Chair’s Message
By Peter J. Kuhn

The 2006/07 academic year was a productive one for our department. One highlight is our hire of Peter Rupert, a former Senior Economic Advisor at the Federal Reserve Bank of Cleveland. In addition to sharing his expertise with our faculty and graduate students, Peter will be sharing his real-world experience in shaping the nation’s monetary policy with literally hundreds of students of introductory macroeconomics this year.

Our Accounting Program continues to win awards; this year we are proud to say we became one of KPMG’s thirty-eight “Premier Schools” in the United States where the company focuses its recruiting efforts. During the year, the department also added a new Computational Economics minor. This minor will allow UCSB’s Computer Science majors to add a significant component of economics training to their degrees.

We received several important new donations this year, including gifts of $100,000 or more towards PhD fellowships from Bill Thor- mahlen, Janet Alpert and one in honor of Jennifer Jo Williamson. These gifts will allow us to keep attracting better and better students to our program.

Elite Annual Events Bring Respected Names to Campus

The Economics Department is honored to present two annual lectures through the generosity of distinguished donors. One is the Herbert C. Kay Undergraduate Lecture. Herbert C. Kay taught in the UCSB Department of Economics in the 1960s and is now a successful private investor in Los Angeles. Many of Professor Kay’s former students cite his inspiration as a major factor in their own successful career development. Professor Kay established the lectures—featuring dynamic business pioneers—to inspire UCSB undergraduates to become the entrepreneurs and leaders of tomorrow. The series affirms the importance of undergraduate education at UCSB. The other lecture is the Annual Carl Snyder Memorial Lecture, established by the estate of Mrs. Madeleine Raisch in memory of her husband, who was an economist and author.

Herbert Kay Undergraduate Lecture

This year’s speaker was Jerry Putnam, Founder of Archipelago Holdings and current President of the NYSE Group. As President and Co-Chief Operating Officer of NYSE Group, Inc., Mr. Putnam is responsible for the Group’s market operations, technology initiatives, new products, and information business. When Jerry Putnam founded Archipelago Holdings in 1996 the US equities markets were about to enter a new phase of innovation and change with Archipelago leading the charge. In 2006, Archipelago merged with the New York Stock Exchange and the world’s equities markets are changing at a rapid pace once continued on page 7

AEA Summer Program and Minority Scholarship Program

The department is proud to announce its recent selection by the American Economic Association as the next host institution for its Summer Program and Minority Scholarship Program. The American Economic Association Summer Program is a research- and mathematics-intensive, 8-week course of study that prepares highly motivated undergraduate students from all over the United States for successful Ph.D. study in economics. Attached to the program is a scholarship program that supports the participation of students from historically disadvantaged minorities who have demonstrated financial need. The current host institution is Duke University; UCSB is scheduled to take over as host for the summers of 2008-2010. Funding for the program comes from a number of sources, including the American Economic Association, National Science Foundation, and UCSB’s Division of Social Sciences. Information about the current program is available at: www.econ.ucsb.edu/aeastp

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The Economics of Auctions
by Rod Garratt

Auctions have become a common way to sell items. EBay auctions now total over $US30 billion a year in annual sales. The auctions for spectrum licenses conducted by the Federal Communications Commission have earned over $US32 billion for the U.S. Treasury. The recent high-profile Google initial public offering was conducted by auction. Because of the prominent role auctions now play in everyday life, there is increased interest in understanding them. In particular, people are interested in understanding aspects of auctions that might overturn conventional wisdom regarding revenue and efficiency properties of auction mechanisms and the susceptibility of auctions to collusion.

One real-world aspect of auctions that has recently received much attention is resale. While there is an extensive literature on auctions as one-shot games, the impact of resale opportunities for auction winners has only been actively addressed in the last decade. Initial work suggested that resale opportunities do not undermine the predictions of one-shot auction theory. In particular, standard auction formats, such as the ascending price English auction and the first-price sealed bid auction, that were deemed efficient and revenue-equivalent in the absence of resale were thought to retain these properties when resale opportunities were introduced. However, recent work by Rod Garratt, UCSB, and Thomas Troger, University of Bonn, shows that resale opportunities provide a role for speculative bidding that undermines efficiency and impacts seller revenue differentially across auction formats, thus destroying revenue-equivalence.

Garratt and Troger (Econometrica, 2006) look at the role resale creates for speculators – bidders who are commonly known to have no use value for the good on sale. Active speculators add competition to the first-price auction and increase initial seller revenue. However, speculators drive regular bidders out of the English auction and can decrease initial seller revenue. In either auction format, a winning speculator will charge a reserve price above her zero use-value in the resale market and hence the outcome of the resale auction may be inefficient.

More recently, Garratt, Troger and Charles Zheng of Iowa State University, look at the role resale plays in facilitating collusive behavior. Collusion in auctions refers to the situation where bidders conspire to limit their bids so that one of the colluders wins the auction at a low price. In one-shot games, collusive arrangements require some form of external agreement on how to divide the spoils and some type of enforcement mechanism to prevent bidders from deviating from the collusive bidding plan. These agreements are illegal and hence collusion is prevented to some extent by the threat of antitrust prosecution. However, Garratt, Troger and Zheng (2007) show that with resale collusive bidding in English auctions can emerge as equilibrium behavior without any commitment on bidding behavior or post-bidding spoil division. Hence, resale opportunities may make collusion in auctions more prevalent.

The Department of Economics held a conference this past April showcasing theoretical and experimental research on this exciting and important topic.
The Role of Emotions in Economic Decision-making
by Gary Charness

The standard economic model presumes that people only care about their own financial payoffs. However, this presumption has been found to be false in a great number of laboratory experiments. One key aspect of this deviation from pure financial maximization concerns the role of emotion in making economic decisions. One particular area where this comes into play is in bargaining or work environments. If one feels unfairly treated, one may well sacrifice money to punish the person responsible for their mistreatment. This is a key point in a number of my papers; in Charness and Rabin (2002, Quarterly Journal of Economics), we observe this behavior (negative reciprocity) in many experimental games and provide a formal model of social preferences. In Charness and Levine (2007, Economic Journal), a student in the role of a worker can choose to sacrifice money to either reward or punish a student in the role of a firm, who has chosen to pay either a high or a low wage. There is also a stochastic element to the wage received, so that the net wage may be the same with a low wage and good luck or with a high wage and bad luck.

We find that, his behavior depends considerably on the path by which this identical net wage is reached.

Another environment in which emotion can play a role is when a person has been deliberately deceived. In Brandts and Charness (2003, Management Science), one player can send a message to the other concerning his or her intended play, which can be generous or selfish. Following the message, a game is played simultaneously. A particular cell, unfavorable to the message receiver, can be reached by either an honest signal and selfish play, or a deceptive signal and subsequent selfish play. If this cell is reached, the receiver can sacrifice money to punish the sender. We find that punishment rates are twice as high following a deceptive message.

Another relevant case involves messages and promises. In Charness and Dufwenberg (2006, Econometrica), we pair people in what is effectively a sequential Prisoner's Dilemma game, and allow one person in the pair (the responder) to send a message to the other party (the first mover). If the first mover receives a promise concerning the subsequent play of the responder, he or she is more likely to make the cooperative choice; the person making the promise is also more likely to make the cooperative choice, even though this is a dominated strategy in terms of this person's financial payoffs. Overall, the rate of mutual cooperative play is more than doubled with promises. We propose a model of guilt aversion, whereby one is reluctant to disappoint someone who is expecting the person to behave favorably.

All in all, it has become increasingly clear that emotions play an important role in economic decisions. Research continues in this area, and new, more descriptive models are in the process of being formulated.

Chair's Message
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The research of several of our faculty members was again highlighted in the media this year. For example Kelly Bedard’s work on school starting ages was recently featured in the New York Times Magazine, and Olivier Deschenes’ research on economic impacts of global warming appeared in the Atlantic Monthly online.

I am also proud to say that the department was awarded a grant of $510,000 by the American Economics Association to host the Association’s Summer Training Program (AEASTP) from 2008 to 2010. This program, directed by Professor Douglas Steigerwald, brings undergraduates from disadvantaged backgrounds to UCSB for intensive preparatory study for a Ph.D. in economics. With all the students, visiting faculty and program alumni it typically attracts, the AEASTP will make the department particularly lively the next few summers!

Aside from continuing to improve instruction and research at all levels, I look forward to several important prospects for the coming year. One highlight will be the official opening of our new laboratory for experimental economics, right here in North Hall. Please check the department website for news about this and other department events, including the annual Kay and Snyder lectures.
An Interview with Alum Jay Cohen

At the age of 9, Jay A. Cohen took his first economics class, and “was hooked.”

Once I took that class I knew what I was going to major in when I entered college,” Cohen said during an interview. Which is exactly what he did upon entering UCSB in 1980. “I had such a clear view of what I wanted to study, and I knew that I wanted to eventually become an investment banker.”

Cohen majored in Economics and especially enjoyed the accounting classes that he took as an undergraduate. “Each class opened my eyes to issues highlighted in annual reports of public companies. I knew that I needed to work for at least two years before I entered a top business school, so I felt two years as an accountant would provide a good base for my career.”

Upon receiving his Bachelor of Arts in Business Economics in 1984, Cohen became a Certified Public Accountant (CPA) for Peat Marwick. Knowing that this was a “stepping stone” in his path towards receiving his MBA, he stayed with Marwick for “two years to the day.” Cohen and his wife, Laura Cox (UCSB class of ’83), both attended Northwestern University for their MBA’s and “had no problem competing with top students from top universities around the country.” They both graduated in the top 15% of their class and feel that “UCSB prepared us to compete in any environment.”

After completing his MBA, Cohen worked for Merrill Lynch, in their Mergers and Acquisitions Group, and eventually became the Director in their Corporate Finance Division. But after seven years of 90-hour workweeks and extensive traveling, Cohen wanted to focus on his family. Which he did in 1995 when he started Cohen Capital Management, Inc. As President and Founder, Cohen wanted “to stay small and focus on a few large relationships.” His goal was to “provide wealthy families with a turnkey solution to investment and financial planning needs.” Cohen currently works as the portfolio manager of all assets under management, totaling $400 million.

“As an investment banker and money manager, [having] a deep understanding of how economic issues affect various markets has been vital to my success. Almost everyday key economic statistics are announced and the impact on markets is played out. An understanding of how these factors affect the economy is vital in my day-to-day decision-making set. It is about taking economic statistics and having the ability to convert that information into a view on how specific industries and companies will be affected by the changing economic trends. My training in Economics at UCSB has provided me with the intellectual tools to successfully make these important connections.”

As an undergraduate Cohen especially enjoyed Economics 105 with Professor John Marshall because he “loved applying his math skills to economics, and Professor Marshall always made it interesting.” Which is why Cohen’s advice to current and future undergraduate students is “to use your math skills and take the 104 and 105 series.” Cohen also stresses to use your time as an undergraduate “to try classes that are well out of your comfort zone.”

The department of Economics congratulates the 2007 PhD graduating class. The six graduates have gone on to promising careers in Economics.

Elizabeth Dhuey studied under Peter Kuhn on the economics of early childhood education. She has joined the faculty of the University of Toronto.

Francisco Azeredo worked under Rajnish Mehra on issues in aggregate economics and finance. He is currently a visiting lecturer at UC Riverside.

John Hartman worked under Ted Bergstrom on experimental studies of highway congestion. He is working as a postdoctoral researcher and lecturer at UCSB.

Stephen Lipscomb studied under Peter Kuhn on education finance and high school leadership. He has taken a position at the Public Policy Institute of California in San Francisco.

Wan-Ru Yang worked under Rajnish Mehra on the asymmetric information in the financial market. She has accepted a position at National University of Kaohsiung.

Yongli Zhang worked under Stephen LeRoy on the effect of risk on the equilibrium risk-free rate of return. He has joined the faculty of China Economics and Management Academy of the Central University of Finance and Economics in Beijing, China.
On March 3, the Department of Economics sponsored a symposium in honor of Mortimer Andron and the generous support that he has provided to our graduate students throughout the years. In 1978, Mortimer Andron, UCSB Professor Emeritus of Economics, made a key gift that has, over the years, allowed the department to provide fellowship support for seventy-four doctoral students. During his academic career, Professor Andron taught courses in finance and investments and served several years as Chair of the Academic Senate. He was also a highly successful individual investor, and it was this success that allowed him to establish the Andron Fellowship Fund. Professor Andron continues to remain involved in departmental events and activities, and this symposium included presentations by six Andron fellows.

Health Economics Conference

On March 17, the Economics Department proudly sponsored a conference on quasi-experimental research in Health Economics. Quasi-experimental methods have becoming increasingly used in Health Economics, and this conference highlighted the resulting recent research. Scholars from around the country and from UCSB participated in the conference. The presentations covered a wide range of topics, including the health impacts of Head Start, the effect of laws restricting access to alcohol to health, and the impact of education on mortality.

Inaugural Meeting of the Trans-Pacific Labor Seminar

Twenty years ago, quantitative labor economics was a discipline confined mostly to one side of the Pacific (the United States and Canada). Since then, this research methodology has diffused to the other side of the Pacific. By now there exists the critical mass on both sides of the Pacific who shares similar research interests and methodology. At the same time, with the rising prominence of multi-national corporations and the enhanced cross-national interactions of domestic firms in Pacific Rim countries, researchers, policy makers and practitioners on both side of the Pacific are facing increasingly similar labor and employment issues. The purpose of the TPLS is to begin a much-needed process of international academic integration of labor economists in the Pacific Rim. The inaugural meeting of the TPLS, “Evolving Employment Practices in Japan and the U.S.” was co-sponsored by The Suntory Foundation, Colgate University, and UCSB, and featured scholars from both sides of the Pacific.

Retiring Faculty Members

This past spring, the department of economics bade farewell to five faculty members. We wish them the best of luck in their future endeavors.

ROBERT CROUCH joined the department in 1967 after earning his Ph.D. from the University of Essex, earlier that same year. His research focus was in economic theory.

STEVE LEROY returned to UCSB in 1997 following a six-year hiatus, during which he worked at the University of Minnesota. Having earned his Ph.D. from the University of Pennsylvania, he originally joined the faculty at UCSB in 1977 and specialized in finance.

JACK MARSHALL joined the department in 1972 after receiving his Ph.D. from MIT in 1969. As an economic theorist, his primary fields of interest were the economics of uncertainty, insurance, capital theory, and the economics of information.

DOUG MORGAN joined the department in 1967 while completing his Ph.D. at UC Berkeley. His primary fields of interest include public finance, applied microeconomics, and water resource economics.

JATI SENGUPTA joined the department in 1977. Having earned his Ph.D. from Iowa State University, he specialized in econometrics, operations research, and economic development.
Accounting Program News
by Lisa Maass

The UCSB Accounting Program completed another highly successful year, continuing to graduate more than three hundred students. The primary goal of the Program is to provide a curriculum with sufficient scope and depth to graduate students who will become well-rounded, well-educated professionals. The Program offers a full range of courses, including our intense ten-week Professional Preparation Program to ready students for future professional practice and certification. Enrollment in this summer program has grown from thirty-eight students in 2003 to over seventy students in 2007.

We are also pleased to announce that Don Loster has designed a course in the growing field of Forensic Accounting. This course will be offered beginning in spring 2008. It will involve the application of knowledge in accounting, auditing, and finance to resolve financial issues in areas ranging from fraud and identity theft to organized crime and terrorism investigation.

Our students continue to be heavily recruited by companies including the Big Four and other regional and local accounting firms. The Big Four have designated UCSB as a key recruiting school, which allows our graduates to be hired into offices throughout the United States. In addition, in 2006 KPMG designated UCSB as one of thirty-eight “Premier Schools” in the United States where the company intends to focus its recruiting efforts and resources. This designation is based on the quality of the UCSB Accounting Program, the success of UCSB students in passing the CPA Examination, and the number of talented and successful on-campus hires from UCSB at KPMG.

The UCSB Accounting Program congratulates Irene Altman, one of our 2006 graduates, who was recently recognized by the AICPA as an Elijah Watt Sells award winner for her performance on the CPA Examination. This annual award is reserved for those ten candidates in the United States who earn the highest cumulative scores on all four sections of the CPA Examination.

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again. U.S. equities exchanges are establishing a global footprint through mergers, partnerships and other alliances with international exchanges as evidenced by the NYSE Groups pending merger with Euronext and Nasdaq’s bid for the London Stock Exchange. As many of the world’s exchanges look to international alliances, become publicly traded entities and/or more broadly diversify their product offerings to include multiple financial instruments like futures, bonds, and options in addition to stocks, the vision of a truly global exchange is closer than it may appear.

Carl Snyder Memorial Lecture

This year’s esteemed speaker was Claudia Goldin, Henry Lee Professor of Economics at Harvard University and director of the NBER’s Development of the American Economy program. She spoke on “American Leadership and the Human Capital Century: The Virtues of the Past”. In her research in American economic history she interprets the “present through the lens of the past” and explores the origins of current issues of concern. Her work on the rise of mass education in the United States and its impact on economic growth and wage inequality form the core of a forthcoming book, *The Race Between Education and Technology* (with L. Katz).
You Can Be a Part of Futures Filled with Hope and Promise!

Donations to the Economics Department Support These Activities:

**Graduate Student Support**
- including entry-level scholarships designed to attract the most promising students to our campus, and support for continuing students writing dissertations.

**Promoting Excellence in Undergraduate Education**
- by funding awards to top-performing undergraduate students, and creating innovative and challenging undergraduate courses.

**Supporting Visiting Scholars**
- Donations support the visits of top-flight speakers and teachers from around the world to UCSB, enriching the intellectual lives of both students and faculty.

**Research Support**
- Donations to the department provide crucial seed money for new research projects that can eventually yield major institutional grants and benefits to society.

**Infrastructure**
- Keeping the department’s instructional space in North Hall up-to-date and attractive is a constant challenge given our huge enrollments and rapid advances in instructional technology. Donor funds play an important role here as well.

For more information on giving opportunities to UCSB Economics, please visit http://econ.ucsb.edu/giving/index.html. There’s no time like now to support this important mission.

To make a contribution to the Department of Economics, mail this form and your tax-deductible donation to:

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