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Editors: António Afonso, Filipe Oliveira, Joana Pais

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Phone: +351 213 925 912. e-mail: rem@iseg.ulisboa.pt

The Latest REM Working Papers

Research in Economics and Mathematics (REM) circulates research, notably by its affiliated members, as working papers intended for professional and public discussion and comment. The papers have not been peer reviewed.

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Events

10th UECE Conference on Economic and Financial Adjustments, ISEG/UL – Lisbon School of Economics and Management/University of Lisbon, **July 22, 2022** (rooms and online). **5 June 2022**, submission deadline.

Keynote speakers:
Xavier Debrun (National Banl of Belgium); **Cecilio Tamarit** (University of Valencia)

Papers presented at the conference can be considered for the Special Issue of the *European Journal of Political Economy*, according to selected topical guidelines to be set up.

REM Working Papers

Climate change and behavior: Do environmental attitudes and perceptions impact on subjective well-being in Europe?, Ary José A. Souza-Jr., *Working Paper 0207-2021*

Do subjects' reactions to climate change help us understand how behavior affects their well-being level? To answer, this article assesses the impact of a large set of Environmental Perceptions and Attitudes (EPA) on subjective well-being across 21 European countries, using an ordered probit model. Furthermore, it tests whether personality traits are capable to influence the relationship between EPA and well-being. The estimation uses data from the European Social Survey, along with air pollution (PM10), precipitation, waste production, and macro variables. This paper builds on Ferreri-Carbonell and Gowdy (2007), considering two additional groups of EPA: energy affairs and new expressions of environmental awareness. The results show that both groups have a statistically significant effect on well-being, indicating that a higher variety of EPA may influence welfare. The outcomes also indicate that personality traits partially influence the link between well-being and EPA across Europe.

Tax us, if you can: a game theoretic approach to profit shifting within the European Union, Joana Andrade Vicente, *Working Paper 0206-2021*

In this paper we theoretically analyse the European Union's ongoing political impasse regarding the choice of a single method to allocate multinational enterprises' profits across countries and we find that this strategic situation resembles a coordination game with distributional consequences. The two Nash equilibria involve no efficiency trade-off (only a movement along the Pareto frontier), but the conflictual distribution of welfare gains and the presence of heterogeneous preferences have been preventing the implementation of a new long-term comprehensive tax policy reform. A unitary taxation approach with formulary apportionment in the European Union is better suited to tackle artificial profit shifting via transfer pricing and would mean an evolutionary change without disrupting the current international tax policy environment. It would restore faith in fairness in the European tax system and allow for further coordination of the transfer pricing policies of the two main international political forces – the United States and the European Union.

Two-way relationship between inequality and growth within fiscal policy channel: an empirical assessment for European countries, José Carlos Coelho, José Alves, *Working Paper 0205-2021*

We investigate the role of fiscal policy, through several measures of government revenues and expenditures and redistribution, on disposable and market income inequality and economic growth as well as the interaction between inequality and growth for 31 European countries from 1995 to 2019. In this article, we employ SUR regressions and SEM models, and we conclude that: i) while post-tax and transfers inequality has a negative impact on public expenditure variables and redistribution, pre-tax and transfers inequality has a positive impact; ii) public expenditure variables and direct taxation negatively influence economic growth; iii) average post-tax and transfers inequality has a negative effect on growth and average pre-tax and transfers inequality has a positive impact; iv) growth contributes to the reduction of average post-tax and transfers inequality and to the increase in average pre-tax and transfers inequality; and v) fiscal policy allows for the attenuation of disposable income inequality. The different results between the role of pre and post-tax and transfers inequality levels lead us to suggest tax progressivity as an important feature to take into account when analyse the trivariate relationship between fiscal policy, growth, and inequalities.

Unemployment and financial development: evidence for OECD countries, António Afonso, M. Carmen Blanco-Arana, *Working Paper 0204-2021*

It has been argued that credit market frictions may contribute to high unemployment. Hence, we assess the relationship between financial development and the labor market in OECD countries during the period 1990–2020. Using a random effects model for a panel dataset, we conclude that an increase in market capitalization and in the volume of shares traded can significantly reduce the unemployment rate. Likewise, inflation and per capita GDP growth are found to have significantly affected the evolution of the unemployment rate during the period under study.

Euro area time-varying cyclicality of fiscal policy, António Afonso, Francisco Tiago Carvalho, *Working Paper 0202-2021*

We assess the cyclicality of fiscal policy in the 19 Euro area countries, notably during recessions, for the period 1995-2020. We use a time-varying measure of fiscal cyclicality to describe fiscal policy developments. The results suggest that during recessions discretionary fiscal policy becomes more pro-cyclical, but the overall budget balance becomes more countercyclical. Hence, pursuing a Ricardian fiscal regime by more indebted countries leads to higher counter-cyclicality of fiscal policy. Government size reduces counter-cyclicality, as well as trade openness, and financial development has a positive impact on counter-cyclicality.

Market Power and Inequality: a model of the Brazilian economy, Pedro Cavalcanti Gonçalves Ferreira, *Working Paper 0201-2021*

This paper attempts to draw some lines regarding the interplay between market concentration and income inequality in the Brazilian economy. Our goal is to uncover some of the mechanisms by which market power influences macroeconomic aggregates and, consequently, indicators such as the share of the income appropriated by the richest and the Country's Gini index. For this purpose, we have first conducted an empirical estimation using a PVAR approach with data from Brazilian states. We found that the markup shock is positively related to inequality. Moreover, that result is robust to changes in the model specification or different Cholesky ordering. Second, we built a dynamic general equilibrium model and calibrated it to reproduce the Brazilian economy. The model has three representative agents and heterogeneity in asset market participation and labor supply/skills. Additionally, firms exhibit endogenous oligopolistic and oligopsonistic (in the labor market) behavior. In response to unexpected markup shocks, the model showed a regressive dynamic, transferring income from the bottom to the top of the distribution. Nevertheless, its effects on economic growth may be positive in the short term, due to the increased investment in creating new companies. The disturbances in the TFP reduce inequality on impact, which is due to the countercyclical behavior of the markup. Instead, when we allow the TFP shock to be correlated with the markup, this effect is reversed, with the largest share of income being appropriated by the wealthiest. Finally, it is noteworthy that the labor supply elasticities partially determine the behavior of income distribution between poor and middle-class households.

Improving the air connectivity of hub airports: an instrument to boost the economic performance of EU countries?, Maria Inês Castro, Maria Paula Fontoura, *Working Paper 0200-2021*

This study discusses the importance of hub airports' air connectivity in improving the economic performance of the European Union countries during the period of 2008-2019. For this purpose, we use two different measurements of air connectivity - airport and hub connectivity, which are calculated using the Nestcan Model, and then, as a first step, we analyse the degree of linear association of each one of them with gross domestic product (GDP) and with a set of economic variables (hereafter designated as EVs) which, according to the literature, are expected to be positively determined by air connectivity and will boost a country´s economic performance, namely: inflows and outflows of foreign direct investment (FDI), imports, exports, and international tourism expenditures. We conclude that the type of air connectivity adopted matters. The results show that hub connectivity has a higher correlation with key variables for

economic growth and is increasingly correlated with GDP during the period analysed, while a downward tendency over the more recent years was observed with regards airport connectivity. Next, we test the strength and direction of the quantitative relationship between hub connectivity and GDP/each EV for a sample of EU countries with a hub connectivity level of at least 5% of the TOP hub-connected EU country (Germany). Finally, we extract conclusions for individual countries, with the help of the scatter diagrams and regression lines. The results provide policy guidance regarding the role of hub connectivity in increasing the economic performance of a country, especially for those countries that are highly dependent on FDI, trade, and tourism for economic growth, as we illustrate for the case of Portugal.