutschland GmbH, then talked about “Transfer Mechanisms of Security Innovations into Markets.”

The second day of the Innovation conference ended with Session IV on *Innovation and Entrepreneurship*. Chaired by Stefanie Shipp from the Science and Technology Policy Institute, this session opened with Julie A. Elston of the Business School at the University of Oregon. Her talk was on “What Makes a Successful High-Technology Entrepreneur?” Utz Weitzel from Max Planck Institute Jena and Radboud University Nijmegen followed with his paper, “Potential Entrepreneurs and Performance in the IOWA Gambling Task.” Alexander Kritikos, Vice President of DIW Berlin and Director of Innovation, was the last presenter in Session IV. His presentation was on “The Impact of Personality Characteristics on Entrepreneurial Development.” The conference ended with Professor Zimmermann, Chairman of DIWDC’s Board of Directors, who thanked all of the participants and paper contributors for their support, and reminded all that the next conference will be in Berlin in May 2011. ■

**Meeting Global Challenges:
US-German Innovation Policy
Organized jointly by the National Academies
and the German Institute for Economic Research (DIW)
in Cooperation with the Embassy of the Federal Republic of Germany**

November 1, 2010

**The Ballroom
The National Press Club
529 14th Street, NW
Washington, DC**

- 8:30 AM **Welcome**
Alan Wm. Wolff, Dewey & LeBoeuf, LLP, and Chair, National Academies Study of Comparative National Innovation Policies
Klaus F. Zimmermann, President, Deutsches Institut für Wirtschaftsforschung (German Institute for Economic Research)
- 9:00 AM **Opening Remarks**
John Holdren, Science Adviser to the President & Director, White House Office of Science and Technology Policy
The Honorable Klaus Scharioth, German Ambassador to the United States
- 9:30 AM **Panel I: Current Trends in Innovation Policy**
Moderator: Charles Wessner, National Academy Scholar and Director of Technology, Innovation, and Entrepreneurship, The National Academies
- U.S. Innovation Policy: New Initiatives**
Ginger Lew, Senior Counselor, White House National Economic Council
- New Initiatives in German Innovation Policy**
Engelbert Beyer, Head of Directorate for Innovation Strategies, Federal Ministry of Education and Research (Bundesministerium für Bildung und Forschung)
- 10:15 AM **Coffee Break**
- 10:30 AM **Panel II: Energy Policy: Lessons and Opportunities**
Moderator: Ken Zweibel, Director, The George Washington University Solar Institute
- Building an Industry: German Solar Policy**
Bernhard Milow, Director, Energy Program, German Aerospace Center (DLR)
- New Initiatives in U.S. Solar Energy Policy**
John Lushetsky, Program Manager, Solar Energy Technologies Program, U.S. Department of Energy
- 11:15 AM **Panel III: Building the Electric Vehicle Industry**
Moderator: Kevin Hurst, White House Office of Science & Technology Policy
- U.S. Battery Initiative for Electric Drive Vehicles**
Patrick Davis, Program Manager, Vehicle Technologies, Energy Efficiency and Renewable Energy, U.S. Department of Energy
- German Perspectives on Electric Vehicles**
Richard Steinberg, Electric Vehicle Operations and Strategy, BMW of North America
- 12:15 PM **Lunch and Discussion in the Ballroom**

- 1:15 PM **Panel IV: Manufacturing and Trade: Lessons in Export Policy**
Moderator: Michael Czinkota, Professor of Business, Georgetown University
- Germany's Support for Manufacturing and Export Performance**
Klaus F. Zimmermann, President, Deutsches Institut für Wirtschaftsforschung (German Institute for Economic Research)
- U.S. Initiatives to Stimulate Manufacturing**
Ron Bloom, Senior Counselor for Manufacturing Policy, Department of the Treasury
- 2:00 PM **Panel V: Helping Small Business: Perspectives from the U.S. and Germany**
Moderator: Alexander Kritikos, Vice-President, Deutsches Institut für Wirtschaftsforschung
- The Fraunhofer Network: R&D for SMEs**
Roland Schindler, Executive Director, the Fraunhofer, CSE
- The U.S. Manufacturing Extension Partnership Program**
Roger Kilmer, Director, the Hollings Manufacturing Extension Partnership (MEP) Program, National Institute of Standards and Technology
- 3:00 PM **Coffee Break**
- 3:15 PM **Panel VI: Universities for the 21st Century**
Moderator: Dietmar Harhoff, President, the Commission of Experts for Research and Innovation
- U.S. University**
Mark Allen, Senior Vice Provost for Research and Innovation, Georgia Institute of Technology
- German University**
Andreas Pinkwart, Former Deputy Prime Minister and Minister for Innovation, Science, Research and Technology of North Rhine Westphalia
- 4:00PM **Roundtable**
Chair: Alan Wm. Wolff, Dewey & LeBoeuf, LLP, and Chair, National Academies Study of Comparative National Innovation Policies
- Engelbert Beyer, Head of Directorate for Innovation Strategies, Federal Ministry of Education and Research (Bundesministerium für Bildung und Forschung)*
- Carl Dahlman, Henry R Luce Associate Professor, Georgetown University School of Foreign Service and Member, NAS Committee on Comparative National Innovation Policies*
- Dietmar Harhoff, President, the Commission of Experts for Research and Innovation*
- Charles Wessner, National Academy Scholar and Director of Technology, Innovation, and Entrepreneurship, The National Academies*
- 4:45 PM **Closing Remarks**
Klaus F. Zimmermann, President, Deutsches Institut für Wirtschaftsforschung (German Institute for Economic Research)
- Alan Wm. Wolff, Dewey & LeBoeuf, LLP, and Chair, National Academies Study of Comparative National Innovation Policies*
- 5:00 PM **Adjourn to Reception in the First Amendment Lounge**


DIWDC

**Meeting Global Challenges:
US-German Innovation Policy**

November 2, 2010

**Columbia Square
555 Thirteenth Street, NW
Washington, DC
Fulbright West – Conference Room**

Program

8:30 AM **Registration / Coffee / Tea**

8:45 AM **Opening Remarks**

*Amelie Constant, Executive Director, DIWDC and George Washington University
Charles Wessner, National Academies*

9:00 AM **Session I: Measuring Innovation**

Moderator: Anne Golla, International Center for Research on Women

The Atlantic Century Report

Robert D. Atkinson, President, the Information Technology & Innovation Foundation

Innovation Indicator Germany

Jens Schmidt-Ehmcke, DIW Berlin

Measuring Innovation – New Developments and Progress

Dietmar Harhoff, President, the Commission of Experts for Research and Innovation and University of Munich

10:30 AM **Coffee Break**

10:45 AM **Session II: Green Innovations**

Moderator: Amelie Constant, DIWDC and George Washington University

Sources of Progress in Photovoltaics

Ken Zweibel, Director, the George Washington University Solar Institute

Technology Policies for Photovoltaics

Karsten Neuhoff, Director, the Berlin Office of Climate Policy Initiative and DIW Berlin

Carbon Capture, Transportation, and Storage (CCTS): Silver Bullet or Wishful Thinking?

Christian von Hirschhausen, Professor, Technical University Berlin and Research Director, DIW Berlin

12:15 AM **Lunch**

12:45 AM **Honorary Luncheon Address**

How Does Innovation Help Economic Growth

Prof. Rebecca Blank, Under Secretary of the Department of Commerce

1:15 PM

Session III: Innovations in Security*Moderator: Tim Stuchtey, Managing Director, BIGS Potsdam***Innovations for Enhancing Security***Alan Shaffer, Principal Deputy Director, Defense Research and Engineering, the USA***Transfer Mechanisms of Security Innovations into Markets***Richard K. Arning, Vice President EADS Deutschland GmbH***The Potential of Transatlantic R&D Projects in the Security Sector***Tim Stuchtey, Managing Director BIGS Potsdam*

2:45 PM

Coffee Break

3:00 PM

Session IV: Innovation and Entrepreneurship*Moderator: Stephanie Shipp, Science and Technology Policy Institute***What Makes a Successful High-Technology Entrepreneur?***Julie Ann Elston, Professor, Business School, Oregon State University***Potential Entrepreneurs and Performance in the IOWA Gambling Task***Utz Weitzel, Max Planck Institute Jena & Radboud University Nijmegen***The Impact of Personality Characteristics on Entrepreneurial Development***Alexander Kritikos, Vice President, DIW Berlin and University of Potsdam*

4:30 PM

Closing Remarks*Klaus F. Zimmermann, President DIW Berlin and Bonn University*

The Fourth Annual “German Day on Development” at the World Bank Headquarters in DC¹

Returning to the World Bank headquarters in Washington DC, the fourth annual “German Day on Development” conference was hosted by Germany on November 3.² This day-long conference is organized by DIWDC in cooperation with IZA, DIW Berlin, and the World Bank. Attended by several World Bank officials, this event provides an excellent opportunity for experts to discuss the latest research on conflict, development, investment, and migration issues. The German Day on Development also enhances collaboration and communication between researchers in Washington and Germany. As a new Washingtonian, Ms. Ingrid Hoven, Executive Director for Germany at the World Bank, presided over the commencement of the conference as her first official duty. Professor Dr. Klaus F. Zimmermann and Dr. Amelie F. Constant, Executive Director of DIWDC, followed Ms. Hoven’s opening remarks. Economic specialists presented extensive research analyses on a broad array of topics, ranging from the effects of conflict on both micro- and macro-economic development, positional income concerns, leader educational attainment and FDI (Foreign Direct Investment) flows, and East Asia regional considerations.

This year, the conference sessions included session chairs and paper discussants from various departments of the World Bank. The highlight of the conference was the keynote by Dr. Mwangi S. Kimenyi from the Brookings Institution. Dr. Amelie Constant highlighted the background of the honored speaker and moderated the Q&A session. In the lively atmosphere provided by the fully-packed room, Dr. Kimenyi presented his research on “The Centrality of Mirco-(self-governing) Institutions in the Development Process.” According to Dr. Kimenyi’s research,

Africa’s problems are rooted in its institutions: the African state is not consensual, and ethnicity is an important institution. Although deemed important for building a nation-state, Democratic elections often do not result in “consensus-low-trust equilibrium” societies. Therefore, Dr. Kimenyi opines that institutional building should focus on strengthening self-governing units.

The conference was comprised of three diverse sessions. Session A was dedicated to research on *Measuring the Impact of Conflicts: Micro and Macro Perspectives*. It was chaired by Dr. Quentin Wodon of the World Bank, and contained several papers. The first was “Identifying Conflict and Violence in Micro-Level Surveys,” presented by Tilman Brueck, DIW Berlin and Humboldt University. Dr. Brueck explained that the overall goal is to increase the capacity of researchers and policy practitioners to identify (comparatively, and across time) how individuals, households, and communities are affected by violent conflict. The second was “Beyond the Economic Downturn: Evidence on Sector-Specific Effect of Violent Conflict,” presented by Marc Vothknecht of the DIW Berlin Graduate Center.

Using conflict data on Indonesia, Mr. Vothknecht found that the manufacturing, construction, and transportation industries are most affected during violent conflicts. In the short term, however, conflicts affect economic growth, and some sectors recover immediately after the end of conflict. The last paper was “Measuring the Global Economic Cost of Conflict,” presented by Olaf



¹ The program of this conference is on page 17.

² Germany is the third largest donor government to the World Bank, following the United States and Japan.

de Groot of DIW Berlin. Dr. de Groot's research estimated the global economic costs of conflict by focusing on spillover effects. Since 1960, conflict has led to a 14% output gap in global GDP, but there are no strong spillovers on the global scale. Damien De Walque, Sibel Kulaksiz, and Humberto Lopez, all from the World Bank, were the respective discussants.

Chaired by Dr. Sonia Plaza, the World Bank, Session B was entitled "Positional Income Concerns in Ethiopia and African Leaders." The session began with Bienvenue Tien of DIWDC, who presented his paper, "African Leaders: Their Education Abroad and FDI Flows," which he co-authored with Dr. Amelie Constant, also of DIWDC. Their paper examines the role of African leaders' foreign education on Foreign Direct Investments (FDI) in their country. They find that tertiary education in general and specifically tertiary education obtained outside Africa matter for FDI inflows above and beyond standard FDI determinants. The next paper presented was "Do Positional Concerns Matter in Poor Societies? Evidence from a Survey Experiment" by Dr. Alpaslan Akay of IZA. Preliminary results show that there are very low concerns for positionality. However, positional concerns are slightly larger in the case of the aid package income. Abdu Muwonge and Boniface Essama-Nssah, both of the World Bank, discussed the papers and provided constructive comments.

The conference concluded with Session C on *East Asia Regional Considerations*. Chaired by Dr. David Margolis of the World Bank, the session started with Tanika Chakraborty of DIW Berlin, who presented her work on "English Language Premium: Evidence from a Policy Experiment in India." Estimating the economic returns to English language skills in India, she found that individuals with English training have better occupational outcomes. She also found that these results can be applied to other developing countries, as countries integrate in the global economy. The next presentation was by Corrado Giulietti of IZA, who presented his co-authored paper entitled "Social Networks and the Labour Market Outcomes of Rural to Urban Migrants in China." He found that social networks help people to find better-paying jobs, and that the characteristics of such networks are positively correlated with wages. Klaus F. Zimmermann of DIWDC was the final presenter of Session C. His co-authored paper, "Relative Concerns of Rural-to-Urban Migrants in China: Do Migrants Switch Reference Groups?," uses a new dataset on Chinese rural-to-urban migration. The paper finds strong relative concerns among Chinese migrants. Moreover, there is a strong signal effect (positive) toward urban income. Not only are urban wages viewed as a signal of future prosperity, but also the status effect vis-à-vis other migrants and workers in rural home regions is negative due to envy and rivalry. Klaus Tilmes, Johannes Koettl, and Rita Almeida, all of the World Bank, discussed the papers of Session C.



Closing remarks were given by Professor Klaus F. Zimmermann and Dr. Amelie F. Constant, who thanked all of the participants for their contributions. They also thanked DIWDC, the World Bank, IZA, and DIW Berlin for their generous support, and pledged to continue this event in 2011. ■



DIW DC



German Day on Development
Deutsche Tagung für Entwicklung
 (DIWDC, IZA, DIW Berlin, The World Bank)

Wednesday, November 3, 2010

The World Bank
 Washington, D.C
 Room: MC9-100

Registration, Coffee and Pastries

8:30 am – 9:00 am

Welcome

9:00 am – 9:15 am

Ingrid Hoven (Executive Director for Germany, World Bank)

Klaus F. Zimmermann (University of Bonn, President DIW Berlin, Director IZA, Chairman of the Board DIWDC)

Amelie F. Constant (Executive Director DIWDC and IZA)



Session A: Measuring the Impact of Conflict: Micro and Macro Perspectives

9:15 am – 11:15 am

Chair: Quentin Wodon, World Bank

“Identifying Conflict and Violence in Micro-Level Surveys”

Tilman Brück (DIW Berlin, Humboldt University Berlin), **Patricia Justino** (IDS, University of Sussex), **Philip Verwimp** (ECARES, FU Brussels), and **Alexandra Avdeenko** (DIW Berlin)

“Beyond the Overall Downturn: Evidence on Sector-Specific Effects of Violent Conflict”

Marc Vothknecht (DIW Berlin), and **Sudarno Sumarto** (SMERU Research Institute, Jakarta)

“Measuring the Global Economic Costs of Conflict”

Tilman Brück, Carlos Bozzoli, and **Olaf J. de Groot** (DIW Berlin)

Discussants: Damien De Walque, World Bank
Sibel Kulaksiz, World Bank
Humberto Lopez, World Bank

Coffee Break

11:15 am – 11:30 am

Session B: Positional Income Concerns in Ethiopia and African Leaders

11:30 am – 12:50 pm

Chair: Sonia Plaza, World Bank

“African Leaders: Their Education Abroad and FDI Flows”

Amelie F. Constant and Bienvenue N. Tien (DIWDC)

“Do Positional Concerns Matter in Poor Societies? Evidence from a Survey Experiment in Rural Ethiopia”
Alpaslan Akay (IZA) Peter Martinsson and Haileselassie Medhinc (University of Gothenburg, Sweden)

Discussants: Abdu Muwonge, World Bank
Boniface Essama-Nssah, World Bank

Lunch

12:50 pm – 1:00 pm

Luncheon Keynote Address by
Mwangi S. Kimenyi

Director Africa Growth Initiative, Brookings Institute and Senior Fellow, Brookings Institute

“The Centrality of Micro Institutions in the Development Process”

1:00 pm – 2:00 pm

Session C: East Asia Regional Considerations

2:00 pm – 4:00 pm

Chair: David Margolis, World Bank

“English Language Premium: Evidence from a Policy Experiment in India”

Tanika Chakraborty (DIW Berlin) and Shilpi Kapur (TERI, India)

“Social Networks and the Labour Market Outcomes of Rural to Urban Migrants in China”
Corrado Giulietti, Martin Guzi, Klaus F. Zimmermann (IZA) and Zhong Zhao (Renmin University, China)

“Relative Concerns of Rural-to-Urban Migrants in China - Do Migrants Switch Reference Groups?”

Klaus F. Zimmermann, Alpaslan Akay and Olivier Bargain (IZA)

Discussants: Klaus Tilmes, World Bank
Johannes Koettl, World Bank
Rita Almeida, World Bank

6:00 pm

Wine and Cheese Reception
DIWDC

1800 K Street, NW, Office Suite 716

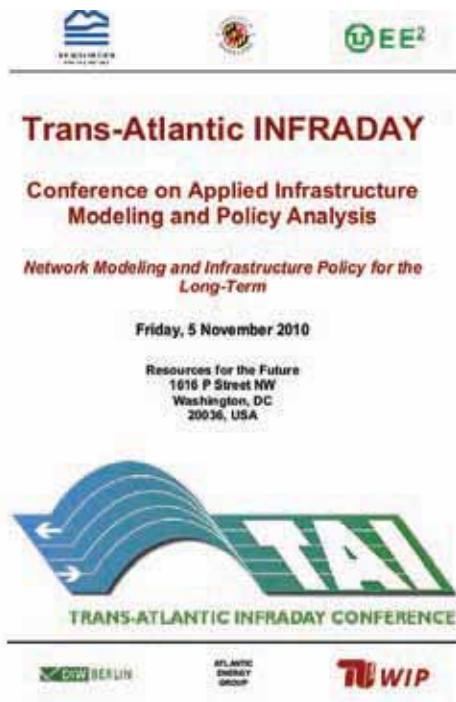
Contact: **Amelie F. Constant** (constant@diwdc.org)

“Troubled Waters” in Washington DC

“**T**roubled Waters: Piracy and Governance” was the title of the luncheon talk that Dr. Olaf de Groot from DIW Berlin gave on November 5. This was another event organized by DIWDC and hosted at the Center for Strategic & International Studies (CSIS). Dr. Sidney Weintraub, Holder of the William E. Simon Chair at CSIS and a veteran scientist and policymaker, chaired and moderated the talk. Talking to a rapt audience, Dr. de Groot presented his research from his DIW Berlin Discussion Paper No. 1063, entitled “Gov-arrgh-nance Jolly Rogers and Dodgy Rulers.” This paper is co-authored with Anja Shortland (DIW Berlin and Brunel University). Going to the roots of the word piracy, which is defined as an act of robbery on the high seas, Dr. de Groot discussed the probability of piracy and its correlation to the level of governance. By using a unique micro dataset in which piracy is reported by shipowners, the authors give exceptional insights into crime in badly-governed countries. They show that profitable forms of piracy can flourish in countries where the state does not have the capacity to intervene and/or where bureaucrats can be bribed to turn a blind eye to malfeasance. Piracy can thrive, however, even in countries with good stability and infrastructure. ■



Another Rewarding Infraday in Washington DC



DIWDC was thrilled to be involved in the 4th annual conference “Infraday,” a conference that unites economists and engineers. Infraday stands for “Applied Infrastructure Modeling and Policy Analysis.” As it has been in the past, this transatlantic conference was co-organized by DIW Berlin, Dresden University of Technology, Technical University of Berlin, Germany, and the University of Maryland. Infraday took place at the Resources for the Future, a nonprofit and nonpartisan organization, on November 5. The theme of this year’s conference was “Network Modeling and Infrastructure Policy for the Long-Run.” The objective this year was to identify similarities and differences between various networked industries such as energy, transportation, and water, as well as to draw comparisons between North American and European experiences in research in this area. Particular emphasis was placed on the engineering-economic connection, as well as its policy implications. The day-long conference included twenty-five presentations and three keynote speeches. This year, Infraday was held in tandem with the conference on “Next Generation Power System Planning Models.” This companion conference was held at the Federal Energy Regulatory Commission (FERC) in Washington, DC, on November 4. Between these two events, there were about 40 talks discussing a variety of aspects of critical infrastructure modeling and policy analysis from perspectives from both sides of the Atlantic. ■

Executive Director Gives Keynote at the Migration Scribani International Conference in Madrid

“European Migration and Asylum Policies: Coherence or Contradiction?” was the theme of this year’s Scribani International Conference, held at the Universidad Pontificia Comillas, Madrid and the University Institute for Migration Studies (<http://www.upcomillas.es/pagnew/iem/index.asp>). The University Institute for Migration Studies was founded in 1994 and joined the Scribani Network from its beginning in 2003. Its principal areas of activity are: migration research, teaching on migration at all levels of university education, giving advice and support to public and private entities involved in activities related to immigration, and providing practical formation for the assistance of ethnic groups and people in migration.

Dr. Amelie Constant, Executive Director of DIWDC, was invited to deliver a keynote at this three-day international and interdisciplinary conference on migration. The conference focused on the new challenges raised by the European asylum and immigration policy from an interdisciplinary point of view, and was structured around four major pillars: Legal Migration and Integration; Irregular Migration and Border Controls; Right to Asylum; and EU Migration, Development Policies, and the Fundamentals of the Integration of Nations and Regions.

The conference opened with welcome speeches by the University Rector, Jose Ramon Busto Saiz and the President of the Conference of European SJ Provincials, Mark Rotsaert. On September 10, 2010, in front of a large audience and on the presence of migration veterans like Professor Stark Oded, Dr. Constant presented her talk on “Sizing it up: Labor Migration Lessons of the EU Enlargement to 27.” Professor Dr. Christiane Timmerman, Director of the Centre for Migration and Intercultural Studies (CeMIS) at the University of Antwerp, introduced Dr. Constant and moderated the session.

In her keynote address, Dr. Constant reminded the audience about the integral part of migration in Europe’s past, present, and future, and described the evolution of the European Union’s (EU) labor migration after the expansion of the EU to 27 member states. She addressed pre-enlargement fears of mass migration, “welfare tourism” and displacement effects in the labor markets. With an emphasis on removing barriers to the free movement of people and commodities in the EU, Dr. Constant first showed there were considerable flows from the New Member States (NMS) to the older states (EU15). The biggest sending countries among NMS were Poland, Rumania, Bulgaria, Slovakia, and Latvia. The preferred destinations of these NMS immigrants were Great Britain, Spain, and Germany. After the EU enlargement, migrants from NMS exhibited higher employment rates and lower unemployment and inactivity rates except for Germany. The NMS immigrants were also overrepresented in low and medium-skilled sectors and occupations.

Dr. Constant continued her keynote by demonstrating that, in general, there is no negative impact on receiving countries’ (EU15) wages, unemployment or employment, or the welfare systems attributed to the enlargement. However, in case of the NMS, generally aggregate data document decreasing unemployment, increasing number of vacancies, and employment growth, as well as increasing wages in the post-enlargement period. Referring to recent calibration models, Dr. Constant showed that for the EU as a whole, substantial positive effects in terms of GDP, GDP per capita, productivity and wages, and a somewhat smaller effect for employment could be expected in the long-run. For instance, GDP (and GDP per capita) will increase by about 0.1 percent in the short-run and by 0.2 percent in the long-run.

EU-intra labor migration in light of the recent economic downturn was the last part of Dr. Constant’s keynote. Acknowledging that the economic crisis contributed to a deterioration of most aggregates variables, it is normal to expect a slow down of migrant flows from NMS. It is also expected that many migrants may return to their home countries due, among others reasons, to social pressures fuelled by economics difficulties in the host countries and shrinking social (ethnic) networks. It is noteworthy to add, however, that since the crisis hit both destination and source countries, east-west migration may continue despite the crisis, but the migrant composition might change.

Looking forward, Dr. Constant, an accomplished labor and migration expert addressed following challenges: whether many more people will decide to leave new member states for the old ones; whether the numbers will stabilize at much lower figures than they currently are; the composition of future migration flows; the timing, duration, and frequency of migrants’ stay abroad; how transitory arrangements affect the post-enlargement migration flows and their repercussions; and finally, how to ensure that free mobility in the EU is upheld in all aspects (economic prosperity, well-being, alleviation of economic and financial crisis, etc.). ■

DIWDC Part of USAID-Sponsored Training Program

DIWDC was happy to participate again in a USAID-sponsored training program about not-for-profit think tanks. The goal of the program is to teach the visiting delegations how to create and manage think tanks and robust organizations that are critical for assisting governments in economic transition. On September 16, ten delegates from Tajikistan – along with their translators – visited DIWDC to discuss with Executive Director Amelie Constant how to create, support, and manage an economic think tank. The diverse group of delegates included journalists, sociologists, economists, and others. From this visit, their goal also was to obtain information about the importance of a think tank and its function. As the founding director of DIWDC, Dr. Constant shared with the delegation various strategies about staffing a think tank and how such decisions can affect the outcomes of each think tank's performance. Dr. Constant additionally discussed topics such as member credentials and ways to maintain in-house experts while outsourcing other aspects of the think tank to consultants.



Dr. Constant emphasized the crucial role that think tanks occupy in a country due to the valuable information they communicate to the media as well as to policymakers. DIWDC is an independent, non partisan, and non-profit organization. As such, Dr. Constant said, the Institute has a duty to the serve the public, to increase the public good, and to offer unbiased and impartial research results. Maintaining a connection between the government, the media, as well as other institutions and universities are ways in which Dr. Constant suggested the delegation go about creating a credible standing for newly-formed think tanks. The Tajiki delegation asked a plethora of questions about the economy, the recession in the U.S., and about transatlantic cooperation. Dr. Constant gave to the delegates brochures and other informational material about DIWDC for them to study. The delegates reciprocated by offering Dr. Constant traditional socks that they had brought with them from Tajikistan. The delegates walked away with some valuable information to take back with them to Tajikistan as they attempt to start their own think tanks. ■



DIWDC'S Economics Seminar Series!

DIWDC is proud to continue its *Economics Seminar Series* in the last quarter of this year. As an economic think tank dedicated to teaching and research, DIWDC holds several seminars a year in which advanced graduate students along with established economists and other scientists and specialists are given the opportunity to present their original research to a select audience. Intermittent seminars cover a wide range of topics in economics and public policy and last for an hour and a half, allowing ample time for Q&A. Active participation is required and a dialectical method of debating encouraged. DIWDC is dedicated to providing a beneficial learning environment that fosters the engagement of young as well as more experienced individuals in the field of economics and which can stimulate thinking and generate new ideas.

In September, visiting fellow Mr. Steffen Otterbach (University of Hohenheim, Germany) presented his current work on *Over-employment and Health: A Panel Analysis of Germany and the UK*. Economists from the Institute, DIW Berlin, as well as from the World Bank and Georgetown University attended Mr. Otterbach's presentation. Long-time visiting scholar, Dr. Jens Schmidt-Ehmcke (DIW Berlin), presented his latest work on innovation entitled the *Innovation Index of DIW Berlin and its Policy Relevance*. Mr. Bienvenue N. Tien (DIWDC) was the seminar presenter in October. In front of a select crowd of economists from the Institute, from Georgetown University and the World Bank, he presented his co-authored work with Amelie Constant entitled *African Leaders: Their Education Abroad and FDI Flows*. Mr. Bienvenue Tien, a research assistant at DIWDC, received many useful comments. ■



To learn more about DIWDC's *Economics Seminar Schedule*, please visit our website at www.diwdc.org and click on "DIWDC News" to find out more!

DIWDC Contributes to *Migration, Employment and Labour Market Integration Policies in the European Union (2000-2009): An IOM Two-Volume Study*



In the course of this year, DIWDC's staff served as a national expert for Germany at the Independent Network of Labour Migration and Integration. A. F. Constant, B. N. Tien, and A. Xidou carried out the study on the employment impacts of migration and policy outcomes in Germany that is part of IOM's two-volume study *Migration, Employment and Labour Market Integration Policies in the European Union (2000-2009)*. The 650-page study investigates evidence of the labor market



impact of migration and explores the role of relevant migrant admission and employment policies in the European Union of 25, as well as in Croatia, Norway, and Turkey. The pre-publication is on-line at: <http://www.labourmigration.eu/research/report/13-migration-employment-and-the-outcomes-of-labour-market-integration-policies-in-the-european-union>. ■

Kudos to Professor Francine D. Blau



Francine D. Blau, Frances Perkins Professor of Industrial and Labor Relations and Labor Economics at Cornell University, receives the prestigious 2010 IZA Prize in Labor Economics for her seminal contributions to the economic analysis of labor market inequality. A Harvard graduate, Professor Blau has devoted her career to research on the role of women in the labor market and on gender differences in many aspects of economic life. The IZA award committee recognized that Professor Blau's "work has profoundly shaped the view of scholars and policymakers on the causes and consequences of gender differences in economic outcomes, and on policies for advancing women's labor market position and well-being." The award ceremony will take place at the ASSA annual meetings in Denver on January 8, 2010.

Professor Blau has served as vice president of the American Economic Association, and as chair of its Committee on the Status of Women in the Economics Profession. She was also president of the Society of Labor Economists and of the Labor and Employment Relations Association. ■

Internship Program at DIWDC

DIWDC is accepting applications for internships in the fields of economics, public relations, and administration. Interns at the graduate and undergraduate level are considered for internship opportunities. Interns at DIWDC experience first-hand the execution of real economics research along with the economic and political networking of Washington. Interns provide extensive assistance in planning and organizing various conferences and events and supporting our public relations and administration. Under the guidance of Dr. Amelie Constant interns engage in substantial economic research and contribute to DIWDC's scientific and policy outlets. Interns also attend conferences and talks by other think tanks in DC and represent the institute at various functions. *If you are interested in interning at DIWDC, please contact us at: info@diwdc.org or call 202.429.2904.* ■

Recent Visiting Fellow at DIWDC

Steffen Otterbach was a visiting fellow at DIWDC in September. Mr. Otterbach is a research assistant at the Department of Household and Consumer Economics at the University of Hohenheim in Stuttgart, Germany, where he is finishing his PhD. With a specialization in empirical economics, his research interests are in the fields of labor and health economics. His research focuses on time allocation, especially on working time and the mismatches between actual and desired working hours. During his fellowship at DIWDC he worked on the impacts of working hours constraints on happiness and health. He presented his research on "Over-employment and Health: A Panel Analysis of Germany and the UK," at the DIWDC's Economics Seminar. ■



DIWDC Fellowship Foundation Program

DIWDC is proud to serve as a platform for fellows and specialists who are seeking a base of operation during their stay in Washington, DC. DIWDC is located in the heart of Washington DC's golden triangle, at 1800 K Street NW, which provides convenient access to various prestigious universities, international organizations such as the World Bank and the IMF, as well as other economic and political think tanks. *For more information about DIWDC's fellowship foundation program contact us at info@diwdc.org or call 202.429.2904.* ■

The End of 2010: Our Scientific Output

As a non-profit organization, DIWDC exists for educational and philanthropic reasons, and provides programs and services that are of public benefit. Producing scientific output is DIWDC's forte. During this last quarter, DIWDC's staff has been exceptionally prolific. The team has recently published numerous papers and policy briefs of high relevance in current debates; whether it is about China's rise, African leaders and foreign direct investments in the continent, risk-taking behavior among unemployed natives and second-generation migrants, or about remittances and the political divide in Ukraine. Below we take stock of DIWDC's most recent publication record.

Discussion Papers

- "African Leaders: Their Education Abroad and FDI Flows," (December 2010). A. F. Constant and B. N. Tien, *IZA DP 5353 [also DIW Berlin DP 1087]*
- "Economic Preferences and Attitudes of the Unemployed: Are Natives and Second Generation Migrants Alike?" (December 2010). A. F. Constant, A. Krause, U. Rinne and K. F. Zimmermann, *IZA DP 5380 [also DIW Berlin DP 1088]*
- "Reservation Wages of First and Second Generation Migrants," (December 2010). A. F. Constant, A. Krause, U. Rinne and K. F. Zimmermann, *IZA DP 5396 [also DIW Berlin DP 1089]*
- "An Expert Stakeholder's View on European Integration Challenges," (December 2010). A. F. Constant, M. Kahanec and K. F. Zimmermann, *IZA DP 5398*

Policy Briefs and Reports

- "China's Overt Economic Rise and Latent Human Capital Investment: Achieving Milestones and Competing for the Top," (September 2010). A. F. Constant, B. N. Tien, K. F. Zimmermann and J. Meng, *IZA Policy Paper No. 19 [also DIW Berlin DP 1062]*
- "Handelswettbewerb um Asien: Die Freihandelsabkommen der USA und der EU mit Südkorea," (June 2010). A. F. Constant, B. N. Tien, and K.F. Zimmermann, *DIW-Wochenbericht, Nr. 25/2010, 2-9*
- "The Impact of Migration on Employment and the Outcomes of Labor Market Integration Policies in Germany," (December 2010). A.F. Constant, B.N. Tien and A. Xidou, chapter in the International Organization for Migration's (IOM) two-volume study on *Migration, Employment and Labour Market Integration Policies in the European Union (2000-2009)*
- "A Race for Free Trade Agreements: The US and EU Battling over South Korea," (June 2010). A. F. Constant, B. N. Tien and K.F. Zimmermann, *DIWDC Policy Brief*

Peer Reviewed Papers and Book Chapters (Published or Forthcoming)

- "Economic Preferences and Attitudes of the Unemployed: Are Natives and Second Generation Migrants Alike?" (Accepted December 2010). A. F. Constant, A. Krause, U. Rinne and K. F. Zimmermann. *International Journal of Manpower*, forthcoming in 2011
- Circular and Repeat Migration: Counts of Exits and Years Away From the Host Country," (Accepted December 2010). A. F. Constant and K. F. Zimmermann. *Population Research and Policy Review*, forthcoming in 2011
- "Cultural Integration in Germany," (Accepted 2009). A. F. Constant, O. Nottmeyer and K. F. Zimmermann, in: *Cultural Integration in Europe*. A. Bisin, A. Manning and T. Verdier (eds.). Oxford: OUP, forthcoming in 2011
- "Ethnicity, Job Search and Labor Market Reintegration of the Unemployed," (Accepted December 2010). A. F. Constant, M. Kahanec, U. Rinne, and K.F. Zimmermann. *International Journal of Manpower*, forthcoming in 2011
- The Russian-Ukrainian Political Divide," (Accepted October 2010). A. F. Constant, M. Kahanec and K. F. Zimmermann. *Eastern European Economics*, forthcoming in 2011
- "Migration, Ethnicity and Economic Integration," (Accepted February 2010). A. F. Constant and K. F. Zimmermann, in: *International Handbook of Economic Integration*. M. N. Jovanovic (ed.). Cheltenham: Edward Elgar Publishing, January 2011
- "An Expert Stakeholder's View on European Integration Challenges," (Accepted June 2010). A. F. Constant, M. Kahanec and K. F. Zimmermann, in: *Ethnic Diversity in European Labor Markets*. K. F. Zimmermann and M. Kahanec (Eds.). Cheltenham: Edward Elgar Publishing, forthcoming in 2011 ■

Changing Lives: The European Commission Designates 2011 as the “European Year of Volunteering”



The European Year of Volunteering 2011

As a whole, the EU falls behind the United States in terms of volunteerism, perhaps because time spent on unpaid activities is not highly valued by European employers.² According to European Commission estimates, only 23% of Europeans over the age of 15 are volunteers (approximately 92 to 94 million people).³ However, there is a huge divergence of volunteering engagement across European countries. On one hand it is highly valued in Austria, the Netherlands, and Great Britain, where 40% of the population participates in volunteer activities. In Greece and Bulgaria, on the other hand, volunteering is a rare practice. Moreover, in some countries such as Italy, there can be a negative association with activities that are perceived merely as charity.⁴

Interestingly, there is no clear and universal definition of volunteering in Europe.⁵ Out of the EU-27 member states, only 11 have a legal definition of “volunteering,” according to the Study on Volunteering European (February 2010). In more than half of the EU member countries the main volunteer activities are in order of popularity: sporting or outdoor leisure activities; health, charitable, or religious organizations; culture or education; trade unionism; and research.



As in previous years, the Commission has ambitious objectives to encourage Europeans to give their time to make the world a better place. The Year of Volunteering 2011 seeks to:

- work towards an enabling and facilitating environment for volunteering in the EU
- empower volunteer organizations and improve the quality of volunteering
- reward and recognize volunteering activities
- raise awareness of the value and importance of volunteering

To this end, the Commission has allocated a budget of 6 million Euros for the European Year of Volunteering 2011, with an additional 2 million Euros allocated for preparatory actions that started in 2010. The year will be organized around national conferences and a promotional tour by volunteers and journalists to all EU capitals, starting in Brussels on December 3, 2010. ■

¹ http://ec.europa.eu/citizenship/news/news820_en.html.

² <http://www.europolitics.info/sectorial-policies/2011-to-be-european-year-of-volunteering-art288854-16.html>.

³ <http://www.europolitics.info/sectorial-policies/2011-to-be-european-year-of-volunteering-art288854-16.html>.

⁴ <http://www.europolitics.info/sectorial-policies/2011-to-be-european-year-of-volunteering-art288854-16.html>.

⁵ The European Volunteer Centre defines volunteering as an activity that “can occur in different settings either informally, like helping out in the neighbourhood, or formally within the structures of non-profit organisations. Its nature can vary from parttime (most of the times) to full-time and from one day to many years of practice in several different fields.” (C.f. Volunteering in the European Union, February 2010, p. 50).

Event Participation September – December 2010

- “The Concept of Inclusive Growth and its Policy Relevance for Asia and the Pacific,” IFPRI Policy Seminar, International Food and Policy Research Institute, Washington, DC, *September 28, 2010*
- “The Employment-Based Immigration Reform Solution,” American Enterprise Institute, Washington, DC, *September 29, 2010*
- “The Wind Doesn’t Need a Passport: Stories from the US-Mexico Borderlands,” Migration Policy Institute, Washington, DC, *September 29, 2010*
- “Climate Change and Migration,” Institute for the Study of International Migration at Georgetown University, Washington, DC, *September 30, 2010*
- “German Unification Twenty Years On: A Conversation with Robert Zoellick, President of the World Bank,” The German Marshall Fund of the United States (GMF), Washington, DC, *October 1, 2010*
- “Tag der Deutsche Einheit: 20 Years,” The German Embassy in the United States, Washington, DC, *October 1, 2010*
- “The Central African Republic: Diplomatic and Security Challenges in the Heart of Africa,” Center for Strategic & International Studies, *October 4, 2010*
- “Why Africa is Poor and What Africans Can Do about It?” Cato Book Forum at Cato Institute, Washington, DC, *October 6, 2010*
- “Lessons Learned from the Armenian Diaspora and its Role in Economic Development of the Homeland as a Source of Foreign Direct Investments” ECSPE Migration Club (MIRPAL) at the World Bank, Washington, DC, *October 7, 2010*
- “G2 at GW,” The 3rd Annual Conference on China’s Economic Development and U.S.-China Economic Relations at George Washington University, Washington, DC, *October 8, 2010*
- “Non-Borders,” Migration Policy Institute, Washington, DC, *October 14, 2010*
- “Challenges and Opportunities in the Emerging Arctic: A Norwegian Perspective,” Atlantic Council, Washington, DC, *October 28, 2010*
- “Friends and Colleagues Remember and Celebrate Katherine Terrell Svejnar,” the World Bank, Washington, DC, *November 1, 2010*
- “The Negative Employment Effects of the Paycheck Fairness Act,” Hudson Institute, Washington, DC, *November 10, 2010*
- Society of Government Economists Annual Conference, Washington, DC, *November 15-16, 2010*
- AIRLAP Meeting, the World Bank, Washington, DC, *November 15, 2010*
- “Transatlantic Cooperation in Innovation and Job Creation,” The Congressional Study Group on Germany, German Marshall Fund and TransAtlantic Dialogue, Washington, DC, *November 15, 2010*
- “Entrepreneurship in Challenging Times: Implementing Expeditionary Economics,” Center for Strategic & International Studies, Washington, DC, *November 19, 2010*
- “The G20 at GW: A Postmortem Policy Forum,” Elliott School of International Affairs, Washington, DC, *November 19, 2010*
- “The Role of Africa’s Regional Organizations in Conflict Prevention and Resolution,” The Brookings Institution, Washington, DC, *November 23, 2010*
- “Diaspora: New Partners in Global Development Policy,” Migration Policy Institute, Washington, DC, *November 30, 2010*
- “A Conversation with His Excellency Bronisław Komorowski, President of the Republic of Poland,” at the Willard by the German Marshall Fund of the United States, Washington, DC, *December 8, 2010*
- “Open Knowledge,” A World Bank Conference, Washington DC, *December 9-10, 2010*



- “Preparing for Sudan’s Referendum,” Center for Strategic & International Studies, Washington, DC, *December 10, 2010*
- “US-Polish-German Seminar: A Trilateral Perspective on Russia,” Center for Strategic & International Studies, Washington, DC, *December 14, 2010*
- “Cooperative Mexican – US Antinarcotics Efforts,” Center for Strategic & International Studies, Washington, DC, *December 15, 2010*
- “The US-Japan Alliance and Evolving Challenges in East Asia: Freedom of Navigation and North Korea,” The Brookings Institution, Washington, DC, *December 15, 2010*
- “Not Just Aid: How Making Government Work Can Transform Africa,” by the Honorable Tony Blair, Former Prime Minister of Great Britain. At the Fairfax, by the Center for Global Development, *December 16, 2010*
- “Emerging from the Global Crisis: Growth in African Low-Income Countries,” The Brookings Institution, Washington, DC, *December 17, 2010.* ■



DIWDC Present at University Career Fairs



Every year, DIWDC participates in various career fairs in the DC metropolitan area, and especially in career fairs held by the universities. DIWDC is committed to finding and fostering new talent and providing opportunities for internship and employment to each year’s higher education graduating class. Eager to recruit new talent and strengthen its relationship to area universities, DIWDC participated in highly advertised career and information for graduate students at the American University (AU). The *AU Fall 2010 Job & Internship Fair* attracted more 500 undergraduates, graduate students, and alumni from

American University’s five schools: the Colleges of Arts & Sciences, the Kogod School of Business, the School of Communication, the School of International Service, and the School of Public Affairs. The DIWDC booth was a popular destination, especially for undergraduates in social sciences. DIWDC combines high-caliber research in economics with a policy bent and welcomes any cross-fertilization from other social sciences. Its small size is the value added that many interns and students assistants are looking for, as it can offer more fulfilling experiences. ■

Is An Economic Sunset On the Horizon for the Land of the Rising Sun?

By *Bienvenue N. Tien*



Sony Walkmans. Hello Kitty. Pac-Man. Compact Discs. Pokémon. Nintendo Entertainment Systems. Nikon cameras. Instant ramen noodles. Mikimoto cultured pearls. Game Boys.

These are but a few examples of how Japan's creativity, innovation, and technological acumen used to dominate global culture. Indeed, many people spent the 1980s and 1990s engrossed in Japanese video games such as Super Mario Brothers, Sonic the Hedgehog, and Street Fighter. Contrast these nostalgic pop culture icons with Japan's more recent innovations, such as a mobile Internet service known as "i-mode" and a mobile digital TV standard known as "1Seg." Unlike the heady days of the 1980s, these products are virtually unheard of outside of Japan. And while the Sony VAIO computers are in good standing, at least in the U.S., the Sony flat screen TVs have flopped. While Japan is still the third largest economy behind the U.S. and China, the question is: will this once-mighty country lose its status as one of the world's powerful economies?

In exploring this question, we first review some major events that shaped Japan's destiny. We then analyze Japan's economic foundation over the course of the last three decades. Namely, we look at Japan's Gross Domestic Product (GDP) growth and its main components. Next, we examine Japan's current economic problems, and finally we discuss Japan's economic challenges ahead.

The Wonder Years of the 1980s and the Plaza Accord

Japan's monetary appreciation against the U.S Dollar in the 1970s, its low unemployment rate (2%), and its emphasis on the third sector and its unique structure in international trade, all contributed to Japan's economic power. In the 1980s, Japan was still enjoying over thirty years of post-World War Two prosperity. Indeed, a country that has been traditionally isolated and has been dependent on imports for its survival (88% on energy and 99% on petroleum) became a major exporter of manufactured goods and electronics. Moreover, Japan became a global automobile menace. Japan, it appeared, could easily adapt to economic situations such as global economic recessions and it could play a major role in the international market. While its Ministry of International Trade and Industry (MITI) played a preponderant role, it was the "*Sogo-Shoshas*"¹ that were the key to Japan's commerce. The dual function of the Sogo-Shoshas was to be the intermediary in transactions such as Japan's imports and exports, and to create a supplementary demand for the goods. These oligopolistic conglomerates had "ship-factories," could distribute goods and owned banks. The main trading partner of Japan was the U.S. who bought about 26% of Japanese exports in 1979. South-East Asia was the second most important trading partner of Japan. In parallel with its aggressive export policy, Japan was practicing a rather closed border import policy, making it extremely difficult for foreign companies to penetrate its domestic markets.

The "technological policy" of Japan, based on innovation, was perceived as the means to ameliorate product quality, lower prices, and introduce new products. Technology was also the vehicle that would lead Japan to independence from its allies. Japan started by copying the west and perfecting it. In so doing, Japan avoided all costs, dangers and hazards associated with R&D. Achieving a technological edge was then quite easy for Japan, given its highly educated population. Moreover, Japan was one of the pioneering countries in industrial robot manufacturing and in introducing automation in the labor market as a substitute for repetitive labor tasks. Machines helped Japan's labor shortages in the 1980s, as Japan refused to resort to immigration. Integrated circuits, the heart of electronic devices, received colossal support from the Japanese government. In 1980, Japan was producing two and a half times more integrated circuits than the U.S.

Japan's socio-cultural and religious homogeneity are also factors in creating Japan's economic miracle. The Japanese have managed through centuries to safeguard their ethnic and linguistic identity. Shintoism has shaped the Japanese mentality and social order. The

¹ This is the Japanese name used to describe the grand trading companies. The biggest nine had an annual budget of 8.8 trillion Yen and managed 50% of Japan's trade. They were: Mitsubishi, Mitsui, C.Itoh, Marubeni, Sumitomo, Nissho Iwai, Toyo Menka, Kakematsu, and Nichimen. These companies were industrial organizations of vertical integration (regarding goods) and horizontal integration (regarding their functioning).

spirit of the “*Samurai*” unity and consensus are important virtues. The Japanese mindset about employment is also unique. In Japan, a company or an enterprise is not the sum of the boss plus the workers, that is, $1 + 1 = 2$. Rather it is the multiplication of the boss times the workers, that is, $1 \times 1 = 1$. Faith in the company and in the boss as well as working “together” is the Japanese motto, and this is completely different from Western attitudes. In addition, the Japanese work force, while more educated than the labor force in the West, is paid much less compared to its productivity. Yet the Japanese accept this, because the company is like their family and they believe that the company guarantees them employment for life.

A traditional characteristic of Japan is the identification of the individual with the group as well as the individual’s absorption by the group. This spirit of unity, or at least of no competition, has been an important moral factor in Japan’s economic rise. Japan’s social cohesion and “*Ringi*”² principle have also contributed to the country’s ascent into global stardom. Yet it is these same principles that render the decision process extremely slow, thus decreasing the absorption of new technologies and their integration. Suicide rates are actually higher in Japan than in other countries, because culturally, it is perfectly natural for an individual to sacrifice for the group. Accordingly, any “transgressions” in politics or business are exonerated with *hara-kiri*, but because transgressions are not discussed, no one learns from their mistakes.

It was also in the 1980s that the seeds of modern Japan’s economic struggles were sown. By the end of the decade, a lethal elixir of easy credit, rapid trade growth, and unbridled speculation eventually drove the Japanese equity and real estate markets to astronomical price levels. During the so-called “bubble years,” buyers were confronted with obscene prices for goods, commodities, and grossly overvalued property. The *kairotic* moment? The signing of the Plaza Accord on September 22, 1985.

Against the backdrop of an exceptionally strong U.S. dollar, the rapid growth of Japan had begun to impinge upon the export competitiveness of the U.S. By the mid-eighties, the U.S. began accumulating alarming trade deficits. A concerned David Mulford, then-Undersecretary for International Affairs at the U.S. Treasury, called for a secretive meeting with the finance ministers and central bank governors of the then G-5 nations (the United States, Japan, France, West Germany, and the United Kingdom) at the Plaza Hotel in New York City.³ At the meeting, the parties agreed to deliberately intervene in the foreign exchange markets to lower the value of the U.S. dollar by making an unexpected selling of a large quantity of dollars en masse. Their goal was to strengthen the Japanese yen and thus render American exports cheaper. Once signed, the effects of the Plaza Accord were swift and drastic. The Plaza Accord was a surprise to the global financial market, and the dollar promptly declined. In the next two years, the yen’s value doubled from a low of ¥240 per dollar to ¥125 per dollar.⁴ The exchange rate with the German mark, the French franc, and the British pound all followed this same pattern with the dollar.⁵ To counter the effects of a surging yen on its export-led economy, Japan flooded its economy with liquidity and encouraged more capital investment. The notorious “bubble years” of 1986 to 1991 thus ensued, followed by a severe recession in the 1990s.

The 1990s in Japan: Drowning, Not Waving

The “lost decade” began in 1990 with the twin popping of Japan’s real estate and stock market bubbles. The ensuing deterioration in Japan’s economy and its subsequent high unemployment rate led the Japanese government to postpone many earlier economic reform plans. This created an Ouroboros of declining Japanese consumer confidence and delicate trade tensions. The Japanese economy, however, did become more open to foreigners. As a result, Japan’s merchandise trade surplus with the world continued to spiral up. By the mid-1990s, those export surpluses finally produced a rapid appreciation of the yen against the dollar. Contrary to American expectations, this had only marginal effects on the trade balance. At the same time, the stronger Japanese currency allowed Japanese firms and individuals to invest heavily abroad by buying foreign assets, most notably real estate, at bargain prices. Among the famous trophy U.S. properties that Japan acquired was the Rockefeller Center in New York City, purchased in 1989 by Japan’s Mitsubishi Estate Company for US\$2 billion.

² This is a “bottom-up” approach, whereby each project and each decision is examined by the all personnel at every level, even the lowest. The emphasis is not about the quality of the decision; rather it is about the efficacy of its execution.

³ Joffe-Walt, C. (December 17, 2010). “The Secret Plan to Fix the Dollar.” <http://www.npr.org/blogs/money/2010/12/17/132142673/plaza-accord#commentBlock>.

⁴ Posen, Adam S. (October 26, 2010). “Monetary Ease and Global Rebalancing: Debunking the Japanese Scare Story.” Speech to the Economic & Financial Institutions Research Group, Queen’s University, Belfast.

⁵ Id.

As the Japanese integrated more with the rest of the world, Japan's moral, cultural, and social norms were called into question. Statistics at the time often showed that young Japanese people highly valued "living according to my tastes" rather than "being in the service of society" (Constantopoulou, 1983). Japan's deeply rooted pressure to excel and to represent the group honorably contributed to a high suicide rate.

Another important global change that affected all nations was the mass use of the Internet in the 1990s. By the mid-1990s, Yahoo was a big Internet search engine, e-mail was international, and e-commerce was popular in daily life. The information age pulverized all countries and made competition tougher. In this era, countries need to be technologically advanced at any price. Otherwise, they will find themselves mired in obsolescence.

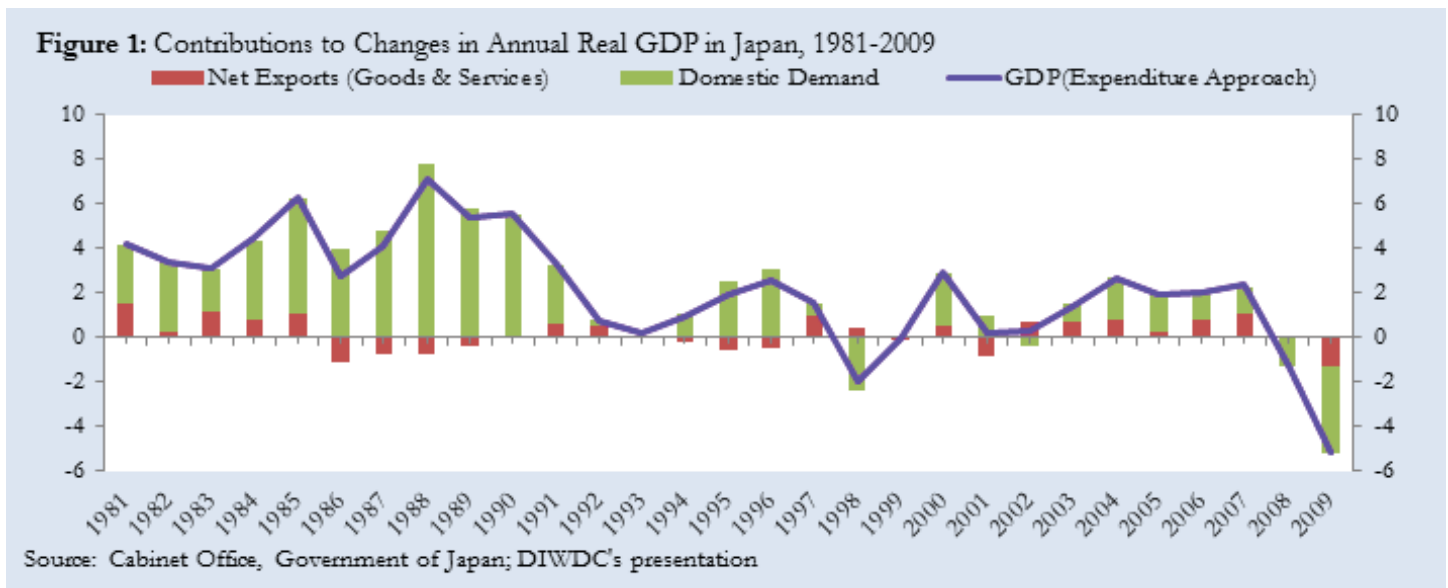
Japan is known for stifling individual creativity for the good of the group. As times and junctures change, can Japan change too? Could it be that the same qualities that made Japan shine up to the mid-1980s eventually turned against it and caused Japan's lackluster performance in the late 2000s?

The Economics of Japan

a. Japan's GDP Growth

Looking at the economic development of Japan over the last three decades, we see that the country's prosperous economy has been shrinking. Figure 1 depicts the evolution of the main two contributors to GDP growth in Japan, namely domestic demand and net exports. Clearly, Japan's economic growth has been mostly driven by its domestic demand.

Figure 1 also shows different economic development patterns. The first pattern is during the period from 1980 to the early 1990s, during which Japan was a strong economic power in terms of GDP growth. For instance, in 1981 the GDP growth was 4% and reached 7% in 1988. In addition, net exports were positive in the first half of the 1980s and negative in the second half. The second pattern refers to the period of economic stagnation. This occurred during the "lost decade" of the early 1990s to the early 2000s. Abe (2010) cites two main reasons for the Lost Decade. First, Japan's economic downturn was accompanied by a financial crisis, and second, the business sector was plagued by three excesses: excess equipment, excess employment, and excess debt. A negative domestic demand is even recorded in 1998.



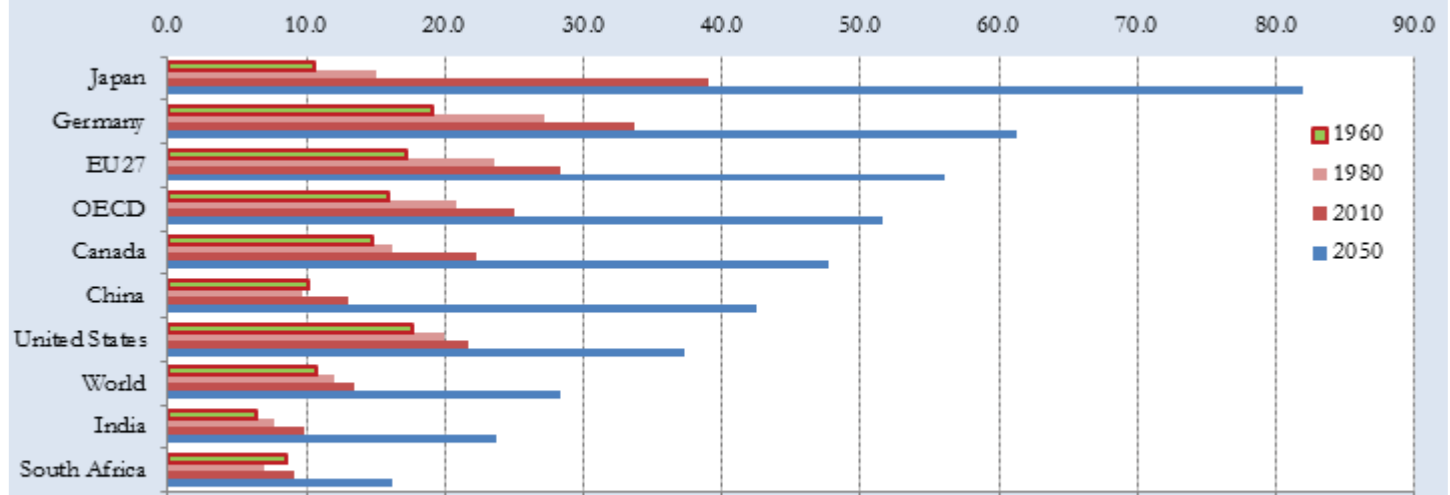
The last period is from the early 2000s up to the recent economic crisis of 2008. During this time, Japan showed some signs of a slow recovery from the Lost Decade. The global crisis of 2008, however, hit Japan brutally. OECD's⁶ recent economic outlook shows that Japan is finally responding to its slowing growth. In late 2010, Japan introduced fiscal packages with projected annual growth to reach 1^{3/4}%.

⁶ OECD (2010) "Japan – Economic Outlook 88 Country Summary." http://www.oecd.org/document/11/0,3343,en_33873108_33873539_45268539_1_1_1,00.html.

b. A Shrinking Economic Superpower

Most experts⁷ agree that the Japanese economy is fundamentally hampered by the following factors: deflation, exorbitant public debt, huge demographic problems (aging population), and political lethargy among policymakers. As in most industrialized economies, Japan's increased longevity will ensure that the old-age dependency ratio will rise sharply over the next forty years.⁸ The evolution of age-dependency ratio is a function of mortality, fertility rates, and of net migration. It is defined as the ratio of persons older than 65 relative to those aged 20 to 64. Figure 2 displays the old-age dependency ratios for selected countries and regions across time. Japan is on the top with the ratio of 39% in 2010, already the world's highest ratio. OECD predicts that this ratio will more than double by 2050, reaching 82%. Today, the old-age dependency ratio in the OECD area is 25% and is projected to be 52% by 2050.

Figure 2: Old-Age Dependency Ratios for Selected Countries and Regions, Historical and Projected Values



Source: OECD, Pensions at Glance, 2009; DIWDC's presentation

Note: * The OECD defines the old-age-dependency ratio as the ratio for persons aged 65 and more relative to the number of individuals aged 20 to 64

It is of no surprise that Japan has the highest old-age dependency ratio. Its people are well educated and healthy; child mortality rates, old age mortality rates, and fertility rates are all very low. In addition, there is practically no migration to Japan. Thirty years ago there were about half a million Korean workers in Japan. They were never integrated into Japanese society and were always *gaijin*, meaning foreigners. Over the years, several nationalities tried to migrate to Japan in vain. Japan's tiered and homogeneous society, in which family plays a critical role, is not opened to outsiders. The exception to receiving immigrants were the Peruvian Japanese migrants—the Nipo-peruano—whom Japan accepted mostly because of phenotypical resemblances.⁹ An influx of Japanese Brazilians in the 2000s¹⁰ is also recorded. No matter how threatened the Japanese feel from foreigners, the bottom line is that registered foreigners in 2004 were only 1.6% of its total population. How long can an aging Japan survive alone, without any foreign replacement? Can Japan substitute robots for its shrinking labor force again?

The second problem with Japan's economy is deflation. Figure 3 illustrates Japan's inflation rates from 1986 to the present and juxtaposes it to Japan's output gap in percent of potential GDP. Noticeably, Japan's economy continues to operate far below its capacity. In 2009, the output gap was about 7%; fairly three times bigger than it was in the 1990s and the asset price-bubble. However, according to IMF's estimates and forecasts, Japan will be producing at its full capacity by 2015.

⁷ The Economist (2010). "Japan's Debt-Ridden Economy: Crisis in Slow Motion." <http://www.economist.com/node/15867844>.

⁸ The Economist (2009). "Old-Age Dependency Ratios." <http://www.economist.com/node/13611235>.

⁹ These Japanese descendants went to Peru in the 1800s. In the 1980s due to the economic instability in Peru, many of them went to Japan.

¹⁰ The Brazilian population in Japan more than tripled from 1990 to 1995, going from 56,000 to over 176,000; in 2004 it was over 286,000 (MPI, <http://www.migrationinformation.org/Feature/display.cfm?id=487>).

Figure 3 also shows that the output gap in percent of potential GDP correlates well with deflation. The huge output gap puts a downward pressure on consumer's prices. Falling prices, in turn, imply that nominal GDP is likely to remain in the "deep freeze." Such a situation will ultimately add pressure to public deficit or, in other terms, the gross debt-to-GDP ratio will continue to rise. Some experts argue that the combination of deflation-sapped growth and high debt makes Japan next in line for a Greek-style debt crisis.¹¹

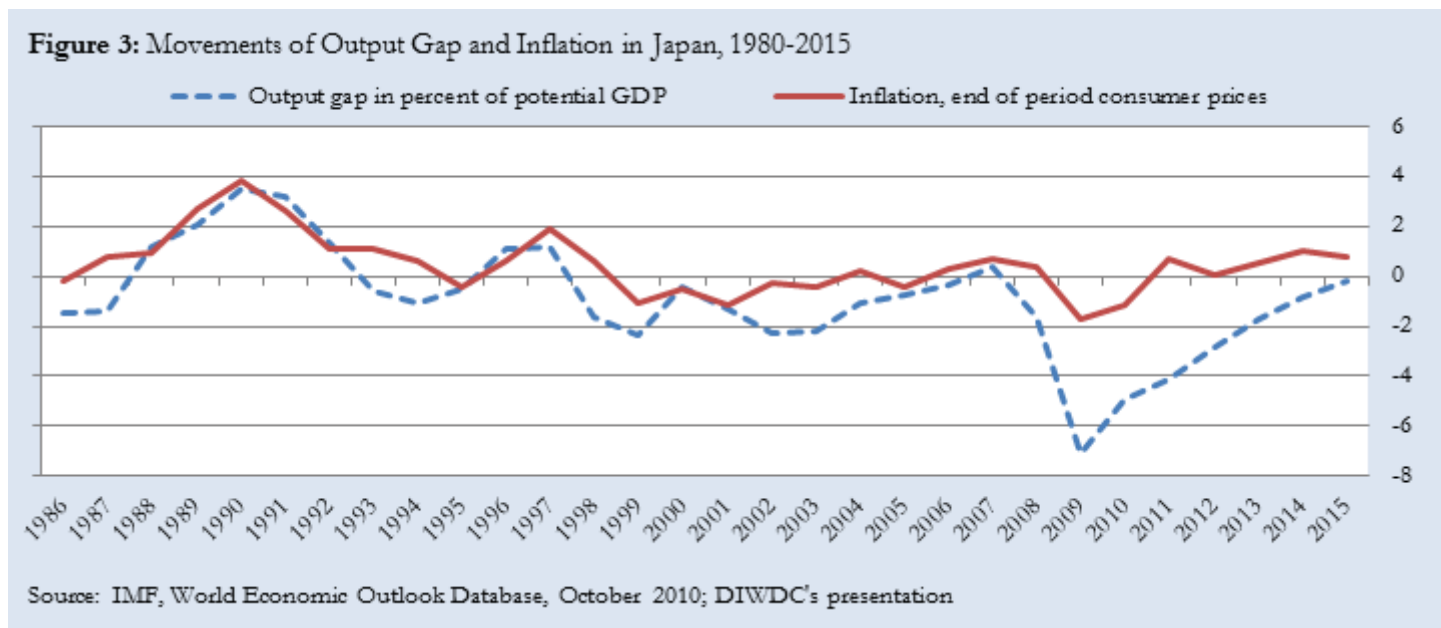


Table 1 shows Japan's debt in contrast to other selected developed countries. There is no doubt that today and in the foreseeable future, Japan has the highest government net debt as a percent of GDP among the G7. Compared to the 1980s and 1990s, when Japan had the lowest net debt as a share of GDP, the current debt is huge. It has drastically risen from 17% in 1980 to 82% in 2007, before the financial crisis of 2008. By 2015 Japan's national debt is estimated to be 153% of the national product.

Table 1: General Government Net Debt as Percentage of GDP in G7-Countries

Country	1980	1990	2000	2007	2010	2013	2015
Canada	-	43.7	46.2	23.1	32.2	34.0	32.2
France	-	25.4	47.7	54.1	74.5	80.3	78.7
Germany	-	-	40.8	50.1	58.7	61.9	61.7
Italy	-	89.5	93.7	87.2	99.0	100.1	99.5
Japan	17.1	13.4	60.4	81.5	120.7	142.2	153.4
The U.K.	40.5	26.7	33.6	38.2	68.8	78.2	76.0
U.S.	25.6	45.8	35.5	42.4	65.8	78.8	84.7

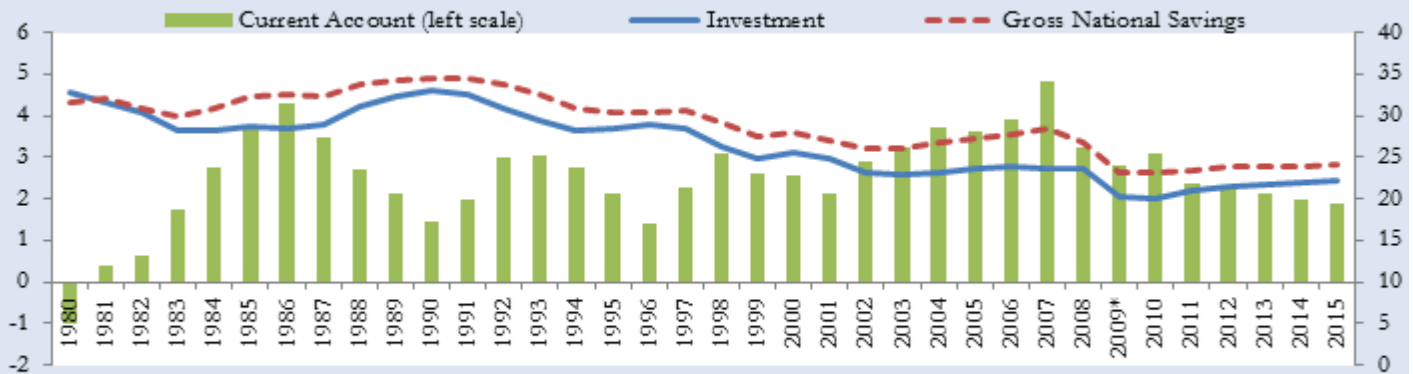
Source: IMF World Economic Outlook Database, October 2010; DIWDC's presentation

Note: Shaded cells indicate IMF estimates

c. Poisonous Savings and Current Account Surpluses

Among the industrialized countries, Japan is well known as a nation of high national savings. Investments and savings go hand in hand. Figure 4 depicts the correlation between national savings and investments. In the 1980s, Japan's savings were very high. They

¹¹ The Economist (2010) "Japan's Debt-Ridden Economy: Crisis in Slow Motion."

Figure 4: Movement of Investment, Gross National Savings, and Current Accounts as Percentage of GDP: 1980-2015

Source: IMF World Economic Outlook Database, October 2010; DIWDC's presentation

Note: * Estimates start after 2009

started following a decreasing path in the 1990s until 2002. This decline was mainly due to a large drop in public savings (IMF, 2005). In addition, as portrayed in Figure 4, Japan has maintained huge current account surpluses over time. Nonetheless, the high saving rates and current account surpluses have necessarily led to a sustained growth in Japan. Assuming that savings are foregone consumption, Madsen (2009) argues that the chronic increase of the national savings rate was problematic. Foregone consumption implies a weaker domestic demand and, inevitably, lower GDP growth. This problem did not become immediately obvious, however, because of a combination of measures such as a loose monetary policy, innovations in financial technology (*zaitech*), and bad regulation. Madsen maintains that this led to the inflation of an asset bubble and a boom in corporate investment. Big trade surpluses, running simultaneously, sustained demand and rapid GDP growth. One important clarification worth noting is the discrepancy between planned and realized investment.

As for Japan's socio-health status, OECD health data from 2006 show that the countries with the highest suicide rates were Japan, Korea, Hungary, and Finland. While suicide rates have been decreasing in OECD countries since the 1990s, death rates from suicides have been increasing in Japan and stand well above the OECD average (OECD, 2009).¹² A recent study on income inequality and suicide rates in Japan, established a uni-directional causality from income inequality to suicide (Inagaki, 2010).

Despite Japan's apparent economic decline, the country still has huge sums of capital at its disposal; US\$16 trillion in household assets are one example. Is it possible to see a comeback of the *sogo-shosha* glory? The Strategy + Business Magazine (March 10, 2010, <http://www.strategy-business.com/article/li00115?gko=dba5a>), reveals an interesting dealing between the *Sogo-Shosha* Itochu and energy investment companies BayCorp Holdings Ltd. and Energy Management Inc. In November 2008, these companies grouped together and created American Renewables LLC. The goal of the new company is to be the largest biomass facility in the country. As Japanese *sogo-shosha*s try to reinvent themselves and reign again, they target small U.S. enterprises in the area of information technology, renewables, solar system integrators, photovoltaics, etc. What is most interesting is that the Ministry of Economy, Trade, and Industry (METI) is again behind the *Sogo-Shosha*s. METI is the new name of MITI that was the driving force in Japan's economic ascendance after the Second World War. This time around, the U.S. is keener in receiving help from the Japanese. After all, if the Japanese can create jobs in the U.S. they are welcome. While Mitsubishi, Sumitomo and other *Sogo-Shosha*s are still very interested in U.S. technology, the world watches Nikkei 225 – a Japanese stock market index.

In sum, we have looked at some cultural and socio-economic reasons for Japan's economic decline, at least its decline from the headlines. First, we examined the wonder decades of socio-economic prosperity during the 1950s to the mid-1980s. Second, we searched for contributing factors to Japan's economy, as well as Japan's economic trajectory over the last three decades. While Japan is still the third largest economy in the world (falling behind China only earlier this year), it has a high national debt, a rapidly aging population, and chronic deflationary pressures. These are factors that hamper Japan's economic growth and therefore pose some real

¹² OECD (2009) "Health at a Glance 2009: OECD Indicators."

challenges for policymakers in Japan. In light of a shrinking labor force due to the nation's changing demographic structure, Japan needs to have a "productivity revolution," according to Katz (2010), or a "creative destruction" according to Schumpeter. As for Japan's innovative capabilities, there are some good signs for the future. Japan was ranked fourth (out of 133 countries) in innovation by the Global Competitive Index 2009-2010.¹³ Japan's human capital is also very high. Can Japan, a country that excelled in copying and perfecting European and U.S. inventions, increase innovation and succeed in a global market? Moreover, some scholars have suggested an opening of Japan's immigration policy. Allowing more migrants into Japan could shore up its declining work force (Abe, 2010). It is doubtful, however, that Japan will open its borders to foreigners. Can Japan overcome such political, societal, and physical limitations and rebound in the next decade? The global economy will be waiting to see. ■

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¹³ For more details on others pillars see DIWDCSynopsis, January-April 2010. www.diwdc.org.

An Eventful Start for the New Year 2011 for DIWDC!

DIWDC is Present at the ASSA 2011 Meetings in Denver, CO

Like every year, the staff of DIWDC will attend the largest congress of all economic and social science societies and associations. At ASSA, DIWDC will be presenting its research in sessions, interviewing candidates, and exhibiting. On January 8, 2011, Executive Director Dr. Amelie Constant (DIWDC, George Washington University, and IZA) will present her co-authored paper with Annabelle Krause (IZA), Ulf Rinne (IZA), and Klaus F. Zimmermann (IZA, University of Bonn and DIW Berlin) on “Ethnic Identity and Reservation Wages of the First and Second Generation Migrants.” Professor Laura Argys (University of Colorado-Denver) will be presiding this AEA session entitled “Ethnicity, Identity, and the Labor Market.”



In another AEA session entitled “Migration in Central Asia: The Experience of Four Countries,” Dr. Constant will discuss the paper by Charles Becker (Duke University) and Nurgul Ukueva (University of Central Asia) on “Remittances and Investment: Evidence from Kyrgyz Panel Data.” The session will be presided by Professor Kathryn Anderson (Vanderbilt University), a long-time friend of the Institute and a member of DIWDC’s Board of Distinguished Advisers. ■

DIWDC to Participate in Immigration Conference

Dr. Constant (DIWDC) has been invited by The International Comparative Policy Analysis Forum to participate on a panel entitled “Immigration and Its Impact on Human Capital Development” at the 2011 conference in Baltimore, MD on March 11-15. DIWDC, an economics think tank, is happy to be involved in interdisciplinary research. ■

DIWDC Will Attend the Annual Meeting of the Atlantic Economic Association

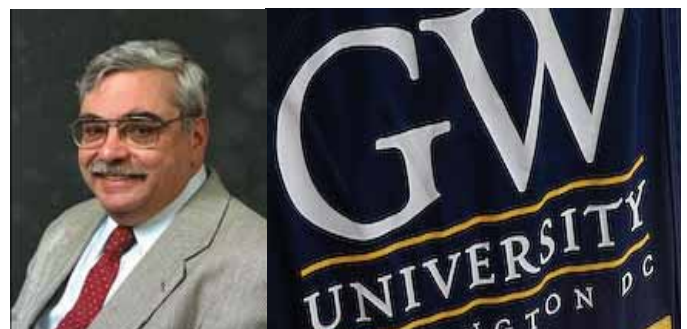
“Greece Exodus from the Current Crisis” is the title of a plenary session at the AEA annual conference, to be held in Athens, Greece on March 16-20. Dr. Constant (DIWDC) is invited to be on the panel and will talk about Greece’s drama, its implication for the future of the Euro, and potential exit strategies. DIWDC is glad to participate and contribute to transatlantic research and collaboration. ■

Professor Barry R. Chiswick Joins George Washington University to Chair the Economics Department

Renowned economist Professor Barry R. Chiswick joins George Washington University’s Columbian College of Arts and Sciences (CCAS) in January 2011, as the new chair of the Department of Economics. Professor Chiswick comes to GWU from the University of Illinois at Chicago (UIC), where he has served as the Chair of the Economics Department for decades as a distinguished professor of UIC and as the founding director of the UIC Center for Economic Education. A famous scholar in labor economics and the economics of migration, Professor Chiswick became the Program Director for the Migration Area at IZA Bonn in 2004. Executive Director Amelie Constant is the Deputy of the Migration Area at IZA Bonn.

Professor Chiswick is thrilled to come to Washington, DC and GWU and is looking forward to working with new colleagues and students “to enhance GW’s research in economics and to educate the next generation of economists” (GWU Media Room).

DIWDC’s Executive Director, Dr. Constant, is delighted to hear the news and to have Professor Chiswick three blocks away from the Institute. Dr. Constant looks forward to continuing their excellent history of collaboration. ■



Upcoming Events

- January 8, 2011: "Ethnicity, Identity and the Labor Market," AEA Annual Meeting, Denver, CO
January 8, 2011: "IZA Prize in Labor Economics to Francine Blau," ASSA Annual Meetings, Denver, CO
April 14-17, 2011: Annual Meeting on the Economics of Risky Behaviors, IZA, Bonn, Germany
May 11-15, 2011: Annual Migration Meeting, Columbia Square, Washington, DC
May 30-31, 2011: Employment and Development Annual Meeting, IZA and the World Bank, Mexico City, ME
June 1, 2011: Child Labor Annual Meeting, IZA, Mexico City, ME

DIW DC Executive Director

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